RESEARCH REPORT

An Assessment of Payday Lending: Markets and Regulatory Responses

October 2016

ATLANTIC PROVINCES ECONOMIC COUNCIL | CONSEIL ÉCONOMIQUE DES PROVINCES DE L'ATLANTIQUE

About the Atlantic Provinces Economic Council

The Atlantic Provinces Economic Council (APEC) is an independent think-tank dedicated to economic progress in Atlantic Canada. Founded in 1954 as a partnership between the provincial governments and the private sector, its objective is to promote the economic development of the Atlantic region of Canada. It accomplishes this through analysing current and emerging economic trends and policies; by communicating the results of its analysis and consulting with a wide audience; and by advocating the appropriate public and private sector response.

Mail:	5121 Sackville Street
	Suite 500
	Halifax, NS B3J 1K1
Telephone:	(902) 422-6516
Fax:	(902) 429-6803
E-mail:	info@apec-econ.ca
Homepage:	www.apec-econ.ca

An Assessment of Payday Lending:
Markets and Regulatory Responses

By Finn Poschmann, President and Chief Executive Officer, Atlantic Provinces Economic Council, with research assistance from Cedric Smith, Chris Haley and Bob Millard

Acknowledgements

The opinions expressed in this report are those of the author, and may not reflect the views of the Atlantic Provinces Economic Council, its Board of Directors or Members. Financial support for this report was provided by the Canadian Consumer Finance Association. The author would like to thank the numerous individuals who provided background to this report, as well as anonymous readers. The author is responsible for the conclusions, accuracy and reliability of the information presented. Information in this report is believed current to October 2016.

Chapter 1

Summary and Overview of Recommendations: An Assessment of Payday Lending

The payday loan market comprises borrowers who seek very short term, small dollar credit – or liquidity, to be precise – for which they tend to be willing to pay a high price. The high cost of credit naturally attracts concerns from social advocates and policymakers, and for good reason.

Payday borrowers tend to have poor credit records or none, and little or no access to conventional credit sources or desirable alternatives, or borrowers would pursue those lower cost options. Small-dollar loans from banks or credit unions are rare to nonexistent in the Canadian marketplace, conventional loans or lines of credit are unavailable to those with poor credit, and advances on credit cards are unlikely to be available to those who are severely credit constrained. Payday borrowers therefore generally are not in good financial standing, and often are strapped for alternatives.

Meanwhile, providing short term, risky liquidity in small amounts is an expensive proposition for payday lenders, but this market is served where legislation and regulation permit. The policy debate mostly surrounds the terms and conditions, or the price and availability of such credit.

In competitive markets, where neither buyers nor sellers are able to exercise significant pricing power, and where information quality is reasonably good for most participants, market processes will deliver socially beneficial combinations of borrowing, lending and pricing, and regulatory intervention will tend to be unwarranted. Ordinary supply and demand conditions determine the market clearing prices and quantity of credit.

Therefore, if the above conditions hold with respect to market competition and information symmetry, regulatory interventions are more likely than not to be socially harmful.

Meanwhile, in Canada and abroad, the payday loan industry has expanded over the past few decades, with an advance and decline in physical storefronts ("bricks and mortar"), and overall growth in online services. Variations on the latter seem likely to expand, as consumer comfort with peer-to-peer lending and other financial technologies grow.

Surveys indicate that the online market includes many unlicensed payday lenders, who are less likely to comply with provincial regulations, such as fee disclosure. They may pose higher risks to the prospective borrower. Evidence from markets that have introduced restrictive payday lending legislation and regulation suggests that unregulated online lenders grow in volume quickly when traditional payday lenders are more restrained.

As to clientele, some surveys report that a typical borrower of payday loans is younger than a non-client, has less education and income, and cites as the main reason for using payday loans the need for emergency cash for necessities. The data also indicate that borrowers consider the cost of alternatives before pursuing payday finance.

Alternatives for payday loans, online or not, are separated into two categories: Traditional – including banks, credit unions and overdraft protection, and non-traditional – for the most part pawnshop loans and ordinary loan-sharking. Peer-to-peer online lending, also seems to be emerging as an alternative; data, however, are too sparse to permit further evaluation in this report.

Regulatory Context

Payday lending in Canada marked a turning point in 2007, when the federal Criminal Code was amended to allow high-fee lending in provinces that made legislative and regulatory provision for it.

Most provinces since have introduced extensive regulation detailing signage and notice provision to payday loan customers, among other disclosure requirements, including contract disclosure of fees and their annual interest rate equivalents. These disclosure requirements, or conduct regulation, are aimed at redressing presumed information asymmetry across borrowers and lenders. Put otherwise, the conduct regulation is intended to compensate for a lack of financial sophistication on the part of borrowers.

Regulations also specify maximum loan fees, and there is a significant range across provinces. This is price regulation, as distinct from conduct regulation, and where prices are set below the market clearing level, such regulation decreases the quantity of credit supplied, which pushes high risk borrowers out of the market.

Some provinces also have, and some others are considering, rules that would limit how many times a borrower could take a loan from a particular lender over a fixed period. Subsequent loans would have a longer term or become instalment debt. This is a potential transformation of the marketplace, as it would cut off one form of credit and push payday lenders into a part of the market that conventional lenders have not found it generally profitable to serve. The likely impact is a restriction on the supply of credit or higher prices for it.

Empirical Evidence

Empirical evidence on the consumer welfare consequences of payday lending is mixed, and has a particular focus on the extent to which payday loans prevent or encourage the use of potentially inferior alternatives. Among the findings:

- While payday loans may help consumers in weathering financial shocks, some portion of demand may stem from cognitive biases and a lack of information, as discussed above.
- Interventions to improve borrower information and reduce cognitive biases may reduce payday loan demand but may also result in costly unintended consequences.
- Price regulation reduces credit supply, and may price some clients out of the market. Clients with poor information on credit market alternatives might thereby be better off, yet the net result may nonetheless be socially harmful.
- Outright or effective bans on payday lending may reduce overall high-cost credit use but may also increase demand for less appealing alternatives, such as unregulated suppliers, pawnshop loans, and loans from illegal sources.
- Regulations aimed at reducing repetitive borrowing are likely to have mixed effects on welfare.

Regulatory Responses

The distinction between conduct regulation and price regulation is useful in contemplating the payday loan market. Both tend to raise the costs of provision; the first is conceptually justifiable if is addresses market imperfections, while the second is likely to limit the supply of credit, in particular with respect to potential clients who are willing and motivated to pay the most for such credit.

Some legislation and regulation seeks to protect such borrowers from the consequences of actions they might take, over worries that they will enter into a personally or socially damaging debt cycle. Theoretical and empirical evidence, however, does not allow the conclusion that such interventions or restrictions improve net social welfare. What is clearer is that some borrowers who would benefit from access to short term liquidity, even if it was expensive, would be harmed if the market was sharply constrained.

Recent evidence suggests instead that where the licensed payday lending market has been sharply constrained, unregulated (unlicensed) and typically online suppliers have entered the space, in an environment where disclosure and fair dealing is less likely, which is the primary concern for policymakers. Measures that squeeze licensed markets are likely to push buyers and sellers into unlicensed markets, with potential risks to social welfare.

Accordingly, interventions directly aimed at shrinking the size of the payday lending market, such as maximum limits on fees that leave the market unprofitable to serve, or price regulation more generally, are unlikely to be socially beneficial.

There are a limited number of more or less healthy alternatives. Regulations aimed at clear disclosure with respect to consumer fees, and attention to financial literacy generally, may possibly benefit consumers. Where cost effective, such interventions can address information asymmetry, and much of the related regulation is already in place – where these protections are not in place is the unlicensed online marketplace, which creates a challenge for regulators to address.

Limitations on repeat use of payday loans should be approached gingerly. To the extent that such repeat users are profitable to serve, they also subsidize borrowers who are more costly to serve; lenders would be able to serve fewer customers.

Regulations requiring conversion to longer term or instalment debt also should be approached gingerly. These regulations fundamentally change the loan product, which in the first instance is liquidity, to a different product that requires a different capital and pricing structure to serve.

Again, this leaves regulatory interventions aimed at addressing market imperfections and missing or imperfect information as the class of options most likely to be beneficial. Measures may include credit counselling for payday borrowers who seek repetitive loans, and this could extend to credit workouts.

Finally, although there is limited market evidence to date, changes in other markets suggest that developments in financial technology may transform small-dollar lending markets in ways that benefit consumers. This will pose competitive and pricing challenges to existing payday lenders, and it will challenge regulators to ensure that consumer legislation meets the evolving needs of the economy.

In summary, however, the message for policymakers is one of caution. For some analysts, it is axiomatic that ever more stringent regulation of the payday lending market would be socially beneficial. Neither theory nor empirical evidence demands such a conclusion.

Chapter 2

The Simple Economics of Payday Lending

Chapter Summary

- Payday borrowers seek very short term, small dollar credit – liquidity, in fact – for which they tend to be willing to pay a high price.
- Payday borrowers tend to have poor credit records, and little or no access to conventional credit sources or desirable alternatives, or borrowers likely would pursue those lower cost options.
- Providing short term, risky liquidity in small amounts is an expensive proposition for payday lenders, but the market is served where legislation and regulation permit.
- In competitive markets, where neither buyers nor sellers are able to exercise significant pricing power, and where information quality is reasonably good for most participants in the payday lending market, market processes will deliver socially beneficial combinations of borrowing, lending and pricing.
- If the above conditions hold, regulatory interventions are more likely than not to be socially harmful.

This section reports thematically on demand and supply factors in the payday lending market. The related theoretical and empirical literature is discussed in a later section of this report.

2.1 Demand

The demand for very short term credit, labelled payday lending or small dollar loans, and generally accepted to be a high cost source of consumer finance, is conditioned by a range of economic and behavioural factors.

The first and key characteristic is the immediacy of demand. Commonly reported reasons for taking advantage of a payday loan service include sudden and unexpected expenses, such as automobile or home repairs. As a matter of course, this occurrence is most likely to arise where households do not have liquid savings available, say to cover two months' worth of typical expenditures, which is one indicator of an initial state of some financial fragility.

The second necessary or likely feature of such borrowers it that they have little access to credit from other sources. As a matter of practice, credit card borrowing is likely to have much lower costs than payday loan borrowing; for potential borrowers with sufficiently high credit ratings, such borrowings or purchased overdraft protection from banks could be much less expensive forms of liquidity. Consumers who aware of these possibilities presumably would make use of them, were they available. Such conventional choices generally are not available to payday borrowers, however, exactly because their credit histories do not facilitate longer term borrowing.

As hinted above, even if a household is financially fragile, what that household seeks is not a loan in the conventional sense, but short term liquidity. This form of demand is not the form of maturity transformation with which the banking sector is concerned, and which typically can be delivered at a relatively low negotiated price; the payday loan product is, in this instance, simply liquidity that facilitates short- to medium-term smoothing, or matching, of household income and spending requirements.

Another and related feature or characteristic of payday demand is consumers' occasional need or desire for very short term finance to avoid other costs, such as those associated with late rent or bill payments and associated fees, which can be very high on an annualized basis, or to avoid charges for cheques drawn on accounts with insufficient funds.

When such needs arise, they are more symptomatic of predictable expense requirements, as opposed to the unexpected category, and to that extent indicative of a deeper level of household financial instability than in the cases described above. Generically, or reading across a wide range of statistical and empirical research, the typical reasons for this class of instability include the loss of employment and the inability to find reemployment in short order, the death of a spouse or divorce. Recovery from this form of instability is usually contingent on paid employment or family reformation.

There are other demand-side features of the payday lending market, which follow mostly from its existence, and the fact that it is a high cost source of temporary finance. On this point, there are two importantly different views, one based on the availability, or lack thereof, of lower cost alternatives, or access to credit, and the other based on potential borrowers' knowledge of the range of alternatives and the cost of each among them.

Borrowers seek payday loans because they perceive such loans as their best choice. In the generic need-for-liquidity case described above, the high cost loan might be seen by a household as better than going without a working car for even a short period, owing to travel needs for employment. Other scenarios include those with variable incomes and an overdue utility bill to pay. In dollar terms, the cost of a small-dollar or payday loan may be less than the sum of a late payment fee and disconnect and reconnect utility fees. Hence household borrowing and spending in the short term, for food and heat, for example, may be rational choices, and justify buying liquidity even at a high price.

Another aspect of demand may be less rational in the usual financial sense, in that it may result from insufficient or asymmetric information. In other words, the perception that payday loans are the best financial choice may simply be incorrect. In the case of possibly insufficient information, borrowers may not know, by assumption, of lower cost sources of liquidity, such as available borrowing room on credit cards. The borrower's information, however, might not be just insufficient or imperfect, but asymmetric, in the sense that lenders may know or make or correct assumptions about borrowers, while the borrowers may know less about lenders' characteristics, and in particular may not have the arithmetic skills sufficient to identify the true cost of lending and borrowing through one funding channel or another.

If this scenario is accurate, in that information is asymmetric and lenders possess better information than borrowers, then moral hazard may result – lenders take advantage of borrowers. Absent other influences, moral hazard of this form is usually considered to create an economically justifiable rationale for regulatory intervention in the marketplace, which may include disclosure or (fee) regulation.

While information asymmetry may harm borrowers, it is not safe to assume that such asymmetry exists, or that one party to a transaction typically has better information than another. Borrowers, if they know themselves to be bad risks, have an incentive to represent themselves to lenders as better risks than they are, as they may then be able to achieve better loan terms. The same issue, adverse selection, is ever-present in insurance markets. Insurers wish to filter out bad health or safety risks, while the insurance buyers have an incentive to present themselves as healthy or safe; this creates an inherent instability in insurance markets, and in some lending markets. Disclosure requirements are a regulatory element that seeks to address such issues.

Finally, it may also be that payday loan borrowers have personal characteristics that are different from an accepted norm. Some authors and researchers suggest that payday borrowers do not correctly assess the full costs of borrowing (a finding disputed by other researchers) and, as above, that disclosure regulation and financial education may be called for, among relatively non-intrusive measures.

But what policymakers may be further concerned with is the subset of the borrowing population that has an extremely high rate of personal time preference, meaning a strong preference for consumption (gratification) now over consumption later. Policymakers who feel this way may therefore be of the view that potential payroll borrowers' future selves need protection from their current selves, or current choices, and that this warrants market intervention of one form or another. Conventional economics has little clear direction to offer on such matters, because the financial questions quickly emerge as moral issues.

2.2 Supply

In all markets, potential suppliers respond to opportunity, and seek to earn a return on human, physical and financial capital, by providing goods or services to customers who want them.

In the case of payday lenders, what customers generally seek is short-term liquidity, and lenders are able to supply such credit very quickly, with limited information about a customer – beyond having a bank account and some evidence of ability to repay – and lenders are not able under law to take a security interest or collateral from the borrower. Suppliers (lenders) know that doing so under these conditions, rather than participating in other forms of lending, will expose them to a high risk of not being repaid on time, in full or at all.

These features limit the pool of potential suppliers to those willing and able to take such risks, at a price that at least meets investors required rate of return on investment. If returns fall short of that rate, owing to changes in economic, legal or regulatory circumstances, suppliers exit the market until the price matches some suppliers' required rate of return, in which case markets will again clear.

In competitive markets, meaning that there a sufficient number of suppliers or potential suppliers, as well as a meaningful number of customers, then neither buyers nor sellers have significant pricing power in the market. Further, if information also is reasonably symmetric, then markets will clear at a price that is welfare improving for buyers and sellers. If these conditions do not well describe the market, owing for example to pricing power on the part of suppliers, information asymmetries, or regulation, then prices will either be higher than otherwise or some portion of demand will be unmet, and social welfare generally lower than otherwise.

2.3 Generic Characteristics of Regulation

The payday lending market is mostly regulated, with respect to conduct as well as price.

Conduct regulation primarily involve disclosure of prescribed forms, such as fee disclosure on signage in physical stores, as described in Appendix A, and in contract terms, such as disclosure of fees in dollar terms and expressed as an annual percentage rate.

While the impact of such disclosure on consumer behaviour is uncertain, it aims to address a presumed lack of financial sophistication among borrowers. In other words, disclosure regulation seeks to address the information asymmetry that may exist in the marketplace; if it is cost-effective in doing so, this form of regulation may be positive in terms of net social welfare.

The other category of regulation is direct fee regulation; in this case, prescribed fee maximums defined as dollars per one hundred dollars of loan principal. Where a fee or rate ceiling is sufficiently in excess of the market-clearing price of credit, the ceiling has no impact on the quantity or price of credit supplied. Where a ceiling is set below the market price that would otherwise prevail, less credit is offered.

There are three possible rationales for restrictive price regulation: a) to stand as proxy for maximum interest rate regulation, in the manner of an anti-usury law; b) to prevent ill-informed potential borrowers from being taken advantage of, backstopping disclosure regulation; or c) to limit the lending businesses' size, by making it profitable to serve only the highest quality credits (borrowers), or none at all.[1]

Economic arguments occasionally support price regulation, such as where there is evidence of monopoly characteristics in the supply of a good or service – a municipal water utility is a typical example. This view does not in general hold in competitive markets, and the theory and literature on the point are both voluminous and unambiguous. Rate ceilings are ineffective at protecting consumers, because they cannot lower the cost of credit without restricting the supply of it that consumers would otherwise seek.[2]

Price regulation has another common characteristic: price ceilings tend to become price floors, necessarily so when price is regulated near the market clearing level. This limits the ability of competition to deliver a range of prices and products of different quality. In the jurisdiction within which a price ceiling binds, therefore, the likely result is a single price and a narrow product range, and these characteristics generally hold for the Canadian payday lending market.

2.4 Implications

The payday lending market's characteristics have implications for financial structure and pricing.

To recap, payday borrowers seek immediate access to funds, and they do not have access to savings or traditional forms of short term credit. This means that they are willing to pay a higher price than others would for short term credit, and that they are relatively high risk borrowers.

Payday lenders, therefore, are more likely than other lenders to experience loan losses, and their profitability or sustainability will depend on cycling through a large number of profitable loans per year, so that operating and capital costs are covered.[3]

Suppose now that regulation is introduced that sets a minimum term on loans or requires them in certain circumstances to be converted to instalment loans. For a

[1] Since bad debt costs are a significant part of payday lending operating costs, regulatory pressure on operating margins creates an incentive for suppliers to limit potential bad debt exposures, by rejecting more loan applications from lesser quality credits.
[2] Staten (2008) is thoroughly encompassing on this point.
[3] Operating costs can be significant, because physical presence of storefronts and staff tends to be preferred by the clientele.

given amount of financial (risk) capital available to lenders, fewer loans may then be underwritten or, for a given number of loans, capital needs will be higher. This will raise costs and reduce supplier margins, creating the likelihood that some suppliers will exit the market.

Again, if the competitive market assumptions described above are relevant, and borrowers make economically rational decisions, then the marketplace will tend to deliver a socially beneficial combination of prices and loan volumes. If so, then regulatory restraints on loan provision, other things being equal, because they are likely to lead to supplier exits, lower lending volumes or higher costs, may be social welfare reducing.

Chapter 3

Industry Profile – Payday Loans

Chapter Summary

- The payday loan industry has expanded over the past few decades, as measured by physical storefronts ("bricks and mortar") and online services.
- Some surveys report that a typical payday borrower of payday loans is younger than non-clients, has less education and income, and cites as the main reason for using payday loans the need for emergency cash for necessities.
- The online market is largely composed of unlicensed payday lenders, who are less likely to comply with provincial regulations, such as fee disclosures. They may pose higher a to the prospective borrower.
- Alternatives for payday loans, online or not, are separated into two categories: Traditional – including banks, credit unions and overdraft protection, and non-traditional – pawnshop loans, rent-to-own (RTO) loans and loan-sharking.

This chapter provides a profile of the payday lending industry in Canada. The profile includes a brief overview of payday loans, key players, current regulations, a profile of the payday loan borrower, discussion of online payday lenders and brief mention of short-term credit alternatives.

3.1 Overview

A payday loan is a small, short-term loan with a pre-determined date of maturity, often corresponding to the borrower's next payday.[4] This unsecured credit is typically extended based on a percentage of the borrower's net pay, and in Canada cannot exceed a loan size of $1,500, or a term of more than 62 days.[5] A borrower must provide documentation and evidence of employment, possess a bank account

[4] Bhutta, Neil; Goldin, Jacob; and Homonoff, Tatiana (2016). Consumer Borrowing After Payday Loan Bans. *Unpublished Manuscript*, July.

[5] An Act to amend the Criminal Code (criminal interest rate) S.C. 2007, c. 9 http://laws-lois.justice.gc.ca/eng/annualstatutes/2007_9/page-1.html.

with a financial institution, and valid identification to qualify for a payday loan. Payday lenders commonly offer multiple services such as cheque cashing, wire transfers, bill payments, and tax refunds, but their primary business is the payday loan service.[6]

Canadian payday lenders may not take a collateral claim on borrowers' property, and the loans therefore are not registered under a provincial property security act, for example. Neither, in Canada, are payday loan transactions recorded with credit bureaus. Lenders cannot easily track borrower history across suppliers, and borrowers cannot use payday transactions to build their credit scores.

The industry has seen rapid expansion over the late 1990s and 2000s[7] in physical storefronts ("bricks and mortar" type), recently there has been increased concern regarding the online payday lending market[8] via the Internet.[9] This strong growth has stimulated debate regarding the risks and rewards of payday lending. [10] The payday loan sector offers advantages over the mainstream financial sector that become attractive to certain types of prospective borrowers; primarily convenience and immediate access to liquidity.[11] The industry's primary clientele group includes relatively low income households,[12] including families and individuals who are in need of cash advances to meet expenditures that they might otherwise have been unable to meet. [13]

The next section provides detail on the size, scope, and growth of the payday loan industry, and offers some comments on cost structure.

3.2 Payday Lenders

Size, Scope, and Growth

---

[6] Ernst & Young (2004). *The Cost of Providing Payday Loans in Canada*. Toronto.

[7] Bhutta, Neil (2013). Payday Loans and Consumer Financial Health. *Finance and Economics Discussion Series,* no. 2013-81, September. Washington: Federal Reserve Board. www.federalreserve.gov/pubs/feds/2013/201381/201381pap.pdf

[8] Public Utilities Board of Manitoba (2013). *The 2013 Payday Loans Review*. Winnipeg

[9] Nova Scotia Utility and Review Board (2015). *Decision*. Halifax. http://www.cpla-acps.ca/english/reports/M06084%20Payday%20Loans%20%20Decision.pdf

[10] Bhutta, Neil (2013).

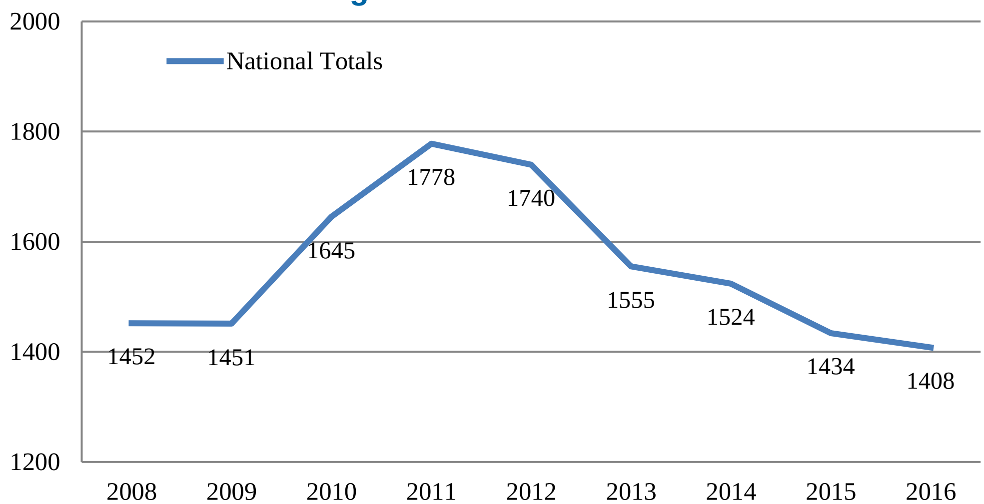
[11] Ramsay, Iain (2000). *Access to Credit in the Alternative Consumer Credit Market*. Office of Consumer Affairs of Industry Canada. Ottawa

[12] Islam, Khan and Simpson, Wayne (2014). *A Profile of Payday Loans Consumers Based on the 2014 Canadian Financial Capability Survey.* Winnipeg. http://www.pub.gov.mb.ca/payday_loan_review2016/cac_6_tab_4_cfcs_analysis_w_simpson_and_k_islam.pdf

[13] Pyper, Wendy (2007). Payday Loans. *Statistics Canada – Catalogue no. 75-001-XIE*. Winnipeg

The number of licenses issued to operate a payday lending service has fluctuated heavily within the last decade, owing to legislative, regulatory and market transformations. As seen in Figure 3.1, the number of licensees and storefront locations spiked between 2009 and 2012, and has subsequently tailed off.

Fig. 3.1 Licensees and Storefront Locations in Canada Decreasing Since 2011

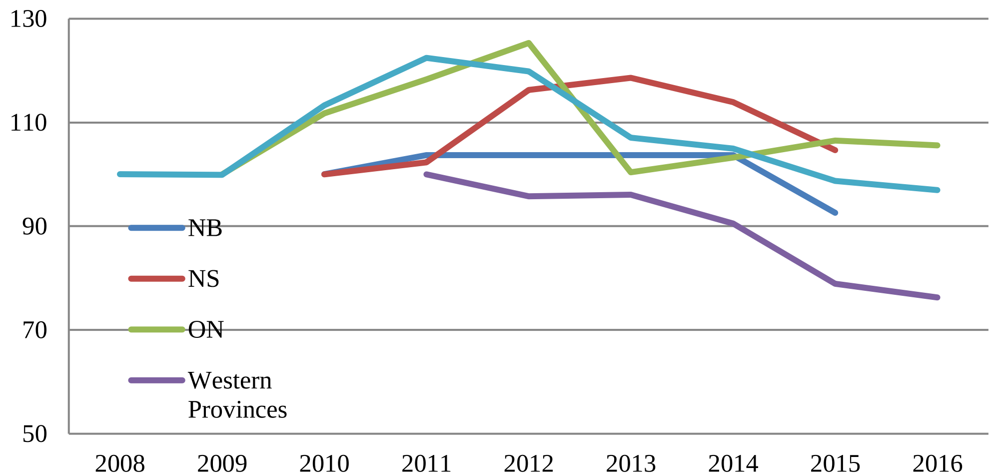


Source: Canadian Consumer Finance Association, 2016

The bulk of the 2009-2012 increase can be attributed to Ontario, which experienced the sharpest hike in storefront locations, to 960 in 2012 (see Table 3.1). To provide an idea of the growth in terms of individual provinces, Figure 3.2 illustrates the normalized growth of licensed lenders for each province between 2008 and 2016, while Table 3.1 displays the total number of licensed lenders for each province in this time period.

Fig. 3.2 Western Provinces' Licensed Lenders Growth Decreasing at Faster Rate than Others

Earliest year of data for each province = 100



Source: Canadian Consumer Finance Association, 2016

Table 3.1 Ontario Has Largest Share of Licensed Payday Lenders

Total Number of Licensed Lenders by Province

Year	NS	NB	ON	MB	SK	AB	BC
2008					45		
2009			766	89	45	248	
2010	43	27	856	84	44	251	
2011	44	28	906	82	44	279	282
2012	50	28	960	43	44	272	299
2013	51	28	769	43	47	282	288
2014	49	28	791	43	47	261	271
2015	45	25	816	46	49	240	207
2016			809	43	49	230	202

Source: Canadian Consumer Finance Association, 2016

As previously mentioned, Ontario accounts for the majority of the sharp increase in licensees and store locations between 2009 and 2012 across the country, with an increase of 194 stores in three years.

Table 3.2 provides a snapshot of the most current numbers of licensed locations and lenders, categorized by province, across Canada:

Table 3.2 Number of Licensed Payday Lenders and Locations

Most Recent Totals by Province

Province	Total: Licensed Locations	Total: Licensed Lenders	Date Verified
CAN	1408	-	01/01/2016
NS	45	13	22/10/2015
NB	25	-	01/01/2015
ON	826	-	12/07/2016
MB	43	19	12/01/2016
SK	49	11	13/10/2015
AB	230	35	15/10/2015
BC	203	29	24/02/2016

Source: Canadian Consumer Finance Association, 2016

Ontario substantially leads all provinces in the number of licensed payday lending locations, with a more than triple the number of locations, 826, than the next largest province, Alberta, 230. To gather insight on the components of these growth trends, there will be an analysis of two key industry players.

Key Industry Players

The Canadian industry leader for payday lending is the National Money Mart Company, a Victoria-based subsidiary of the US based Dollar Financial Group (DFG) Inc.[14] DFG was bought in April 2014 and is currently owned by the global private equity firm Lone Star Funds. Upon finishing the 2013 fiscal year, the Money Mart brand offered payday loans in 12 of the 13 provinces and territories across Canada, with 249 locations in Ontario, 81 in British Columbia, 75 in Alberta, 19 in Manitoba,

[14] Kitching, Andrew and Starky, Sheena (2006). *Payday Loan Companies in Canada: Determining the Public Interest.* Library of Parliament. Ottawa.

and 65 more in other provinces and territories. As well, there is at "least one store in nearly every Canadian city with a population exceeding 50,000."[15]

Data supplied by the Canadian Consumer Finance Association indicated that, as of July 12, 2016, the number of store locations Money Mart operated in Ontario was 256. This accounts for just over 30 percent of the number of stores within the province.[16] While there is no public evidence on what percentage of volume of business these stores account for in 2016, in 2007 Money Mart's share of total volume of payday lending in Canada was believed to be 50 percent.[17] [18]

Cash Money Cheque Cashing Inc. is another large provider of payday loans in Canada. As of 2007, there were 70 payday loan store locations across Canada.[19] Cash Money stores has increased this number to 122 locations in Ontario alone.[20] Within the Ontario market, Cash Money makes up about 15 percent of all payday loan locations, versus 31 percent for Money Mart, meaning that while these two firms are dominant forces in the market, the market is relatively open and competitive.

Comments on Cost Structure

Given the payday loan sector's reliance on physical storefronts to establish market presence and to be available to disburse funds on short notice, it is not surprising that the sector should have high operating costs.

According to a recent (unpublished as of August 2016) survey from Deloitte LLP, in Ontario, the largest market in Canada, respondent payday lenders provided $1.4 billion in loans through 549 locations, implying loan volumes averaging $2.5 million per shop. This is not a large sales base over which to amortize the costs of maintaining a physical building and staffing it throughout typically long store hours, while maintaining loan capital and buffers.

---

[15] DFC Global Corp. (2013). *Report on Form 10-K for the Year Ended June 30, 2013.* United States Securities and Exchange Commission. Washington. pp. 7. https://www.sec.gov/Archives/edgar/data/1271625/000119312513352311/d590562d10k.htm#tx590562_8

[16] Canadian Consumer Finance Association (2016).

[17] Berry, Ruth E. (2007).

[18] Further analysis of DFG's past annual reports give a broad outlook on the magnitude of revenues generated within this industry and company: in 2013 it was reported that total revenues topped out at $1,122.3 million, which consumer lending accounted for $728.3 million of. DFG's revenues were primarily composed of foreign subsidiaries, accounting for 88.4 percent of total revenues.[18] It should be noted that DFG Inc. also operated as a parent company for subsidiaries in the UK, Sweden, and the EU, so an accurate estimation of Money Mart's share of total revenues is not within scope, however these numbers do provide some insight to the size of the payday lending sector.

[19] Kitching, Andrew and Starky, Sheena (2006).

[20] Canadian Consumer Finance Association (2016).

The current Deloitte LLP survey for Ontario asked individual lending stores to self-report operating costs, cost of capital, cost of supplementary capital (defined as cash reserves and a percentage of fixed assets) and bad debt costs. The respondents on average attributed payday lending costs, as distinct from other operating costs, of $18.14 per $100 of payday loan. This figure may be interpreted as breakeven cost of loan issuance, or average total cost, where the cost base includes required returns on capital, or cost of capital, which is taken to be 14 percent and comprises the cost of equity, debt, and hybrids. Of that $18.14, 63 percent is reported to be operating costs, more than a quarter as bad debt costs, and the remainder as capital costs.

Expressing payday lending costs on a per $100 of loan basis provides for easy comparison with regulated fees, which in Canada tend to be in the $15 to $25 per $100 of loan range. The Deloitte survey's reported costs are the quotient of total costs divided by $100 of payday loans issued during the year and in good standing, meaning loans other than those that are eventually unrecoverable. Relying on those data and the assumptions that underlie them, the cost per $100 loan issued in Ontario, regardless of standing, would be approximately $17.40.

3.2 Profile of Borrowers

Characteristics

Payday borrowers tend to have lower household income[21] and education levels.[22] For example, a Maritime loan customer study conducted in 2014 by the Canadian Consumer Finance Association found that 51 percent of payday customers in the Maritime Provinces had no higher than a high school degree, and 31 percent had community college education levels.[23] The study also found that 63 percent of payday loan users have less than $50,000 annual income (23 percent less than $25,000, and 40 percent between $25-50,000).This implies that not all borrowers are in the lowest income bracket.

Canadian reports from Canadian Ipsos-Reid Express (CIRE) in 2005 provide similar evidence. The most frequent users of payday loans (more than once a month) were

[21] Islam, Khan and Simpson, Wayne (2014).
[22] Pyper, Wendy (2007).
[23] Canadian Payday Loan Association (2014). *Payday Loan Customer Study: PEI, NB, and NS*. Hamilton. http://www.cpla-acps.ca/english/reports/PDL%20Customer%20Study%20CPLA%20Dec%202014%20Final.pdf

those with lower educational attainment (24 percent among those with less than high school), and those with household incomes of less than $30,000.[24]

Standing in some contradiction to these findings, Hoyes, Michalos & Associates Inc. found in 2015 that use of payday loans among insolvent debtors with an income of over $4,000 per month were as likely as those with an income between $1,001 and $2,000 per month,[25] indicating the existence of a class of borrowers with profound mismatch between monthly expenditure and income, as distinct from households with low income overall. This finding does not have an obvious interpretation, other than that those with high debts and difficulty servicing them are likely to find themselves in insolvency.

The above report identified increased payday loan use, total loan debt, and number of loans among the regional insolvency filings examined:

Table 3.3 Ontario Increasing Use and Average Size of Payday Loans

Over Three Year Comparison	2013-2014	2011-2012
Percentage of Debtors (%)	18	12
Total Loan Debt ($)	2,749	2,463
Average Loan Size ($)	794	743
Number of Loans	3.5	3.3

Source: Hoyes, J. Douglas and Michalos, Ted (2015) pp. 10

Payday borrowers also tend to be young.[26] An analysis of the 2005 Survey of Financial Security (SFS) reported that young people (15-34 years) were three times more likely to have used payday loans than their older counterparts (34-45 years).[27] The Maritimes study referenced above did not find the same younger age characteristics; the Maritime region’s population and employment profile, which is older than the rest of Canada’s, may account for some of the differences.

[24] Ipsos Reid (2005). *Public Experiences with Financial Services and Awareness of the FCAC*. Financial Consumer Agency of Canada. Calgary.
[25] Hoyes, J. Douglas and Michalos, Ted (2015). *Joe Debtor: Marginalized by Debt*. Toronto.
[26] Islam, Khan and Simpson, Wayne (2014).
[27] Pyper, Wendy (2007).

While payday borrowers tend to be young, have lower education levels and lower income, these characteristics do not make obvious the reasons why this group uses payday loans. The next section will describe the main reasons as to why borrowers take out payday loans, as well as their increased popularity among consumers.

Reasons for Taking out a Payday Loan and Increase in Popularity

Albertan payday borrowers, according to a study commissioned by the CPLA and conducted by Environics Research Group, reported primary reasons for taking out a payday loan as: emergency cash to pay for necessities (56 percent), to help out with an unexpected expense (37 percent), to help avoid late charges on routine bills (23 percent), to help get through a temporary reduction in income (22 percent), to buy something wanted (14 percent), and to avoid bouncing a cheque (12 percent).[28]

Evidence of rising payday loan use was reported in the same survey. In 2012, when asked what option respondents would choose if they needed $300, 67 percent chose payday loan companies over other options (borrowing from a friend/family member, cash advance on credit card, using bank overdraft protection), as compared with 58 percent in 2008.[29]

This increased use may not be limited to the low income payday borrower. Simpson and Islam found that "the proportion of borrowers in the highest income group increased in the Canadian Financial Capability Survey (CFCS) 2014, which implies that the penetration of payday lending among richer households is increasing."[30] These groups generally have greater access to alternative loaning options, such as mainstream financial services. Furthermore, the proportion of borrowers who have a post-secondary or university degree has also increased.[31] These factors imply a growth of popularity for payday loans among non-traditional borrowers.

To summarize, the profile of a traditional borrower includes the characteristics, not universal, of youth and relatively low levels of education and income. Many identify the primary reason for using the service as a need for emergency cash for

[28] Canadian Payday Loan Association (2013). *Payday Loan Users Study Alberta*. Hamilton. http://www.cpla-acps.ca/english/reports/CPLA%202012%20e%20Users%20AB.PDF
[29] Canadian Payday Loan Association (2013).
[30] Islam, Khan; Simpson, Wayne (2014).
[31] Islam, Khan; Simpson, Wayne (2014).

necessities. Some reports have also indicate rising payday loan usage among low and slightly higher income groups. Next, an overview of the online payday lender's market will be conducted to provide insight on this growing share of the industry.

3.3 Online Markets

Traditionally, payday loans have been a store-front based service ("bricks and mortar" style), yet such loans are increasingly available online.[32]

The online market provides relatively ready access to unlicensed lenders. In a report (Barrett 2015) for the Consumers Council of Canada on consumer experiences with online payday loans, participants were asked to access payday lending websites in each province. Table 3.4 displays the prevalence of online unlicensed payday lenders within the sample across Canada.

Table 3.4 More Unlicensed Online Lenders in Most Provinces

Sample Size per Each Province Varies

Province	Total	Licensed	Unlicensed	Percentage Unlicensed (%)
NL	12	0	12	100.0
PE	9	0	9	100.0
NS	11	3	8	72.7
NB	9	0	9	100.0
QC	14	0	14	100.0
ON	25	9	16	64.0
MB	12	2	10	83.3
SK	9	8	1	11.1
AB	19	11	8	42.1
BC	10	7	3	30.0
YT	4	0	4	100.0
Total	**134**	**40**	**94**	**70.1**

Source: Barrett, Denise (2015) pp. 29

[32] Deloitte (2014). *Strengthening Ontario`s Payday Loans Act: Payday Lending Panel Findings and Recommendations Report.* Toronto.

The evidence indicates that unlicensed lenders are less likely than others to comply with provincial regulations and consumer protection legislation.[33] Typical instances of noncompliance with regulatory protocols include:

1. Asking borrowers to provide private banking information – such as account numbers, answers to security questions, and online passwords – which would give lenders open access to the borrower's bank account.

2. Claiming to obey requirements of legislation regarding regulation, without actually doing so.

3. Not providing complete contact information for the lender and basic information about repayment. [34]

Another fundamental requirement of licensed payday lenders is to disclose all fees for the service (i.e., total loan cost). Unlicensed online lenders compliance with fee disclosure appears sparse (Table 3.5).

Table 3.5 Majority of Online Lenders Adhering to Fee Disclosure Requirements are Licensed

Sample Size per Each Province Varies

Province	Number of Online Lenders (Sample)	Licensed Lenders Who Complied (%)	Unlicensed Lenders Who Complied (%)
NL	12	-	0.0
PE	9	-	11.1
NS	11	100.0	25.0
NB	9	-	11.1
QC	14	-	0.0
ON	25	88.9	6.3
MB	12	100.0	10.0
SK	9	100.0	0.0
AB	19	100.0	12.5
BC	10	85.7	33.3
YK	4	-	25.0
Total	**134**	**95.0**	**9.6**

Source: Barrett, Denise (2015) pp. 30

[33] Barrett, Denise (2015).
[34] Barrett, Denise (2015). p. 6

Licensed lenders appear to show a high degree of compliance with regulations, with 95 percent of the sample meeting the requirements, with about 10 percent of unlicensed lenders doing so.[35] The risk of financial harm to consumers from product offerings by unlicensed lenders is likely higher than the licensed channel,[36] and this will pose challenges to regulators.

The growth of the online payday lending sector, in particular the unregulated form, seems evident in jurisdictions that have taken sharply restrictive steps in the regulated loan sector. In the U.S. market, states that have prohibitive or highly restrictive regulation are likely to see more loans provided by unlicensed lenders, a pattern similar to the UK's.[37]

Online payday loans have become more accessible to borrowers, by assumption with an increased amount of risk, specifically regarding the prevalence of unlicensed lenders. Their lack of compliance with provincial regulations is strongly evident, and poses a difficult challenge to provincial regulators. In any event, unlicensed lenders are not the only alternatives to licensed lenders, as other forms of short-term, high interest credit exist as competition for the payday lending industry.

A brief enumeration of existing market competitors to payday loans follows; these will be revisited below in discussion of empirical findings.

[35] Barrett, Denise (2015).
[36] Public Utilities Board of Manitoba (2013).
[37] Policis (2014), Dungen et. al (2016).

3.5 Alternatives to Payday Loans

Other forms of short-term, high interest credit can be listed in two separate categories: Traditional (credit products issued by mainstream financial services), and non-traditional (all others).

Traditional Credit Alternatives

Banks and Credit Unions – May offer short term, small dollar lending products, if rarely so in the Canadian marketplace.[38] [39] Traditional banking-sector alternatives are limited to the following three categories.

1. Overdraft Protection – For customers who are approved for the service, banks will allow account holders to withdraw an amount that exceeds their account balance, and the extra amount is named overdraft. Interest will be charged on the overdraft amount, along with a small fee for the cost of borrowing from the bank.[40]

2. Lines of Credit – Are typically secured, and allow the borrower to withdraw cash up to an agreed credit limit. Interest is charged on amounts drawn on the credit line for the period that the funds are outstanding.

3. Credit Card Cash Advance –Withdrawing cash from a bank using a credit card up to the available credit limit. There is no interest free period on this credit, however the rates are lower than payday loans.[41]

Non-Traditional Credit Alternatives

1. Pawnshop Loans – Small, short-term loans that are secured by physical collateral. Customers trade tangible personal property for cash loans based on the value of the collateral. If the borrower does not repay the loan within

---

[38] Mann, Ronald and Hawkins, Jim (2007). Just Until Payday. *University of California Los Angeles Law Review,* vol. 54, no. 4, pp. 855-912.

[39] An informal survey of bank and credit union offerings, conducted by the authors of this report, found no equivalent Canadian bank product, other than overdraft protection, that had term or liquidity characteristics similar to a payday loan, or was available to borrowers with poor credit. A small number of credit unions have offerings with some payday loan characteristics; these are short term instalment loans with interest rates equivalent to a high-rate credit card.

[40] Canadian Bankers Associations (2016). *Banks and Alternatives to Payday Loans*. Ottawa. http://www.cba.ca/contents/files/backgrounders/bkg_paydayloans_en.pdf

[41] Financial Consumer Agency of Canada (2016). *Payday Loans: An Expensive Way to Borrow. Mortgages and Loans*. Ottawa

the specified time period, the item is forfeited to the lender, who may resell it.[42]

2. Rent-to-Own (RTO) Loans – Borrowers acquire goods, often furniture, in exchange for periodic payments to the lender. If the borrower defaults on the payment, the goods are collected and returned to the lender.[43]

3. Loan-Sharking – The Canadian Department of Justice defines loan-sharking according to two criteria: high interest rates and the often unique nature of collateral.[44] The risks associated with defaulting on these types of loans may potentially involve real or threatened violence.[45]

The Future Market

The telecommunications revolution of the past generation, because of its impact on data-handling capacity, enabled very large financial services markets and businesses to evolve. It is also fundamentally changing some market structures.

The obvious examples are AirBnB in the short-term accommodation rental market, and Uber in the taxi market. Each service operates by aggregating market supply and market demand in real time. This allows the relevant market to clear more easily than otherwise, meaning it improves and speeds price discovery. This increases the efficiency with which resources are used, allowing improved service or lower costs or both.

The increased efficiency of trading in these markets increases social welfare, and it creates losses for participants whose practices are based on traditional market structures. It also creates challenges for regulators, whose enabling legislation and regulation is designed to support those traditional market structures, but are ill-equipped for handling the emerging and very different structure.

Similar changes in financial technology seem likely to have meaningful impacts on consumer lending markets. Some existing platforms aim to pool disparate individual

[42] Bhutta, Neil; Goldin, Jacob and Homonoff, Tatiana (2015).
[43] Mann, Ronald J. and Hawkins, Jim (2007).
[44] Canadian Department of Justice (2015). *A Typology of Profit-Driven Crimes*. Ottawa. http://www.justice.gc.ca/eng/rp-pr/csj-sjc/crime/rr02_3/p34.html#sec3_4
[45] Canadian Department of Justice (2015).

lenders with individual borrowers, so that the small loan market can clear without requiring the formal banking sector in any activity other than funds transfers.[46]

If financial technology allows new models to succeed in the short-term, small-dollar lending market, two results are likely. The first is that existing payday lenders will face higher market discipline than otherwise, and put pressure on prices. If Uber's impact on regional taxi markets is and indicator, technological change may pose an existential challenge to payday lenders.

The second result will be on the need for regulatory reform. Just as regulation has difficulty coping with changes in rental accommodation and taxi markets, it already has difficulty coping with online lenders. This difficulty seems likely to grow.

Conclusion

The payday loan industry has shown expansion in "bricks and mortar" and online services over the last few decades. Key industry players, such as Money Mart and Cash Money, make up a large share of lending services across Canada. Typical borrowers are relatively young compared to the population at large, and without good credit access. They are slightly more likely to have low education or income levels; they tend to list the primary reason as to why they use payday lending services as the need for emergency cash to pay for necessities.

Alongside, alternatives for the short-term, small-dollar credit provided by payday lenders exist. These include online unlicensed payday lenders, which may pose increased risks, as they show poorer records of disclosure to the borrower, notably with respect to fees and recourse. The online market, licensed and unlicensed, seems likely to grow in importance.

[46] Some Canadian chartered banks have announced coordinated programs or alliances that would bring together the new intermediators with their own infrastructure. This may facilitate clearing for the new suppliers, while reducing the competitive threat they may pose to traditional lenders.

Chapter 4

Regulatory Overview – Payday Loans

Chapter Summary

- Most Canadian provinces, through legislation and regulation since 2007, have facilitated the development of the payday loan business.
- Most provinces have extensive regulation detailing signage and notice provision to payday loan customers, among other disclosure requirements.
- Regulations also specify maximum loan fees – there is a significant range across provinces – and the terms under which borrowers may obtain successive loans.
- Provinces also require that lenders allow borrowers, for a short period after taking a loan, to rescind their loan agreements.
- Some provinces have, and some others are considering, rules that would limit how many times a borrower could take a loan from a particular lender of a fixed period. Subsequent loans would have a longer term or become instalment debt.

This chapter provides a current profile of the payday lending regulatory framework in Canada.

4.1 Current Regulation

Regulation of the payday lending industry differs from province to province. The key legislative reference point is 2007, when the Canadian Parliament amended the federal Criminal Code (Section 347) to remove prohibitions on seemingly usurious interest rates, where provinces had introduced specific legislation allowing for licensing, the regulation of and jurisdiction over the payday lending sector.[47]

This measure was a conceptual follow-on to an effort that began in the United States a century previous, an initiative aimed at protecting consumers from loan-sharking. The view, which ultimately prevailed in law and practice, was that loan-sharking could be ended by “legalizing higher-interest small loans with explicit licensing and supervision of lenders by the state”; further, “the transparency of loan costs justified

[47] Kitching, Andrew and Starky, Sheena (2006).

legalization of higher interest rates: poor borrowers seeking small loans would get the loans from licensed and regulated lenders on clear (if still expensive) terms." (Galperin and Weaver 2014, p5)

The 2007 Canadian amendment exempted licensed payday lenders from criminal sanctions; giving provincial government's responsibility over protecting consumers and limiting the overall cost of payday loans.[48] A number of provinces introduced enabling legislation and regulation, while Newfoundland and Labrador refrained from doing so,[49] while Quebec has made payday lending effectively impossible under the *Consumer Protection Act*, by restricting maximum interest rates to 35 percent annually.[50]

Provincial regulations of the payday lending sector are similar at their core; many encompass some of the same claims, requirements, and terms. Key differences involve, for example, the cost of borrowing per $100 loan. A brief overview of general similarities and differences between regulations will be discussed. For a more in depth look, see the tabular overview, Appendix A, showing a selection of relevant current and proposed provincial regulations in each province[51].

General Similarities

1. Limitations on rollovers – rollovers are the extension or renewal of a loan that imposes additional fees or charges on the borrower, or an advancement of a new payday loan to pay out an existing payday loan. Legislation and regulation in all Canadian provinces generally prohibits lenders from granting rollovers.

2. Display Regulations - signs that are posted in the pay lenders place of business and/or on their website usually consist of the following criteria:
    a. Size of 61 cm width, 72 cm length.
    b. A statement of Maximum Allowable Cost per $100 Borrowed within province.

[48] Lo, Janet (2011).
[49] Government of Newfoundland and Labrador (2010). *News Release: Provincial Government Will Not Regulate Payday Loan Companies*. St. John's. http://www.releases.gov.nl.ca/releases/2010/gs/0616n11.htm
[50] Momentum (2014).
[51] All sources of information on regulation are found in the provincial legislation; which are listed in the references and tabular overview.

c. An example loan: "Example: $300 loan for 14 days" with subsequent calculation of the total the borrower would repay given this situation.
d. A statement declaring that the sign is required and is compliant with the provincial regulations and/or the consumer protection acts.
e. The sign must be visible to borrowers immediately upon entering the place of business. For online lending, sign criteria must be at the top of the page or on a webpage that precedes entering information for a payday loan agreement.

3. Rescission or cancellation – borrowers in every regulated province are entitled to rescission rights. Upon entering the payday loan agreement, it may be cancelled without any reason, at any time within 48 hours of the agreement being entered into. If the lender is not open for business on the second day after the agreement, the borrower carries this rescission right to the next day that the lender is open for business. Nova Scotia is the only province which offers extended rescission rights; five days instead of two.[52]

Differences

1. Maximum Cost of Borrowing per $100 Loan – The province with the highest allowable cost of borrowing permitted is Prince Edward Island at $25 per $100 loan, compared to Manitoba, until very recently the lowest, at $17 per $100 loan. As of August 1, 2016, Alberta has enacted legislation setting the maximum fee at $15 per $100, and New Brunswick has a proposed Bill 4, which also would set the maximum cost of borrowing at $15 per $100 loan.

2. Maximum Interest on outstanding principal – As mentioned in the overview, section 347 of the Criminal Code of Canada requires that no lending company charge more than 60 percent annual interest on any outstanding loan, other than fees as may be levied by licensed payday lenders and provided for in provincial regulation. [53] Therefore, Newfoundland and Labrador, the only province to not regulate the payday loan industry, applies by default the 60 percent cap. Nova Scotia, Prince Edward Island, and Ontario do not have other regulations regarding the annual interest charged, so their maximum is

[52] Consumer Protection Act: An Act to Provide for the Fair Disclosure of the Cost of Credit and for the Protection of Buyers of Consumer Goods (2014).
[53] Criminal Code (2016)

60 percent as well. New Brunswick, Saskatchewan, and British Columbia limit the maximum interest to 30 percent per annum on the principal amount of the loan, while Alberta and Manitoba allow 2.5 percent per month of that amount, not compounded.

Noteworthy

Provincial regulations on the payday lending industry possess general similarities such as display regulations, cancellation terms and prohibiting rollovers. The maximum cost of borrowing and interest differ depending on the province. However, proposed changes in some legislation show a tendency toward heightened stringency in regulatory standards.

With the stated aim of avoiding "debt traps" associated with repetitive lending, British Columbia requires that if a borrower enters into a third payday loan agreement within 62 days of having entered the first, the borrower will be given at least three pay periods, rather than one, to pay off the third loan.[54] [55] Other models would require the third loan to be provided in the form of a short term instalment loan. Ontario has proposed and Alberta has now enacted similar legislation and regulation (Bill 156 in Ontario's case), and the Nova Scotia Utility and Review Board has recommended that this policy be endorsed as well.[56]

Such changes, by extending the term of loans, will increase the quantity of financial capital required to fund a given loan volume, and raise operating costs per loan issued. This will decrease the number of loans that are issued, and loans issued will become more costly to provide.

It is not obvious to what degree such provisions might be enforced in the case of borrowers who actively seek repetitive loans. The current and proposed provincial rules apply to the lender, who may not issue repetitive loans to the customer. The customer, however, may simply go to another firm's store. There is no provincial or

---

[54] Given 3 pay periods if income is received on a bi-weekly, semi-monthly, or more frequent basis. Given 2 pay periods if the income is received on a less frequent basis than bi-weekly or semi-monthly.
[55] Business Practices and Consumer Protection Act: Payday Loans Regulation (2009). *Queen`s Printer.* Government of British Columbia. http://www.bclaws.ca/Recon/document/ID/freeside/16_57_2009#section1
[56] Nova Scotia Utility and Review Board (2015) *Payday Loans – Decision and Recommendations.* Halifax. http://www.cpla-acps.ca/english/reports/M06084%20-%20Payday%20Loans%20Letter%20from%20Board%20dated%20March%2030,%202015.pdf

Canadian data universe of borrowers and transaction histories, nor a Canadian credit bureau record for payday loans.[57]

The question of rescission periods also is interesting. A long rescission period may be seen as consumer-friendly regulation. However, a lengthy rescission period grants same borrowers exactly what they seek, very short term credit, at very low or no cost. Should many customers seek to borrow only to rescind, the market cost structure would shift in a manner unfavourable to all.

On its face, therefore, lengthening the rescission period would tend to shrink or damage the market, by raising costs. However, it seems unlikely that customers would repeatedly take to applying for loans only to rescind them, implying that rescission periods may not be seriously damaging to the payday sector.[58]

[57] Matters are different in the US, where there are data services that cover the subprime market. Clarity Services, Inc., is one such provider, which covers most of the payday lending market, which credit bureaus mostly do not do in the US. The Policis studies discussed elsewhere in this report rely significantly on the Clarity universe of data.
[58] Data on the rates of rescission in Nova Scotia as compared to other provinces would help resolve this question.

Chapter 5

Literature Review and Analysis – Payday Loans

Chapter Summary

- Empirical evidence on the consumer welfare consequences of payday lending is mixed and has a particular focus on the extent to which payday loans prevent or encourage the use of potentially inferior alternatives.
- While payday loans may help consumers in weathering financial shocks, some portion of demand may stem from cognitive biases and a lack of information.
- Interventions to improve borrower information and reduce cognitive biases may reduce payday loan demand but may also result in costly unintended consequences.
- Outright or effective bans on payday lending may reduce overall high-cost credit use but may also increase demand for less appealing alternatives, such as unregulated suppliers, pawnshop loans, and loans from illegal sources.
- Regulations aimed at reducing repetitive borrowing are likely to have mixed effects on welfare. Such measures may lower the risk profile of the borrowing clientele, but would also leave that market unserved.
- While industry performance could become more consistent through consolidation across firms, the scope for such consolidation is limited in Canada.

Overview and Theoretical Background

The literature on payday lending sheds light on the consumer welfare impacts both of payday loans and of regulations seeking to ban or restrict the payday loan industry. The majority of papers reviewed are based in the United States, and many examine the impact of changes in payday loan access on consumer behavior.

Changes in payday loan related legislation often form a "natural experiment", permitting the examination of consumer behavior prior to and after rule changes. Table 5.1 below provides an overview of the key methodologies, findings and messages of papers reviewed here.

Economic theory informs the payday loan literature, providing testable hypotheses of the impact of payday lending on consumer welfare.

The existence of demand for the loans indicates that consumers at least initially perceive them as having the potential to improve their welfare.[59] Taking a loan may assist consumers in weathering short-term financial shocks, such as an unexpected medical bill or computer or auto repair. It may allow for a more general smoothing of consumption for borrowers with income and expenses that do not align well. Payday loans may also allow consumers to avoid more costly outcomes – such as credit card or utility reconnection fees.[60]

In some cases, however, payday loans may have detrimental effects. There may exist information asymmetries between the borrower and the lender, in which the lender possesses a greater level of financial literacy or is not fully transparent on the characteristics of the loan. The lender may, for example, obscure the true cost of the loan in the hopes that the borrower will underestimate.[61] Even if the lender is fully transparent, the borrower may have a difficult time comparing the payday loan to alternatives – such as overdraft protection, for which cost estimates would require the ability to calculate interest rates from uncertain future fee payments.[62]

A number of cognitive biases may also contribute to payday loan demand. The consumer may have time-inconsistent preferences – in which the value he places today, on current consumption, is different from what he would place tomorrow on that same consumption – and thus issues with self-control.[63] The borrower may be unrealistic in estimating his own ability to repay.[64] Payday loans have been criticized

[59] Mann, Ronald and Hawkins, Jim (2007). Just Until Payday. *University of California Los Angeles Law Review,* vol. 54, no. 4, pp. 885.
[60] Galperin, Roman V.; and Weaver, Andrew (2014). Payday Lending Regulation and the Demand for Alternative Financial Services. *Community Development Discussion Paper,* no. 2014-01, September. Boston: Federal Reserve Bank of Boston. http://dx.doi.org/10.2139/ssrn.2494426 pp. 3
[61] Stango, Victor; and Zinman, Jonathan (2009). Fuzzy Math, Disclosure Regulation and Credit Market Outcomes: Evidence from Truth in Lending Reform. *Unpublished Manuscript,* April. http://dx.doi.org/10.2139/ssrn.1081635
[62] Mann, Ronald and Hawkins, Jim (2007), p. 882.
[63] Stoianovici, Petru S.; and Maloney, Michael T. (2008). Restrictions on Credit: A Public Policy Analysis of Payday Lending. *Unpublished Manuscript,* October. http://dx.doi.org/10.2139/ssrn.1291278 pp. 10
[64] Bertrand, Marianne; and Morse, Adair (2009). Information Disclosure, Cognitive Biases and Payday Borrowing. *MFI Working Paper Series*, no. 2009-007, October. Chicago: The Milton Friedman Institute for Research in Economics. https://bfi.uchicago.edu/research/becker-friedman-working-paper/information-disclosure-cognitive-biases-and-payday-borrowing pp. 6-7

as creating “debt traps” – in which the inability to repay leads to loan rollovers and mounting interest costs.[65]

There are a number of hypotheses on the link between payday loans and consumer welfare, on which the studies reviewed and discussed in the following section provide some evidence. The sections thereafter provide an overview of literature on the potential regulatory responses.

[65] National Public Radio (2016, June 2). New Rules to Ban Payday Lending ‘Debt Traps’. http://www.npr.org/sections/thetwo-way/2016/06/02/480329986/new-rules-to-ban-payday-lending-debt-traps

Table 5.1 Methodology and Key Findings (Positive View of Payday Lending)

Author(s) (Date)	Article Title	Publisher	Methodology	Findings	Message
N/A (2004)	The effect of interest rate controls in other countries	Policis	Analysis based on an evidence base from the US, the UK, France and Germany. Sources include surveys, relevant literature, interviews and public source data.	Interest rate ceilings associated with outcomes including credit exclusion and diversion of higher risk borrowers into both mainstream and sub-prime credit options they would not otherwise have chosen.	Interest rate controls may not be the most effective method of tackling issues including poverty and exploitative lending.
Donald Morgan and Michael Strain (2007)	Payday Holiday: How Households Fare After Payday Credit Bans	Federal Reserve Bank of New York	Differences in differences analysis comparing Georgia and North Carolina to other states around the time of the former states' payday loan bans.	Payday lending bans associated with higher levels of bounced checks, more complaints about lenders and debt collectors and more Chapter 7 bankruptcy filings.	Provides some evidence against the idea of payday loans as debt traps and for the idea of the loans as preferable substitutes to bounced check protection. Banning payday loans may force consumers into higher-cost credit.
Anna Ellison and Robert Forster (2008)	The impact of interest rate ceilings	Policis	Analysis based on an evidence base from countries including the US, the UK and Australia. Sources include focus groups, surveys and public statistics.	Interest rate ceilings associated with reduced credit supply, diversion of consumers to lower-quality products, greater indebtedness and higher costs of borrowing for some consumers. No evidence that payday loans lead to a "cycle of debt" in Australia.	It may be more useful to encourage high-quality, transparent and competitive lending rather than to impose an interest rate ceiling.

Jonathan Zinman (2008)	Restricting Consumer Credit Access: Household Survey Evidence on Effects Around the Oregon Rate Cap	Manuscript	Differences in differences analysis comparing Oregon and Washington before and after Oregon's 2007 restrictions on payday loans.	Payday loan restrictions associated with a decrease in overall use of high-cost short term borrowing, a shift into potentially inferior alternatives and a deterioration in measures of financial health.	Payday loan restrictions may restrict investment and consumption smoothing. There may be a lack of close substitutes to payday lending.
Bart Wilson, David Findlay, James Meehan, Charissa Wellford and Karl Schurter (2010)	An Experimental Analysis of the Demand for Payday Loans	Manuscript	Computerized laboratory experiment analyzing the impact of payday loan access on financial management and survival.	Payday loans help individuals absorb financial shocks, but can be detrimental when demand rises above a specific threshold. Majority of experimental subjects benefited from payday loan access.	Payday loans may have positive effects for consumer welfare.
Richard Hynes (2012)	Payday Lending, Bankruptcy, and Insolvency	Washington and Lee Law Review	Regressions analyzing the impact of state-level legalization of payday loans on measures of financial hardship including bankruptcy.	Payday lending legalization associated with decline in bankruptcy filings in counties with large military populations.	Provides support to a view of payday loans as beneficial (ex: consumption smoothing).
Donald Morgan, Michael Strain and Ihab Seblani (2012)	How Payday Credit Access Affects Overdrafts and Other Outcomes	Manuscript	Difference in difference analysis comparing financial outcomes in a number of states where payday lending legality changed to states where it remained constant.	Payday loan bans associated with lower Chapter 13 bankruptcy rates, higher levels of returned checks and overdraft fee income at banks and more complaints against lenders and debt collectors.	Payday loan access may increase ability of households to make use of bankruptcy protection and avoid bouncing checks.

Ronald Mann (2014)	Assessing the Optimism of Payday Borrowers	Supreme Court Economic Review	Comparison of results from survey of payday borrowers at the time of borrowing to future repayment and borrowing patterns.	Roughly 60% of borrowers are accurate in their predictions of the time it will take to pay back their payday loans.	Provides evidence against the idea that the majority of payday loan use is the result of lacking information on the part of the borrower.
Neil Bhutta, Jacob Goldin and Tatiana Homonoff (2015)	Consumer Borrowing After Payday Loan Bans	Manuscript	Difference in difference analysis comparing the use of a number of credit products in states that changed the legality of payday lending to states that did not.	Payday loan restrictions associated with increases in pawnshop loan usage and involuntary chequing account closures. No impact on credit card debt or consumer finance loan use.	Payday loan restrictions may only cause substitution among forms of alternative credit services (AFS) rather than decreasing the number of individuals using AFS.
N/A (2016)	The outcomes for consumers of differing approaches to the regulation of small dollar lending.	Policis	Analysis based on evidence base from the US. Sources include interviews with regulators and transactional credit data.	Restricting small sum credit supply does not eliminate demand - demand shifts to online lenders. These lenders are often unlicensed and noncompliant with regulations, and may therefore have a market advantage.	Regulators may be limited in their ability to affect the supply of small sum credit, given the presence of online lenders. New restrictions may have adverse consequences for consumer welfare.

Table 5.2 Methodology and Key Findings (Neutral View of Payday Lending)

Author(s) (Date)	Article Title	Publisher	Methodology	Findings	Message
Petru Stoianovici and Michael Maloney (2008)	Restrictions on Credit: A Public Policy Analysis of Payday Lending	Manuscript	Regressions analyzing the impact of the presence of payday lending stores, in states in which the legality of payday lending has changed, on bankruptcy filings.	Payday lending not significantly associated with total or Chapter 13 bankruptcy filings, small negative association with Chapter 7 filings.	Provides some evidence against the idea that payday lending leads to a "cycle of debt" among borrowers.
Victor Stango and Jonathan Zinman (2009)	Fuzzy Math, Disclosure Regulation and Credit Market Outcomes: Evidence from Truth-in-Lending Reform	Manuscript	Regressions exploiting variation in TILA (Truth in Lending Act) enforcement over time and across lender types. TILA mandated annual percentage rate (APR) disclosure.	Weaker TILA enforcement associated with higher interest rate difference between households more and less likely to misjudge loan APRs and general decrease in APRs of affected firms.	Disclosure regulations may weaken the ability of lenders to take advantage of cognitive biases, but may be limited by high enforcement costs.
Marianne Bertrand and Adair Morse (2009)	Information Disclosure, Cognitive Biases and Payday Borrowing	University of Chicago: The Milton Friedman Institute for Research in Economics	Randomized field trial presenting customers of a large US payday loan company with information on the loan and a self-control tool and analyzing the effect on borrowing behavior.	Borrowers presented with information on total fees payable on a $300 loan outstanding for various time frames (ex: 1 month, 2 months) and typical loan repayment patterns reduce their borrowing. Information disclosure has no impact on borrowers with large loan to income ratios.	Payday borrowing likely a mix of rational and irrational decisions, information disclosure may help reduce irrational borrowing. Regulation on the maximum sum individuals may borrow may be effective as well.

Brian Melzer and Donald Morgan (2009)	Competition and Adverse Selection in a Consumer Loan Market: The Curious Case of Overdraft vs. Payday Credit	Manuscript	Regressions analyzing the impact of payday loan access - through changes in state legislation and proximity to states with legal payday lending - on overdraft fees and the supply of free checking accounts at depositories.	Payday loan access associated with a lower supply of free checking accounts and higher overdraft fees.	Flat overdraft credit fees may expose depositories to adverse selection problems when competition from payday lenders exists, as depositors expecting small overdrafts may switch to payday lenders. This has mixed consumer welfare implications.
N/A (2012)	Payday Lending in America: Who Borrows, Where They Borrow, and Why	The Pew Charitable Trusts	National survey comparing payday loan use in states more and less restrictive of the industry.	States that are restrictive of payday lending do not have a significantly higher rate of usage of payday loans from other (especially online) sources.	Banning one form of alternative financial service may not lead to increased use of other forms of AFS.
Neil Bhutta, Paige Skiba and Jeremy Tobacman (2012)	Payday Loan Choices and Consequences	Vanderbilt University Law School	Regressions exploiting variation in payday loan access arising from a threshold rule for eligibility.	Payday borrowing has nearly no long run association with measures of financial well being including credit scores.	Borrowers may be in poor financial condition at the time of their application; the loan does not have an appreciable impact.
Neil Bhutta (2014)	Payday Loans and Consumer Financial Health	Journal of Banking & Finance	Analyzes the impact of loan access - through changes in state legislation and proximity to states with legal payday lending - on financial well-being.	Payday loan access has little to no impact on outcomes including credit scores and the probability of overdrawing credit lines.	Provides some evidence that payday loans do not have significant positive or negative financial impacts.

Ronald Mann (2014)	Do Defaults on Payday Loans Matter?	University of Columbia: Center for Law and Economic Studies	Regressions analyzing the association between payday loan defaults and credit scores in the years prior to, of and after the defaults.	Payday loan defaults associated with inferior credit score performance in the year of and years leading up to default, superior performance in years after. The overall association is small.	Assuming that credit score changes can be used as proxies for financial health, payday loan defaults do not have a large impact. Consumer financial problems may also begin significantly prior to, rather than being caused by, payday loan use.
Denise Barrett (2015)	Consumer Experiences in Online Payday Loans	Consumer Council of Canada	Audits of online payday lenders, review of relevant provincial legislation, communication with provincial government and industry representatives.	Licensed lenders more likely to be compliant with payday lending regulations than unlicensed ones. Consumers online are likely to encounter unlicensed and non-compliant lenders. Unlicensed sites show noncompliance - such as requests for personal banking information.	Payday lending legislation must take into account the presence of unlicensed lenders.

Table 5.3 Methodology and Key Findings (Negative View of Payday Lending)

Author(s) (Date)	Article Title	Publisher	Methodology	Findings	Message
Dean Wilson (2002)	Payday Lending in Victoria - A research report	Consumer Law Centre Victoria Ltd.	Analysis based on sources including relevant literature, interviews and surveys.	The payday loan industry targets the disadvantaged. Customers tend to be young, low-income and to borrow repeatedly and to cover bills and daily expenses. They report concern over high costs and loans' "addictive" nature.	Effective policy would include ensuring an effective interest rate cap and encouraging the development of new or expansion of existing low cost credit products.
Michael Stegman and Robert Faris (2003)	Payday Lending: A Business Model that Encourages Chronic Borrowing	Economic Development Quarterly	Regressions analyzing the impact of repeat borrowing on the financial performance of payday lending in North Carolina.	A 1 percentage point increase in customers borrowing at least once a month increases gross revenues per payday loan outlet by $1,060.	The financial performance of the payday loan industry may be significantly increased through the conversion of borrowers into repeat customers.
Mark Flannery and Katherine Samolyk (2005)	Payday Lending: Do the Costs Justify the Price?	Federal Deposit Insurance Corporation Center for Financial Research	Tabular and regression analysis of store-level payday loan data.	No evidence that high-frequency borrowers have an outsize effect on payday store profits, beyond impact on loan volume.	The payday loan industry may be able to survive without high-frequency borrowers, but its magnitude and growth may depend on them.

Kim Manturuk and Janneke Ratcliffe (2007)	North Carolina Consumers After Payday Lending: Attitudes and Experiences with Credit Options	UNC Center for Community Capital	Survey of low and middle income North Carolinians, focus groups of former payday loan users.	The ban on payday lending in North Carolina in 2006 did not significantly affect credit availability for North Carolina households. Former payday borrowers generally reported being positively (or not) affected. They viewed payday loans as excessively costly and difficult to stop using.	Payday loans may be welfare-reducing for borrowers. There may be a need for short term consumer credit that is lower cost and easier to manage than payday loans.
Dennis Campbell, Francisco de Asis Martinez-Jerez and Peter Tufano (2008)	Bouncing Out of the Banking System: An Empirical Analysis of Involuntary Bank Account Closures	Manuscript	Regressions analyzing the association between the per-capita number of payday lending establishments and the rate of involuntary debit account closures.	Increase in number of payday lenders associated with increase in involuntary debit account closures of roughly 9.5% relative to the average rate.	Use of payday loans may increase rate at which households overdraw their debit accounts.
Scott Carrell and Jonathan Zinman (2008)	In Harm's Way? Payday Loan Access and Military Personnel Performance	Federal Reserve Bank of Philadelphia	Regressions analyzing the impact of payday loan access - through changes in state legislation - on military personnel outcomes.	Payday loan access by military members associated with decline in job performance and retention, increase in severely poor readiness.	Payday loan access may reduce military readiness and welfare of military members.
Paige Skiba and Jeremy Tobacman (2009)	Do Payday Loans Cause Bankruptcy?	Vanderbilt University Law School	Regressions exploiting a threshold rule for payday loan eligibility.	Barely-eligible first-time applicants file for Chapter 13 bankruptcy significantly more than barely-rejected first-time applicants.	Payday loan applicants likely financially stressed, use of loans may contribute to later bankruptcies.

Sumit Agarwal, Paige Skiba and Jeremy Tobacman (2009)	Payday Loans and Credit Cards: New Liquidity and Credit Scoring Puzzles?	National Bureau of Economic Research	Summary statistics of and basic calculations on a merged dataset of payday loan and credit information.	Payday borrowers have substantial credit card liquidity when taking their first loan, could save by borrowing to their credit limits. Experience large liquidity drops in the year prior to taking a payday loan.	Payday borrowers may lack the capacity to effectively prioritize between credit options.
Susan Carter, Paige Skiba and Jeremy Tobacman (2010)	Pecuniary Mistakes? Payday Borrowing by Credit Union Members	University of Pennsylvania: Pension Research Council	Summary statistics of and calculations on a credit union dataset containing transaction-level information including checking and savings account debits and credits.	Payday borrowers tend to have higher transaction frequencies at lower dollar amounts. The average borrower loses about $88 over a 6.5 month period through using payday loans as opposed to alternative liquidity sources.	Payday borrowers may experience financial stress and have difficulty making financial decisions.
Brian Melzer (2011)	The Real Costs of Credit Access: Evidence from the Payday Lending Market	The Quarterly Journal of Economics	Regressions analyzing the impact of payday loan access - through proximity to states with legal payday lending - on measures of economic hardship.	Payday loan access associated with increased difficulty in paying mortgage, rent and utilities bills.	Payday loan access may increase the debt burden for low-income households and increase their difficulty in paying bills, thus increasing economic hardship.
Brian Melzer (2014)	Spillovers from Costly Credit	Manuscript	Analyses of the impact of payday loan access - through proximity to states with legal payday lending - on food stamp usage and child support payment.	Payday loan access associated with a greater likelihood of food stamp participation and child support payment delinquency.	Provides some evidence that payday loan access creates negative spillover effects for third parties.

Roman Galperin and Andrew Weaver (2014)	Payday Lending Regulation and the Demand for Alternative Financial Services	Federal Reserve Bank of Boston	Regressions analyzing the impact of state-level payday loan bans on demand for refund anticipation loans (RALs).	Payday loan bans associated with a roughly 5% decrease in demand for RALs.	Payday loan demand may be due more to a "cycle of debt" than to rational calculation.

Discussion and Analysis

The empirical literature on the welfare impact of payday loans is mixed.

A number of studies have provided support for the view of payday loans as beneficial. In a laboratory experiment, for example, Wilson and coauthors (2010) found that access to payday loans benefited the majority of participants and helped with the absorption of financial shocks.[66] While Morgan and coauthors (2012) found US payday loan bans to be associated with a decrease in Chapter 13 bankruptcy rates, they also reported an increase in complaints against lenders and debt collectors and an increase in returned check numbers and bank overdraft fee income.[67] This is consistent with payday loans' saving consumers' money through allowing them to avoid bouncing checks, with associated fees and credit score impacts, and avoid spiralling toward insolvency.[68]

Bhutta and coauthors (2016) found payday loan restrictions to be associated with involuntary checking account closures and the use of pawnshop loans.[69] The study perhaps most firmly supporting a positive view of payday loans was performed by Zinman (2008), who found evidence suggesting payday loan restrictions imposed in Oregon in 2007 forced consumers to turn to more costly alternatives – late bills and checking account overdrafts – and led to a decline in their financial condition.[70]

[66] Wilson, Bart J.; Findlay, David W.; Meehan Jr., James W.; Wellford, Charissa P.; and Schurter, Karl (2010). An Experimental analysis of the Demand for Payday Loans. *Unpublished Manuscript,* April. http://dx.doi.org/10.2139/ssrn.1083796
[67] Morgan, Donald P.; Strain, Michael R; and Seblani, Ihab (2012). How Payday Credit Access Affects Overdrafts and Other Outcomes. *Unpublished Manuscript,* February. https://jmcb.osu.edu/sites/jmcb.osu.edu/files/09453.pdf pp. 1
[68] Morgan, Donald P. *et al.* (2012) pp. 1, 11
[69] Bhutta, Neil; Goldin, Jacob; and Homonoff, Tatiana (2015). Consumer Borrowing After Payday Loan Bans. *Unpublished Manuscript*, November.
[70] Zinman, Jonathan (2008). Restricting Consumer Credit Access: Household Survey Evidence on Effects Around the Oregon Rate Cap. *Unpublished Manuscript,* October. www.dartmouth.edu/~jzinman/Papers/Zinman_RestrictingAccess_oct08.pdf pp. 2-4

Other studies have been more neutral. Some have found payday lending to have little or no relationship with variables including bankruptcy filings[71], credit scores and the probability of overdrawing credit lines[72] (Stoianovici and Maloney 2008), (Bhutta 2014), (Bhutta, Skiba and Tobacman 2012).[73] Mann (2014b), using credit scores as proxies for financial health, finds only a small overall association between payday loan defaults and credit scores, as well as evidence that credit score declines begin prior to defaults.[74] Mann (2014b) takes this as evidence that payday loan defaults do not have a large impact on consumer financial health, and that consumer financial problems may precede any default.[75]

Bocian and Sermons (2014), however, have challenged Mann's analysis. Their criticisms included the fact that payday loans can affect consumer welfare through high fees, as well as defaults; Bocian and Sermons argue that credit scores and defaults are poor indicators of financial health – especially at low credit score ranges.[76]

Melzer and Morgan (2009), meanwhile, examined the interaction between payday lending and flat overdraft fees charged by banks and other depositories. They found payday loan access to be associated with a lower supply of free checking accounts and higher overdraft fees. They hypothesized that payday credit access causes depositors expecting smaller overdrafts to use payday loans as a substitute, leaving banks with a pool of higher-cost customers expecting larger overdrafts, and resulting in price increases. By this hypothesis, then, payday loan access has mixed consumer welfare effects, with benefits for the former consumer type (expecting smaller overdrafts) and drawbacks for the latter (expecting larger overdrafts).[77]

In general, the empirical literature does not support the view that the availability of payday loans is likely to be independently associated with higher than otherwise rates of bankruptcy or insolvency. It is a commonplace in economic literature that

---

71 Stoianovici, Petru S. and Maloney, Michael T. (2008) pp. 30
72 Bhutta, Neil (2014). Payday Loans and Consumer Financial Health. *Journal of Banking & Finance*, vol. 47, pp. 230-242. http://dx.doi.org/10.1016/j.jbankfin.2014.04.024. www.federalreserve.gov/pubs/feds/2013/201381/201381pap.pdf
73 Bhutta, Neil; Skiba, Paige Marta; and Tobacman, Jeremy (2012). Payday Loan Choices and Consequences. *Vanderbilt Law and Economics Research Paper,* no. 12-30, October. http://dx.doi.org/10.2139/ssrn.2160947 pp 1.
74 Mann, Ronald (2014b). Do Defaults on Payday Loans Matter? *Columbia Law and Economics Working Paper*, no. 509, December. http://dx.doi.org/10.2139/ssrn.2560005 pp. 11, 18, 20.

75 Mann (2014b), p. 21-24.
76 Bocian, Debbie G. and Sermons, M William (2014). *Research Comment On: "Do Defaults on Payday Loans Matter?".* Centre for Responsible Lending. Durham. http://www.responsiblelending.org/payday-lending/research-analysis/payday_response_ronald_mann.pdf
77 Melzer, Brian; and Morgan, Donald (2009). Competition and Adverse Selection in a Consumer Loan Market: The Curious Case of Overdraft vs. Payday Credit. *Unpublished Manuscript,* February. http://www.kellogg.northwestern.edu/faculty/melzer/papers/melzer_morgan_2_19_2010.pdf pp. 20-21

insolvency rates primarily and almost exclusively are influenced by changes in labour market conditions: a rising unemployment rate or a falling employment rate are likely to be associated with rising rates of personal insolvency.

An analysis of Canadian data over the period 2002 through 2015, at the economic region level of disaggregation, supports this view.[78] Controlling for provincial fixed effects, the regional rate of consumer insolvencies is mostly explained in the statistical sense by rises in unemployment or falls in employment. Over the same period, consumer insolvencies were likely to be fewer proportionally in the provinces west of Ontario, with no clear association with the provincial availability of payday lending.

The literature that supports a more negative perspective on the payday loan industry tends to challenge the idea that payday lending helps consumers avoid more costly alternatives. Payday lending has been found to be positively associated with involuntary debit account closures (Campbell, Martinez Jerez and Tufano 2008)[79] and demand for refund anticipation loans – another alternative financial service (Galperin and Weaver 2014).[80] In 2009, Agarwal, Skiba and Tobacman found that payday loan borrowers with credit cards from major issuers often had substantial liquidity remaining when taking a loan, and could have benefited from substantial savings through borrowing to their credit limits.[81] Carter and coauthors (2010) found similar results, and provided evidence that losses through unnecessary high-cost borrowing can be predicted through factors including lower credit scores and higher line of credit balances.[82] It should be noted, however, that the fact that a consumer has superior credit alternatives is of little import if he or she is unaware of them.

Payday lending has also been associated with some negative welfare outcomes in the US – such as declines in military member job performance and retention (Carrell and

[78] The analysis conducted for this report, results available on request, looked at the 63 Canadian economic regions for which labour force and insolvency data were comparable, providing a sample of 819 observations.
[79] Campbell, Dennis; Martinez-Jerez, Francisco de Asis; and Tufano, Peter (2008). Bouncing Out of the Banking System: An Empirical Analysis of Involuntary Bank Account Closures. *Unpublished Manuscript,* December. http://dx.doi.org/10.2139/ssrn.1335873
[80] Galperin, Roman V. and Weaver, Andrew (2014) pp. 1,2
[81] Agarwal, Sumit; Skiba, Paige Marta; and Tobacman, Jeremy (2009). Payday Loans and Credit Cards: New Liquidity and Credit Scoring Puzzles? *Working Paper,* no. 14659. Cambridge: National Bureau of Economic Research. http://www.nber.org/papers/w14659 pp. 7
[82] Carter, Susan P.; Skiba, Paige M.; and Tobacman, Jeremy (2010). Pecuniary Mistakes? Payday Borrowing by Credit Union Members. *Pension Research Council Working Paper*, no. 2010-32, November. http://dx.doi.org/10.2139/ssrn.1707657 pp. 8-9

Zinman 2008)[83], difficulty in the payment of housing and utility bills (Melzer 2011)[84] and likelihood of both participation in food stamp programs and delinquency in child support payments (Melzer 2014). If correct, the last outcome may indicate that payday loan use may have detrimental consequences not only for the borrower but also for third parties.[85] In general, to the extent that payday lending causes financial distress for the borrower, the potential for the distress to cause negative spillover effects – through mechanisms including greater dependence on social safety nets – suggests at least the potential for payday loans to create broader social consequences.[86]

This line of research, however, is limited in its ability to differentiate between the use of payday loans as a consequence of financial distress, or an independent cause of it. This ambivalent observation is clearly relevant in the analysis of lending near military bases. For example, Carrell and Zinman (2008) simultaneously report that the difficulties arise for "young, inexperienced, and financially unsophisticated airmen," who serve at bases in high unemployment areas. This means that is not at all clear that the availability of payday lending causes harm near bases, but that it is possible for harm to arise when the cofactors just-mentioned are also present. In part this is a matter of distinguishing between the causes of financial distress, and symptoms of its existence.

Finally, in a 2007 study, the Center for Community Capital in North Carolina reported a form of evidence supporting the view of payday loans as debt traps. Former borrowers, in this survey, generally reported themselves as made better off owing to the end of payday lending in the state, describing the loans as expensive and difficult to get out of.[87] It is extremely difficult, however, to place much reliance on this report, as the survey was conducted a year after payday lending had been effectively eliminated from the North Carolina market; accordingly, respondents were not currently making use of payday loans, and were reliant on memory, Few respondents were aware of the prior or current status of the legislation, the small survey was targeted at low income neighbourhoods where incidence of financial

---

[83] Carrell, Scott; and Zinman, Jonathan (2008). In Harm's Way? Payday Loan Access and Military Personnel Performance. *FRB of Philadelphia Working Paper,* no. 08-18, August. Philadelphia: Federal Reserve Bank of Philadelphia. http://dx.doi.org/10.2139/ssrn.1269414.

[84] Melzer, Brian T. (2011). The Real Costs of Credit Access: Evidence from the Payday Lending Market. *The Quarterly Journal of Economics,* vol. 126, no. 1, pp. 517-555.

[85] Melzer, Brian T. (2014). Spillovers from Costly Credit. *Unpublished Manuscript*, August. http://www.kellogg.northwestern.edu/faculty/melzer/papers/spillovers%20from%20costly%20credit_08_13_14.pdf

[86] Mann, Ronald and Hawkins, Jim (2007), p. 884

[87] Manturuk, Kim; and Ratcliffe, Janneke (2007). *North Carolina Consumers After Payday Lending: Attitudes and Experiences with Credit Options.* Chapel Hill: UNC Center for Community Capital.

distress was expected to be high and, of the small number (401) of survey respondents, only a very small share (23 of 401) had reported taking advantage of payday loans.

Even if payday loans do create "debt traps," however, they may still be preferable to alternative credit sources. Mann and Hawkins (2007), for example, have pointed out that regulated payday loans are unlikely to lead to debts that are excessively high at a given time. While the loans may generate increasing interest costs on recurrence, the principal is not permitted to not make up a large portion of the borrower's income.[88]

The evidence on the consumer welfare impact of payday loans on the whole is, therefore, mixed. Some features are clear, however: it is unsafe to assume that stringent regulation with respect to payday lending positive on net for consumer welfare. Some consumers might be financially better if their access is to credit was restricted, but the theoretical and empirical evidence does not allow a generalizable conclusion from that observation.

Regulatory Approaches – Payday Loan Bans and Inferior Substitutes

One legislative option for dealing with payday loans is the imposition of an outright or effective ban. The latter could be achieved through an interest rate ceiling low enough to make payday lending economically unviable. The recurring consideration for policymakers, highlighted throughout this discussion, is whether a ban would significantly reduce the use of high-cost credit among borrowers and whether it would result in an increase in the use of other, potentially inferior, products. The empirical literature simply does not offer unequivocal evidence that effective bans improve consumer outcomes.

It is of course possible that the use of high cost credit decreases with the implementation of interest rate ceilings. The economic concept is simple – an effective rate ceiling (below the market-clearing rate, which will change from time to time and respond to supply and demand) reduces the quantity of credit lenders are willing to supply, while leaving some demand unmet. This leads to an apparent credit shortage and some households having to go without.[89] By definition, this

[88] Mann, Ronald and Hawkins, Jim (2007), p. 886
[89] Federal Reserve Bank of Chicago (2006). *Controlling Interest: Are Ceilings on Interest Rates a Good Idea?* Chicago: Federal Reserve Bank of Chicago, pp. 2-3.

reduces net social welfare, with an uncertain division as to the net losses among consumers (borrowers) and producers (lenders).

The extent to which a payday loan related interest rate ceiling will reduce the overall quantity of credit supplied will depend on whether or how it affects to lenders outside the payday loan industry.

In a 2004 report, Policis provided evidence that while demand for credit among low-income households remained constant across regions studied, credit use was lower in areas with interest rate ceilings, which implies unmet demand.[90] Ellison and Forster (2008), meanwhile, found evidence that interest rate ceilings may exacerbate problems of over-indebtedness but also stated that a likely outcome of a ceiling would be credit exclusion for certain households.[91]

The possibility of a decrease in the use of high-cost credit may be desirable for policymakers who view such use as unambiguously negative. Such policymakers may also be tempted to implement an outright ban. Any welfare gain from reduced borrowing, however, would have to be weighed against losses through the shift of consumers to potentially inferior alternatives.

In 2015 the Consumer Council of Canada released an informal audit of **online payday lenders**, and found that unlicensed lenders are much less compliant with regulations than licensed ones, and often have worrying characteristics – such as requests of consumers for personal banking information.[92] The extent to which bans might increase business for unlicensed online lenders is unclear. In 2012 The Pew Charitable Trusts found that states which are restrictive of payday loans do not experience significantly higher use of payday loans from other sources – including internet based lenders.[93] In 2016, however, the organization Policis stated that, in the United States, the restriction of small sum lending is increasingly leading to demand shifting from storefront and regulated to online and unregulated lenders (respectively). The organization also found evidence that the more restrictive states

[90] Policis (2004). *The effect of interest rate controls in other countries.* London: Policis, pp. 10.
[91] Ellison, Anna; and Forster, Robert (2008). *The impact of interest rate ceilings.* London: Policis, p. 6, 67
[92] Barrett, Denise (2015). *Consumer Experiences in Online Payday Loans.* Toronto: Consumers Council of Canada. pp. 5-6
[93] The Pew Charitable Trusts (2012). *Payday Lending in America: Who Borrows, Where They Borrow, and Why.* Philadelphia: The Pew Charitable Trusts.

are of small sum high cost lending, the greater is the share of online lenders that are unlicensed.[94] [95]

Overdraft protection plans may also act as alternatives to payday loans. As an alternative to refusing to honour cheques owing to insufficient funds, financial institutions may extend credit in exchange for a small fee plus interest, typically through an overdraft protection agreement. The cost can be high in absolute or percentage terms, especially in the US, and when the transaction causing the overdraft is of a small dollar amount.[96] A number of studies already mentioned in this literature review have found evidence suggesting that payday loan bans may lead to increased reliance on overdraft protection, which is a profitable bank service in the US (Zinman 2008; Morgan and co-authors 2012; Melzer and Morgan 2009), while one (Campbell, Martinez Jerez and Tufano 2008) provides evidence to the contrary.

In the Canadian market, paying for overdraft protection is less expensive – $5 dollars for each month an account is overdrawn, plus interest, for example – than a payday loan, but the typical payday borrower will not be approved for overdraft protection. On the other hand, a typical fee for insufficient funds (bouncing a cheque) is $45, comparable to a small payday loan, and bouncing a cheque will further damage a credit record. In rank order, bouncing a cheque is the most expensive option in Canada, a payday loan less expensive, and overdraft protection, if available, the least expensive of the set.

Mann and Hawkins (2007) suggested that **pawnshop loans** would likely be the first product borrowers turn to in the absence of legal payday lending. Pawnbrokers require consumers to trade an item in exchange for a loan. If they are unable to repay with interest, the pawnbroker takes ownership of the item.[97] According to Mann and Hawkins (2007), pawnshop loan interest rates are generally at least as high as those of payday loans.[98] Pawnshop loans also require consumers to permanently forgo the exchange and use value of the pawned item in the event of non-repayment. This might have greater consequences for consumer welfare when

---

[94] In a follow-up piece submitted to the Manitoba Public Utilities Board, Policis provided greater detail on one of its major data sources – a set of transactional data from Clarity Services Inc. Policis expressed confidence in this dataset, pointing out that its record of all the payday loans made by lenders using the organization's credit reference services between 2010 and 2014 (9.4 million), it could be considered a 'full universe' rather than simply a 'sample'.

[95] Policis (2016). *The outcomes for consumers of differing approaches to the regulation of small dollar lending: Presentation to the Manitoba Public Utility Board.* London: Policis, pp. 12, 19-20

[96] Melzer, Brian and Morgan, Donald (2009), p. 1

[97] Mann, Ronald and Hawkins, Jim (2007), p. 891

[98] Mann, Ronald and Hawkins, Jim (2007), p. 892

the item is a computer or bicycle as opposed to a gold ring or diamond brooch.[99] As previously mentioned, Bhutta and co-authors (2015) have found evidence that the use of pawnshop loans increases in response to payday loan restrictions.[100] In a similar vein, the 2004 Policis report found evidence indicating that U.S. borrowers avoid pawnbrokers when cash loans are available.[101]

Refund anticipation loans (RAL) allow consumers to take high-cost loans secured by expected future tax refunds. RALs are similar to payday loans in a number of ways, including their high costs (annualized interest rates between 70 percent and 500 percent) and securitization with future borrower income.[102] Most analysis of the practice is from the U.S. and, as previously mentioned, Galperin and Weaver (2014) have found evidence of a positive correlation between use of the two products, estimating payday loan bans to be associated with a roughly 5 percent decrease in the use of RALs.[103] The authors report that this provides (p4) "evidence that strict regulation of payday loans may benefit households on net by interrupting deleterious behavioral patterns associated with a cycle of debt. However, the relatively modest magnitude of the effect suggests that our results should not be interpreted as providing unequivocal support for strict regulation … disparate impacts imply that some households could experience decreased welfare as a result of regulation." In Canada, the practice is governed by the *Tax Rebate Discounting Act*,[104] which sets the maximum fee at 15 percent of the first $300 of a tax refund, and 5 percent of a tax refund exceeding $300, which for that portion equates to an uncompounded maximum interest rate of 60 percent.

The Canadian Department of Justice defines **loan-sharking** by two main characteristics – high interest rates and the form of collateral – "*in extremis*, the borrower's own person."[105] This last characteristic – the loan shark's willingness to use real or threatened violence to secure repayment[106] – makes this category of lending perhaps the least desirable alternative to payday loans. The 2004 Policis report defines credit impairment as the possession of a credit history that excludes one from mainstream credit options[107] and finds evidence that the credit impaired in

[99] Mann, Ronald and Hawkins, Jim (2007), p. 891
[100] Bhutta, Neil and co-authors (2015)
[101] Policis (2004), p. 12-16
[102] Galperin, Roman V. and Weaver, Andrew (2014), p. 8-9
[103] Galperin, Roman V. and Weaver, Andrew (2014)
[104] http://laws-lois.justice.gc.ca/eng/acts/T-3/FullText.html
[105] http://www.justice.gc.ca/eng/rp-pr/csj-sjc/crime/rr02_3/p34.html#foot8
[106] http://www.justice.gc.ca/eng/rp-pr/csj-sjc/crime/rr02_3/p34.html#foot8
[107] Policis (2004), p. 48

France and Germany, with no legal options, are more likely to turn to illegal lenders than their counterparts in the UK.[108][109]

The above list is not exhaustive. Sub-prime credit cards, car-title loans and rent-to-own transactions are additional examples of (potentially inferior) alternatives to payday loans.[110][111] The potential for legislation that effectively ends payday lending to increase consumption of these products makes a case for a less heavy-handed approach. The following sections, drawing to a significant extent from Mann and Hawkins (2007), will discuss three main regulatory strategies that would both permit the industry to continue existing and decrease possible drawbacks for consumers.

Regulatory Approaches - Transparency and Disclosure

While a large number of consumers may use payday loans with full knowledge of the likely risks and rewards, cognitive biases and information asymmetries between borrowers and lenders, as previously mentioned, may lead to some consumers entering into contracts on the basis of incomplete or inaccurate information. Regulations to increase transparency would increase the probability that contracts benefit parties on both ends of the transaction; it is in this area that the economic literature is most supportive of potential regulatory responses.

Consumers may find it difficult to fully appreciate the cost of payday borrowing. Wilson (2002), for example, found evidence of a lack of comprehension of annual percentage rates (APRs) among payday borrowers, a tendency to understand the costs in terms of dollar amounts, and inaccurate comparisons of the cost of loans of various magnitudes and terms to maturity.[112] Mann and Hawkins (2007), on the basis of evidence of such lack of comprehension – and on factors including the opinion that, in the case of payday loans in which terms to maturity are variable ("until your next payday")[113] but fees are fixed, interest rate disclosures may be

[108] Policis (2004), p. 45

[109] Please note that the 2004 Policis report's definition of illegal lending may not fully overlap with that of the Canadian Department of Justice.

[110] Mann, Ronald and Hawkins, Jim (2007).

[111] Galperin, Roman V. and Weaver, Andrew (2014)

[112] Wilson, Dean (2002). *Payday Lending in Victoria – A research report.* Melbourne: Consumer Law Centre Victoria Ltd, pp. 77.

[113] Mann, Ronald and Hawkins, Jim (2007), p 904

misleading – have advocated for a simple disclosure of the fee per $100 borrowed, which is the common standard on which offerings are judged.[114]

Indeed, it is the high effective APR that tends to attract scrutiny and criticism. Payday lenders are occasionally accused of omitting relevant information, targeting the ill-informed, and charging excessive annual effective interest rates within Canada,[115] owing to that fact that fees can translate to annual interest rates of 400 percent to 800 percent.[116]

Nonetheless, reference to annual percentage rates of interest might be entirely inappropriate to the payday product. Payday loans are by definition are short term (meaning 62 days at most), and the fees they attract are intended to apply to that short term, and not to apply over the course of a year.[117] The payday product's salient quality to the consumer is not the effective price of a long term loan, which is not being procured, but immediate access to liquidity. An occasional analogy to this market is that of taxi services. When without transport, a taxi client finds it worthwhile to pay a taxi company a high amount per mile or minute travelled, owing to the consumer's benefit of immediate access to travel services. It would not be financially sensible to otherwise rent or lease buy a car for that same short term service. Neither would it be practical to use a taxi service for a cross-country trip – this is a different market from urban short haul, and the demand for, pricing and cost structure of one does not apply to the other.[118]

Bertrand and Morse (2009), in a randomized field trial, found evidence supporting Mann and Hawkins (2007) focus on fees rather than APRs. They found that making payday loan customers aware of loan APRs did not have a robust effect on their borrowing,[119] and other studies have provided evidence that payday borrowers compare and remember fees associated with their potential choices of response to liquidity crises, and choose the least costly among them. Providing information on the accumulation of fees for loans outstanding for different periods (for example, 1

---

[114] Mann, Ronald and Hawkins, Jim (2007), p 904-905
[115] Ben-Ishai, Stephanie (2008).
[116] Lo, Janet (2011). *A Criminal Rate of Interest: Update Garland for Consumers*. Public Interest Advocacy Centre. Ottawa. https://www.piac.ca/wp-content/uploads/2014/11/GarlandUpdate_FINAL.pdf
[117] Momentum (2014). *The Real Cost of Payday Lending*. Calgary: Momentum. http://momentum.org/files/Publications/Real-Cost-Payday-Lending.pdf
[118] Berry, Ruth E. and Duncan, Karen A. (2007). T*he Importance of Payday Loans in Canadian Consumer Insolvency*. Office of the Superintendent of Bankruptcy Canada. Toronto. http://www.cpla-acps.ca/english/reports/The%20Importance%20of%20Payday%20Loans%20in%20Canadian%20Consumer%20Insolvency%202007.pdf
[119] Bertrand, Marianne and Morse, Adair (2009), p. 5, 8

month and 2 months), however, decreased future borrowing from the relevant lender by 5.4 percent.[120] The evidence is not entirely clear: Stango and Zinman (2009) reported that APR disclosure requirements reduced the capacity for payday lenders to charge high rates to consumers who were likely to underestimate the cost of borrowing.[121]

Payday loan regulation might also attempt to correct for unrealistic consumer optimism with regards to future repayment. Morgan (2007) speculates that this natural cognitive bias may be exacerbated by unscrupulous lenders who misrepresent factors – including the borrower's future income – that may influence demand.[122] Bertrand and Morse (2009) found evidence that reducing borrower optimism through enforcing an expectation of frequent rollovers resulted in decreased payday loan demand.[123] As against this, Mann (2014), using survey data, found that about 60 percent of payday borrowers accurately predicted the time it would take them to repay. While this indicates that the majority of borrowers are not naïve on their likely future repayment patterns, it provides evidence that a substantial minority may be.[124]

There seems to be potential for regulatory intervention which increases information and reduces cognitive biases to improve outcomes for borrowers, in line with recent research in behavioural economics. Such interventions may be instinctively appealing as moving the credit market closer to a clearly competitive state, which depends on information generally being symmetric as between buyers and sellers, or borrowers and lenders. There will, however, always be some unintended consequences. Stango and Zinman (2009), for example, have found evidence suggesting that disclosure requirements, at least when properly enforced, reduce the supply and increase the cost of credit.[125]

[120] Bertrand, Marianne and Morse, Adair (2009), p. 6, 8
[121] Stango, Victor and Zinman, Jonathan (2009)
[122] Morgan, Donald P. (2007). Defining and Detecting Predatory Lending. *Federal Reserve Bank of New York Staff Reports*, no. 273, January, pp. 2.
[123] Bertrand, Marianne and Morse, Adair (2009), p. 8
[124] Mann, Ronald (2014a). Assessing the Optimism of Payday Loan Borrowers. *Supreme Court Economic Review*, vol. 21, no. 1, pp. 105-132.
[125] Stango, Victor and Zinman, Jonathan (2009), p. 3-4

Regulatory Approaches – Limiting Repetitive Lending

As mentioned previously, concern has been expressed about repetitive lending and the potential for borrowers to be lured into "debt traps."[126] Jurisdictions that wish to permit the payday loan industry to operate in functional form, if more limited, may also wish to take steps that inhibit such behaviour on the part of borrowers and lenders. What is very difficult to establish is whether doing so would be harmful or beneficial from the perspective of consumer welfare.

Restrictions on repetitive borrowing necessarily shrink the payday lending business, while not automatically eliminating it, in the view of some. Stegman and Faris (2003) found evidence that the payday loan industry in North Carolina was "significantly enhanced" by the conversion of consumers from "occasional" to "chronic" borrowers: in other words, repetitive borrowing enabled the industry to flourish.[127] Flannery and Samolyk (2005) reported evidence suggesting that while repeat high frequency borrowers contributed to store volume[128], the industry could survive with slightly fewer of them.[129] Whether that position is plausible depends on one's view of the cost structure of the industry, discussed above.

Mann and Hawkins (2007) have suggested two main features for the U.S. market to better manage repetitive payday lending. The first is a centralized transactions database for licensed payday loan providers. This would identify borrower patterns and enable tracking of borrowers across payday loan providers. [130] The second is a mandated "cooling off period" between payday loans, which the authors imply should be long enough to force borrowers through an entire pay cycle without using a payday loan.[131]

In the Canadian context, the first measure, a lending database aimed at tracking "chronic" borrowers, and presumably would be aimed at enforcing a legislative limit borrowers' access to loans from more than one lender where time limits on repeat loans are prescribed, would face significant hurdles to reach compliance with domestic privacy legislation. It would also tend to filter out some relatively high risk clientele, which would have mixed effects. One is that potential borrowers would have reduced access to regulated payday lenders' products, and that they would

[126] National Public Radio (2016, June 2). New Rules to Ban Payday Lending 'Debt Traps'. http://www.npr.org/sections/thetwo-way/2016/06/02/480329986/new-rules-to-ban-payday-lending-debt-traps
[127] Stegman, Michael A.; and Faris, Robert (2003). Payday Lending: A Business Model that Encourages Chronic Borrowing. *Economic Development Quarterly,* vol. 17, no. 1, pp. 8.
[128] Flannery, Mark and Samolyk, Katherine (2005), p. 1
[129] Flannery, Mark and Samolyk, Katherine (2005), p. 21
[130] Mann, Ronald and Hawkins, Jim (2007), p. 897-898
[131] Mann, Ronald and Hawkins, Jim (2007), p. 898

move to alternative, unregulated suppliers on less favourable terms. A fall in the share of repeat borrowers, who are likely to be profitable clients, also would reduce the extent to which they cross-subsidize the payday lenders' less frequent borrowers. It is less obvious whether the benefits of additional data collection would exceed the costs, which would bear on lenders' margins and therefore the cost and quantity of credit supply.

Similarly, the second measure, a significant cooling off period, would need judicious terms. The same concerns arise as above, owing to the measure's potential restrictiveness: borrowers in distress could be barred access to the market. Further, if high margin clients (from the lenders' perspective) are barred from the market, then prices would be pushed up across the board, and access therefore limited and more costly to otherwise eligible borrowers.

Regulatory Approaches – A "Better Class" of Lender?

Perhaps the main recommendation of Mann and Hawkins (2007) is the creation of a "better class" of payday lenders.[132] The authors have proposed two main ways of doing so.

The first is the implementation of fee caps that would squeeze out smaller "mom and pop" lenders – whom the authors view as more likely to be abusive and inefficient[133] – while permitting more reputable firms to turn a profit.[134] Robinson (2007), for example, in a study for a Canadian organization for low and moderate income families[135] proposed a schedule that would not permit fees greater than 12 percent of the loan principal.[136,137] In the Canadian market place, however, such a low fee clearly would be equivalent to market suppression or a ban which, as discussed elsewhere, would very likely be social welfare-reducing.

The second is the encouragement of large and reputable lenders to enter the market or to consolidate, an issue more relevant to the U.S. than to the Canadian market. Some authors argue that a more consolidated industry would coexist with greater

[132] Mann, Ronald and Hawkins, Jim (2007).
[133] Mann, Ronald and Hawkins, Jim (2007), p. 906

[134] Mann, Ronald and Hawkins, Jim (2007), p. 905-906

[135] http://www.acorncanada.org/about
[136] Robinson also has a separate proposal for loans which are in arrears.
[137] Robinson, Chris (2006). *Regulation of Payday Lending in Canada.* Toronto: ACORN.

efficacy or more stringency in regulation, with greater economies of scale and less potential for harm to consumers.[138]

As previously mentioned, Mann and Hawkins (2007) view small mom-and-pop lenders with some level of suspicion;[139] this level of suspicion seems appropriate for online unregulated lenders as well. The authors have also argued that larger and higher-quality payday lending is associated with standardization and information technology use, which allow for economies of scale. Stegman and Faris (2003), meanwhile, have attributed consolidation in the industry to rising legal costs from increasing regulatory complexity and legal challenges from consumer interest parties.[140]

Mann and Hawkins (2007) also argue that the presence of large reputable lenders in the industry would have a number of legal and regulatory benefits. Larger and consolidated chains of lenders are easier to monitor than numerous smaller outlets; while clearly relevant in the US. This is partly due to economies of scale and partly due to their higher likelihood of possessing detailed and reliable operational data.[141]

On the other hand, the beneficial scale effects associated with consolidation seem unlikely to be available in the regulated sector in Canada, given the market share, discussed above, of its largest participants.

There appears to be some upside to the implementation of policy or regulations that encourage lending by larger and more reputable organizations.

Conclusion

The mixed evidence on the impact of payday loans on consumer welfare and the potential for heavy-handed regulations to have undesirable side effects militates for a cautious approach to payday loan regulation. Outright bans or tight rate caps may, for example, reduce overall high-cost credit use, but may also force remaining borrowers into less financially appealing alternatives. Interventions with a greater likelihood of desirable outcomes include the provision of information to borrowers

---

[138] In a regulated fee environment, consolidation would be unlikely to increase loan costs – but neither would it reduce them.
[139] Mann, Ronald and Hawkins, Jim (2007), p. 906
[140] Stegman, Michael and Faris, Robert (2003), p. 10-11.
[141] Mann, Ronald and Hawkins, Jim (2007), p. 907-908

to reduce the impact of cognitive biases and information asymmetries in payday loan transactions, policies encouraging a responsive and responsible industry.

Chapter 6

Summary and Recommendations

Summary Observations and Recommendations

Payday loans are an expensive form of short term credit, and the sector's clientele, borrowers, tends to have few legitimate alternative suppliers.

Empirically, but not universally, payday borrowers tend to be younger than the rest of the population, have less advanced education, and to have lower incomes than the surrounding population. Policymakers also are concerned that payday borrowers broadly have less financial sophistication than the broader public, or that circumstances put them at risk of being taken advantage of. Legislation and regulation therefore governs licensed payday lenders' conduct, and the prices and terms of their offerings.

The distinction between conduct regulation and price regulation is useful in contemplating legislative and regulatory measures in the payday marketplace. Both classes of responses tend to raise the costs of provision; the first class of measures is conceptually justifiable if they address market imperfections in a manner that improves social welfare, while the second class of measures is likely to limit the supply of credit, in particular with respect to potential clients who are willing and motivated to pay the most for such credit.

Some legislation and regulation seeks to protect such borrowers from the consequences of actions they might take, over worries that they will enter into a personally or socially damaging debt cycle.

Such interventions can include rules that effectively ban or prevent the payday lending business from operating, in the extreme, or involve imposing caps on fees that make the sector less profitable and smaller than otherwise, or preventing frequent loan use by imposing waits or cooling off periods between loans, or rules forcing loan conversion to instalment debt.

Some empirical studies identify particular axes along which such interventions might make some borrowers better off, and human nature suggests that a portion of the population will tend to be worse off through easy access to costly credit. Theoretical and empirical work, however, does not allow the conclusion that interventions or restrictions in general will improve net social welfare. What is clearer is that some borrowers who would benefit from access to short term liquidity, even if it was expensive, would be harmed if the market was sharply constrained.

More generally, where the licensed payday lending market has been sharply constrained, unregulated (unlicensed) and typically online suppliers have entered the space, in an environment where disclosure and fair dealing is less likely.

This, in fact, is the primary concern for policymakers. Measures that squeeze licensed markets are likely to push buyers and sellers into unlicensed markets, with potential risks to social welfare.

Regulations aimed at clear disclosure with respect to consumer fees, and attention to financial literacy generally, may possibly benefit consumers. Such policy interventions, where cost effective, can address information asymmetry, in the economic sense, and mitigate the moral hazard that may result.

Much conduct-related regulation is generally in place – where these protections are not in place is the unlicensed online marketplace, which will be a challenge, not insurmountable, for regulators to address.

Interventions directly aimed at shrinking the size of the payday lending market, such as maximum limits on fees that leave the market unprofitable to serve, or price regulation more generally, are unlikely to be socially beneficial.

Limitations on repeat use of payday loans should be approached gingerly. To the extent that such repeat users are profitable to serve, they subsidize borrowers who less profitable to serve. In the presence of sharply binding limits or repeat use, lenders would be able to serve fewer customers and at higher unit costs.

Regulations requiring conversion to longer term or instalment debt also should be approached gingerly. These regulations fundamentally change the loan product, which in the first instance is liquidity, to a different product that requires a different capital and pricing structure to serve. Because this class of regulation quite directly affects the profitability of the payday lending sector, and therefore likely to shrink it, the impact on consumer welfare is uncertain, and may be negative rather than positive.

This leaves regulatory interventions aimed at addressing market imperfections and missing or imperfect information as the channel most likely to be beneficial. Responses might include credit counselling, perhaps mandatory, for payday borrowers who seek repetitive loans, and this could be extended to credit workouts. Such workouts likely would include options for converting repayment plans to an instalment basis, for clientele who found such an approach suitable to circumstance.

As noted in Chapter 3, emergent financial technology is likely to have an impact on all market participants, including regulators. Current market data do not allow comment on the near term impact. What seems evident, however, is that an evolution in data-handling has facilitated major changes in numerous goods- and services-handling markets, and such changes are emerging in financial intermediation markets.

The short-term, small-dollar lending business is likely to be a market affected by technological change, as evident in observed growth in licensed and unlicensed online lending markets. Handled well, this will place competitive market or pricing pressures on existing offerings from bricks-and-mortar payday lenders, and such competition is likely to benefit consumers.

Changing market behavior also places pressure on regulators and legislators responsible for consumer protection legislation. The current presence of unlicensed online lenders is one issue; adjusting to the new business models that are emerging will pose new challenges to legislators and regulators, who will need to structure flexible policy constructs that respond to the ever-changing marketplace.

In summary, the message for policymakers is one of caution. For some analysts, it is axiomatic that ever more stringent regulation of the payday lending market would be socially beneficial. Neither theory nor empirical evidence permits such a conclusion. Flexible regulation that anticipates changing market structures and competing business models seems likely to better suit consumer welfare.

References

Agarwal, Sumit; Skiba, Paige Marta; and Tobacman, Jeremy (2009). Payday Loans and Credit Cards: New Liquidity and Credit Scoring Puzzles? *Working Paper,* no. 14659. Cambridge: National Bureau of Economic Research. http://www.nber.org/papers/w14659

Barrett, Denise (2015). *Consumer Experiences in Online Payday Loans.* Toronto: Consumers Council of Canada.

Ben-Ishai, Stephanie (2008). Regulating Payday Lenders in Canada: Drawing on American Lessons. *Comparative Research in Law & Political Economy. Research Paper No.16.* Osgoode Hall Law School of York University. http://digitalcommons.osgoode.yorku.ca/clpe/189

Berry, Ruth E. and Duncan, Karen A. (2007). T*he Importance of Payday Loans in Canadian Consumer Insolvency*. Office of the Superintendent of Bankruptcy Canada. Toronto. http://www.cpla-acps.ca/english/reports/The%20Importance%20of%20Payday%20Loans%20in%20Canadian%20Consumer%20Insolvency%202007.pdf

Bertrand, Marianne; and Morse, Adair (2009). Information Disclosure, Cognitive Biases and Payday Borrowing. *MFI Working Paper Series*, no. 2009-007, October. Chicago: The Milton Friedman Institute for Research in Economics. https://bfi.uchicago.edu/research/becker-friedman-working-paper/information-disclosure-cognitive-biases-and-payday-borrowing

Bhutta, Neil; Skiba, Paige Marta; and Tobacman, Jeremy (2012). Payday Loan Choices and Consequences. *Vanderbilt Law and Economics Research Paper,* no. 12-30, October. http://dx.doi.org/10.2139/ssrn.2160947

Bhutta, Neil (2014). Payday Loans and Consumer Financial Health. *Journal of Banking & Finance*, vol. 47, pp. 230-242. http://dx.doi.org/10.1016/j.jbankfin.2014.04.024

Bhutta, Neil; Goldin, Jacob; and Homonoff, Tatiana (2016). Consumer Borrowing After Payday Loan Bans. *Unpublished Manuscript*, July.

Bill 4: An Act Respecting Payday Loans (2008). Government of New Brunswick. http://www.gnb.ca/legis/bill/pdf/56/2/Bill-4.pdf

Bill 15: An Act to End Predatory Lending (2016). *The Legislative Assembly of Alberta*. Province of Alberta. http://www.assembly.ab.ca/ISYS/LADDAR_files/docs/bills/bill/legislature_29/session_2/20160308_bill-015.pdf

Bill 156: Alternative Financial Services Statute Law Amendment Act (2016). *Legislative Assembly of Ontario.* Government of Ontario.

http://www.ontla.on.ca/web/bills/bills_detail.do?locale=en&Intranet=&BillID=3633

Bocian, Debbie G. and Sermons, M William (2014). *Research Comment On: "Do Defaults on Payday Loans Matter?".* Centre for Responsible Lending. Durham. http://www.responsiblelending.org/payday-lending/research-analysis/payday_response_ronald_mann.pdf

Business Practices and Consumer Protection (Payday Loans) Amendment Act (2009). *The British Columbia Gazette, Part II.* Government of British Columbia. http://www.bclaws.ca/civix/document/id/lc/bcgaz2/v52n05_057-2009

Business Practices and Consumer Protection Act: Payday Loans Regulation (2009). *Queen`s Printer.* Government of British Columbia. http://www.bclaws.ca/Recon/document/ID/freeside/16_57_2009#section1

Campbell, Dennis; Martinez-Jerez, Francisco de Asis; and Tufano, Peter (2008). Bouncing Out of the Banking System: An Empirical Analysis of Involuntary Bank Account Closures. *Unpublished Manuscript,* December. http://dx.doi.org/10.2139/ssrn.1335873

Canadian Bankers Associations (2016). *Banks and Alternatives to Payday Loans*. Ottawa. http://www.cba.ca/contents/files/backgrounders/bkg_paydayloans_en.pdf

Canadian Department of Justice (2015). *A Typology of Profit-Driven Crimes*. Ottawa. http://www.justice.gc.ca/eng/rp-pr/csj-sjc/crime/rr02_3/p34.html#sec3_4

Canadian Payday Loan Association (2013). *Payday Loan Users Study Alberta*. Hamilton. http://www.cpla-acps.ca/english/reports/CPLA%202012%20e%20Users%20AB.PDF

Canadian Payday Loan Association (2014). *Payday Loan Customer Study: PEI, NB, and NS*. Hamilton. http://www.cpla-acps.ca/english/reports/PDL%20Customer%20Study%20CPLA%20Dec%202014%20Final.pdf

Carter, Susan P.; Skiba, Paige M.; and Tobacman, Jeremy (2010). Pecuniary Mistakes? Payday Borrowing by Credit Union Members. *Pension Research Council Working Paper*, no. 2010-32, November. http://dx.doi.org/10.2139/ssrn.1707657

Carrell, Scott; and Zinman, Jonathan (2008). In Harm's Way? Payday Loan Access and Military Personnel Performance. *FRB of Philadelphia Working Paper,* no. 08-18, August. Philadelphia: Federal Reserve Bank of Philadelphia. http://dx.doi.org/10.2139/ssrn.1269414

Chapter 5: An Act to Amend an Act Respecting Payday Loans (2016). Government of New Brunswick. http://www.gnb.ca/0062/acts/BBA-2016/Chap-5.pdf

Chapter 31: An Act to Amend an Act Respecting Payday Loans (2014). Government of New Brunswick. http://www.gnb.ca/0062/acts/BBA-2014/Chap-31.pdf

Consumer Protection Act: An Act to Provide for the Fair Disclosure of the Cost of Credit and for the Protection of Buyers of Consumer Goods (2014). *Speaker of the House of Assembly Halifax*. Province of Nova Scotia. http://nslegislature.ca/legc/statutes/consumer%20protection.pdf

Consumer Protection Act: Payday Lenders Regulation (2015). *Royal Gazette Part II*. Government of Nova Scotia. http://www.novascotia.ca/just/regulations/regs/cppayday.htm

Criminal Code (2016) R.S.C., 1985, c. C-46 s.347. Parliament of Canada. http://www.canlii.org/en/ca/laws/stat/rsc-1985-c-c-46/latest/rsc-1985-c-c-46.html#sec347_smooth

DFC Global Corp. (2013). *Report on Form 10-K for the Year Ended June 30, 2013.* United States Securities and Exchange Commission. Washington. https://www.sec.gov/Archives/edgar/data/1271625/000119312513352311/d590562d10k.htm#tx590562_8

Deloitte (2014). *Strengthening Ontario`s Payday Loans Act: Payday Lending Panel Findings and Recommendations Report.* Toronto.

Dungen, Ellen M., Randy Coutts, Rhiannon MacDonnell. (2016). *Fair Financing: Expanding Small-Dollar Short-Term Credit for Albertans*.

Ellison, Anna; and Forster, Robert (2008). *The impact of interest rate ceilings.* London: Policis.

Ernst & Young (2004). *The Cost of Providing Payday Loans in Canada.* Toronto.

Fair Trading Act: Payday Loans Regulation (2016). *Alberta Queen`s Printer.* Province of Alberta. http://www.qp.alberta.ca/documents/Regs/2009_157.pdf

Federal Reserve Bank of Chicago (2006). *Controlling Interest: Are Ceilings on Interest Rates a Good Idea?* Chicago: Federal Reserve Bank of Chicago.

Financial Consumer Agency of Canada (2016). *Payday Loans: An Expensive Way to Borrow. Mortgages and Loans*. Ottawa.

Flannery, Mark; and Samolyk, Katherine (2005). Payday Lending: Do the Costs Justify the Price? *FDIC Center for Financial Research Working Paper,* no. 2005-09, June. Arlington: Federal Deposit Insurance Corporation Center for Financial Research.

Galperin, Roman V.; and Weaver, Andrew (2014). Payday Lending Regulation and the Demand for Alternative Financial Services. *Community Development Discussion Paper,* no. 2014-01, September. Boston: Federal Reserve Bank of Boston. http://dx.doi.org/10.2139/ssrn.2494426

Government of Newfoundland and Labrador (2010). *News Release: Provincial Government Will Not Regulate Payday Loan Companies*. St. John's. http://www.releases.gov.nl.ca/releases/2010/gs/0616n11.htm

Hoyes, J. Douglas and Michalos, Ted (2015). *Joe Debtor: Marginalized by Debt*. Toronto.

Hynes, Richard (2012). Payday Lending, Bankruptcy, and Insolvency. *Washington and Lee Law Review,* vol. 69, no. 2, pp. 607-648.

Islam, Khan and Simpson, Wayne (2014). *A Profile of Payday Loans Consumers Based on the 2014 Canadian Financial Capability Survey.* Winnipeg. http://www.pub.gov.mb.ca/payday_loan_review2016/cac_6_tab_4_cfcs_analysis_w_simpson_and_k_islam.pdf

Ipsos Reid (2005). *Public Experiences with Financial Services and Awareness of the FCAC*. Financial Consumer Agency of Canada. Calgary.

Kitching, Andrew and Starky, Sheena (2006). *Payday Loan Companies in Canada: Determining the Public Interest.* Library of Parliament. Ottawa.

Lo, Janet (2011). *A Criminal Rate of Interest: Update Garland for Consumers*. Public Interest Advocacy Centre. Ottawa. https://www.piac.ca/wp-content/uploads/2014/11/GarlandUpdate_FINAL.pdf

Mann, Ronald (2014a). Assessing the Optimism of Payday Loan Borrowers. *Supreme Court Economic Review*, vol. 21, no. 1, pp. 105-132.

Mann, Ronald (2014b). Do Defaults on Payday Loans Matter? *Columbia Law and Economics Working Paper*, no. 509, December. http://dx.doi.org/10.2139/ssrn.2560005

Mann, Ronald and Hawkins, Jim (2007). Just Until Payday. *University of California Los Angeles Law Review,* vol. 54, no. 4, pp. 855-912.

Manturuk, Kim; and Ratcliffe, Janneke (2007). *North Carolina Consumers After Payday Lending: Attitudes and Experiences with Credit Options.* Chapel Hill: UNC Center for Community Capital.

Melzer, Brian; and Morgan, Donald (2009). Competition and Adverse Selection in a Consumer Loan Market: The Curious Case of Overdraft vs. Payday Credit. *Unpublished Manuscript,* February. http://www.kellogg.northwestern.edu/faculty/melzer/papers/melzer_morgan_2_19_2010.pdf

Melzer, Brian T. (2011). The Real Costs of Credit Access: Evidence from the Payday Lending Market. *The Quarterly Journal of Economics,* vol. 126, no. 1, pp. 517-555.

Melzer, Brian T. (2014). Spillovers from Costly Credit. *Unpublished Manuscript*, August. http://www.kellogg.northwestern.edu/faculty/melzer/papers/spillovers%20from%20costly%20credit_08_13_14.pdf

Momentum (2014). *The Real Cost of Payday Lending*. Calgary: Momentum. http://momentum.org/files/Publications/Real-Cost-Payday-Lending.pdf

Morgan, Donald P. (2007). Defining and Detecting Predatory Lending. *Federal Reserve Bank of New York Staff Reports*, no. 273, January.

Morgan, Donald P.; and Strain, Michael R. (2007). Payday Holiday: How Households Fare after Payday Credit Bans. *Federal Reserve Bank of New York Staff Reports,* no. 309, November. https://www.newyorkfed.org/medialibrary/media/research/staff_reports/sr309.pdf

Morgan, Donald P.; Strain, Michael R; and Seblani, Ihab (2012). How Payday Credit Access Affects Overdrafts and Other Outcomes. *Unpublished Manuscript,* February. https://jmcb.osu.edu/sites/jmcb.osu.edu/files/09453.pdf

National Public Radio (2016, June 2). New Rules to Ban Payday Lending 'Debt Traps'. http://www.npr.org/sections/thetwo-way/2016/06/02/480329986/new-rules-to-ban-payday-lending-debt-traps

Nova Scotia Utility and Review Board (2015). *Decision*. Halifax. http://www.cpla-acps.ca/english/reports/M06084%20Payday%20Loans%20%20Decision.pdf

Nova Scotia Utility and Review Board (2015). *Order*: Halifax. http://www.cpla-acps.ca/english/reports/M06084%20Payday%20Loans%20Order.pdf

Nova Scotia Utility and Review Board (2015) *Payday Loans – Decision and Recommendations.* Halifax. http://www.cpla-acps.ca/english/reports/M06084%20-%20Payday%20Loans%20Letter%20from%20Board%20dated%20March%2030,%202015.pdf

Payday Lending Regulation – Cost of Credit Disclosure and Payday Loans Act (2016). *Lieutenant Governor in Council*. Government of New Brunswick. http://www2.gnb.ca/content/dam/gnb/Departments/eco-bce/pdf/pr/2016/06/16-058E.pdf

Payday Loans Act (2008). *Service Ontario.* Government of Ontario. http://www.cpla-acps.ca/english/reports/Payday_Loans_Act_2008_SO_2008_c.pdf

Payday Loans Act, Ontario Regulation General (2013). *Service Ontario*. Government of Ontario. http://www.cpla-acps.ca/english/reports/elaws_regs_090098_e.pdf

Payday Loans Act: Regulations (2015). *Legislative Counsel Office*. Government of Prince Edward Island. http://www.gov.pe.ca/law/regulations/pdf/P&02-1G.pdf

Policis (2004). *The effect of interest rate controls in other countries.* London: Policis.

Policis (2014). *The future of Illegal Lending.* London: Policis.

Policis (2016). *The outcomes for consumers of differing approaches to the regulation of small dollar lending: Presentation to the Manitoba Public Utility Board.* London: Policis.

Public Utilities Board of Manitoba (2013). *The 2013 Payday Loans Review*. Winnipeg

Pyper, Wendy (2007). Payday Loans. *Statistics Canada – Catalogue no. 75-001-XIE*. Winnipeg

Ramsay, Iain (2000). *Access to Credit in the Alternative Consumer Credit Market*. Office of Consumer Affairs of Industry Canada. Ottawa.

Robinson, Chris (2006). *Regulation of Payday Lending in Canada.* Toronto: ACORN.

Skiba, Paige Marta; and Tobacman, Jeremy (2009). Do Payday Loans Cause Bankruptcy? *Vanderbilt Law and Economics Research Paper,* no. 11-13, November. Nashville: Vanderbilt University Law School. http://dx.doi.org/10.2139/ssrn.1266215

Stango, Victor; and Zinman, Jonathan (2009). Fuzzy Math, Disclosure Regulation and Credit Market Outcomes: Evidence from Truth in Lending Reform. *Unpublished Manuscript,* April. http://dx.doi.org/10.2139/ssrn.1081635

Staten, Michael. (2008). The Impact of Credit Price and Term Regulations on Credit Supply. Joint Center for Housing Studies, Harvard University. http://www.jchs.harvard.edu/sites/jchs.harvard.edu/files/ucc08-8_staten.pdf

Stegman, Michael A.; and Faris, Robert (2003). Payday Lending: A Business Model that Encourages Chronic Borrowing. *Economic Development Quarterly,* vol. 17, no. 1, pp. 8-32.

Stoianovici, Petru S.; and Maloney, Michael T. (2008). Restrictions on Credit: A Public Policy Analysis of Payday Lending. *Unpublished Manuscript,* October. http://dx.doi.org/10.2139/ssrn.1291278

The Consumer Protection Act (2015). Government of Manitoba. http://web2.gov.mb.ca/laws/statutes/ccsm/_pdf.php?cap=c200

The Consumer Protection Act: Payday Loans Regulations (2015). Government of Manitoba. http://web2.gov.mb.ca/laws/regs/current/_pdf-regs.php?reg=99/2007

The Payday Loans Act (2012). Government of Saskatchewan. http://www.cpla-acps.ca/english/forms/The%20Payday%20Loans%20Act%20Chapter%20P-4.3%20of%20The%20Statutes%20of%20Saskatchewan%202007.pdf

The Payday Loans Act: Amended (2013). Government of Saskatchewan. http://www.cpla-acps.ca/english/forms/Payday%20Loan%20Regulations%20Chapter%20P-4.3%20Reg%201.pdf

The Pew Charitable Trusts (2012). *Payday Lending in America: Who Borrows, Where They Borrow, and Why.* Philadelphia: The Pew Charitable Trusts.

Wilson, Bart J.; Findlay, David W.; Meehan Jr., James W.; Wellford, Charissa P.; and Schurter, Karl (2010). An Experimental analysis of the Demand for Payday Loans. *Unpublished Manuscript,* April. http://dx.doi.org/10.2139/ssrn.1083796

Wilson, Dean (2002). *Payday Lending in Victoria – A research report.* Melbourne: Consumer Law Centre Victoria Ltd.

Zinman, Jonathan (2008). Restricting Consumer Credit Access: Household Survey Evidence on Effects Around the Oregon Rate Cap. *Unpublished Manuscript,* October. www.dartmouth.edu/~jzinman/Papers/Zinman_RestrictingAccess_oct08.pdf

This page intentionally left blank.

Appendix A Tabular Overview of Current and Proposed Provincial Regulation

Province	Max Cost of Borrowing	Max Interest on outstanding principal	Max Penalty Chargeable for Default	Permit / Licence Fee	Permit / Licence Expiry	Time Records Must Be Retained	Rescission Period	Timing of Internet Advances
PE	$25 per $100 loan	60% APR on amount owed	Reasonable Charge	•$750 for main office of applicant •$750 for each branch office of the applicant	1 year	2 years	2 days	Same day as when the agreement was entered.
NS	$22 per $100 loan	60% APR on amount owed	$40 per loan	$3,334.65	Unless previously terminated or cancelled, every permit issued expires on July 31st in each year	3 years	5 days	1 hour

Appendix A

Province	Internet Display Regulations	Terms of Repeat / Multiple Loans
PE	•Information required by physical display regulations must be communicated before discussing anything about payday loans. •Agreement must be available for print.	The lender under a payday loan agreement shall not enter into a new payday loan agreement (grant a rollover loan) with the borrower before: •At least 7 days have passed since the borrower has paid the full outstanding balance under the first agreement; or •The borrower has provided to the lender proof that the borrower has paid the full outstanding balance under the first agreement. •No loan broker shall facilitate the making of more than one payday loan agreement between the same borrower and different lenders unless the requirements listed above are met as well.
NS	•Payday lender's websites must display notices that follow the same rules as in store display regulations •This notice must be at / near the top of the introductory page of the website, or in a location on the website that comes before the payday loan application •Permit information must also be displayed at / near the top of the introductory page. •Allows the prospective borrower to print the loan agreement.	•Terms of repeat loans are the same as the first loan, however cannot overlap in time periods •The advancement of a new payday loan cannot pay out an existing payday loan (grant rollovers)

Appendix A

Province	Disclosure Terms & Provision of Information for Borrower
PE	At each licensee's main and branch offices, the certificate of license shall be posted visibly to persons immediately upon entering the office, and includes the following information: •The licensee's legal name; • If the licensee uses a name registered under the Partnership Act at the office in respect of which the certificate is given, the name used at that office; •An indication of whether the licensee is a lender or a loan broker; •The licence number of the licensee; •The address of the office to which the certificate relates; •If the licensee operates more than one office, an indication whether the office to which the certificate relates is the main office or a branch office; •The expiry date of the term of the licence.
NS	A payday lender shall provide the following information to a borrower: •The total amount borrowed expressed as one sum in dollars and cents, that is comprised of 1) The sum actually received by the borrower, and 2) The sum of official fees and premiums for insurance paid by the borrower; • The cost of borrowing expressed in dollars and cents and itemized into interest •The interest payable as a percentage rate; •The cost of borrowing as a percentage of the total amount borrowed expressed at an annual rate; •The total amount to be repaid; •The regulated maximum rates or fees for the cost of borrowing or any other charges applying to payday loans •Charges payable in the event the loan is not repaid by the due date and the allowable maximum charges as determined •How a loan may be cancelled; •The borrower's rights if the lender charges amounts prohibited •The amount of fees and charges that can be applied to any extension or renewal •A copy of the loan agreement

Appendix A

Province	Prohibitions
PE	A lender shall not: •Require a borrower to transact in any good or service as a condition of entering into a payday loan agreement. •Request or accept an assignment of wages or any part of them from the borrower. •Require the borrower to repay or pay the advance or cost of borrowing or any part of it to the lender or anyone else until the end of the term of the agreement; • Make a telephone call or call in person at any of the following times, except at the request of the borrower, on any day of the week, between the hours of 9 p.m. and 8 a.m. local time in Prince Edward Island, or holidays. •Enter into a payday loan agreement with a borrower if the term of the agreement ends before the day on which the borrower is next regularly due to receive income.
NS	A lender shall not: •Require security for a payday loan; •Require undated cheques or require post-dated cheques for any amount exceeding the amount to repay the payday loan by the due date including interest and fees; •Issue a new payday loan to a borrower who already has a loan with the lender; •Discount the principal amount of the loan by deducting or withholding from the initial advance an amount representing any portion of the cost of borrowing; •Where a loan agreement makes provision for instalment payments, require an instalment payment to be in excess of a portion of the borrower’s net pay as prescribed; •Charge a penalty or fee for the early repayment of a loan •Grant rollovers

Appendix A Tabular Overview of Current and Proposed Provincial Regulation

Province	Max Cost of Borrowing	Max Interest on outstanding principal	Max Penalty Chargeable for Default	Permit / Licence Fee	Permit / Licence Expiry	Time Records Must Be Retained	Rescission Period	Timing of Internet Advances
NB**	$15 per $100 loan	30% per annum of principal	•$20 per dishonoured cheque or pre-authorized debit; • A penalty not exceeding 2.5% per month on the amount of the payday loan in default (not compounded and can only be charged once in a 30-day period)		1 year		2 days	
ON	$21 per $100 loan	60% APR on amount owed	$50 per loan	•$750 for main office of applicant •$990 for each branch office per application		2 years	2 days	1 hour

Appendix A

Province	Internet Display Regulations	Terms of Repeat / Multiple Loans
NB**		• No rollover loans
ON ON Bill 156	• The licensee shall communicate to the borrower the information required for display regulations of posters at offices before discussing anything about payday loans with the borrower	•No rollover loans •If a borrower enters into a third payday loan agreement within 62 days of having entered into a first payday loan agreement, the lender shall ensure that: •The term of the agreement is at least 62 days; •The agreement provides that the borrower is required to repay the advance and to pay the cost of borrowing to the lender in the prescribed number of instalments and at the prescribed times.

Appendix A

Province	Disclosure Terms & Provision of Information for Borrower
NB**	A payday lender shall ensure that the payday loan agreement includes the following terms, information and statements: • The payday lender's business address • The payday lender's licence number, telephone number and, if the payday lender has a fax number or e-mail address, that fax number and e-mail address; • The date of the agreement and the date or dates on which the first advance and any other advance will be made to the borrower or to the order of the borrower; • The principal of the payday loan; • The term of the payday loan; • The amount of cash to be advanced to the borrower or the amount of money to be transferred to the borrower or to the order of the borrower; • The total cost of credit and the APR; • The rate of interest that applies, together with a statement of the total amount of interest that is payable under the agreement • The amount and timing of any payments to be made by the borrower; • A statement of the borrower's rights of cancellation
ON	A payday loan agreement shall include the following: •The amount of money transferred to the borrower under the agreement, •The term of the agreement in days, •The cost of borrowing expressed as a total amount; $21 per $100 borrowed •The actual cost of borrowing expressed as an amount per $100 advanced under the agreement, •The total of all payments that the borrower is required to make in connection with the agreement, •The date at which the borrower is required to pay •The borrower's signature •The date of the agreement •The borrowers address and telephone number •The signature and legal name of the lender under the agreement •The methods by which the borrower may make payment to the lender •A statement that the borrower is entitled to receive a copy of the agreement by requesting it within a year of entering said agreement

Appendix A

Province	Prohibitions
NB**	A lender shall not: •Take security (real/personal property, an interest on said property, a guarantee, etc.…) •Make a payday loan contingent on the purchase of insurance or another product or service (tied selling) •Grant rollovers •Enter concurrent payday loans (multiple loans with the same borrower)
ON	A lender shall not: •Charge a penalty or fee for early repayment • Enter into a concurrent payday loan agreement with the borrower before either: 1) At least 7 days have passed since the borrower has paid the full outstanding balance under the first loan 2) The borrower has provided the lender proof that the borrow has paid the full outstanding balance under the first agreement •Enter into a payday loan agreement with a borrower if the term of the agreement ends before the day on which the borrower is next regularly due to receive income •Ask for or accept payment by automatic deduction from the borrowers paycheck (assignment of wages)

Appendix A Tabular Overview of Current and Proposed Provincial Regulation

Province	Max Cost of Borrowing	Max Interest on outstanding principal	Max Penalty Chargeable for Default	Permit / Licence Fee	Permit / Licence Expiry	Time Records Must Be Retained	Rescission Period	Timing of Internet Advances
MB	$17 per $100 loan	2.5% per month of amount of default, not to be compounded	$20 per dishonoured cheque or pre-authorized debit	$5,500	1 year	2 years	2 days	Same day as when the agreement was entered.
SK	$23 per $100 loan	30% per annum of principal	$50 per dishonoured cheque or pre-authorized debit	$2,000	1 year	3 years	2 days	

Appendix A

Province	Internet Display Regulations	Terms of Repeat / Multiple Loans
MB	•Ensure that the website is designed so that the borrower can print a copy of the agreement, as well as a blank copy of the agreement before entering said agreement •Display a notice that contains the same sign requirements as the lender's physical place of business, •This notice must be at or near the top of the introductory page, and also in a location on the website that comes before the payday loan application	• No rollover loans • The total cost of borrowing for a replacement loan must not be greater than 5% of the principal amount of the replacement loan The total cost of borrowing must not be greater than 5% of the principal amount of the payday loan if: •The payday loan is an extension or renewal of a payday loan previously arranged or provided; •The payday loan is arranged or provided by a payday lender within seven days after the borrower repaid in full another payday loan previously arranged or provided by that payday lender.
SK	•Display information set out in the sign requirements for a lender's physical place of business must be on a page of the lender's website that precedes the payday loan application	•No rollover loans

Appendix A

Province	Disclosure Terms & Provision of Information for Borrower
MB	The following information must be included in the payday loan agreement: • The payday lender's business name or style, business and mailing address, email address, and telephone and fax numbers; • The payday lender's licence number; • The borrower's name, address and telephone number; • The principal amount of the loan; • The term of the loan in days; • The amount of the initial advance; • The total cost of credit and the APR; • An itemization of all fees, commissions, charges, penalties, interest and other amounts or consideration charged, paid or given, or to be charged, paid or given, by or to the lender or any other person, in relation to the loan; •The date on which payment is due to the payday lender and, if being repaid by more than one payment, the date and amount of each payment; • Information on cancellation rights • Information about the consequences of payday lender's violation of prohibitions
SK	A payday lender shall provide a written disclosure statement to the borrower or prospective borrower before entering the payday loan agreement which must: •Indicate that the payday loan is a high cost loan; •Include an explanation of all amounts, fees, rates, penalties or other charges that may be payable by the borrower; •Provide notice of the borrower's right to cancel the payday loan, without reason or cost, at any time before the end of the business day following the date that the payday loan agreement was entered into; •Include a form of notice, satisfactory to the director, that the borrower may use to give written notice that he or she is cancelling the payday loan agreement;

Appendix A

Province	Prohibitions
MB	A lender shall not: •Charge any additional amount as consequence of the cancellation of a payday loan •Collect security for the loan •Ask for or accept payment by automatic deduction from the borrowers paycheck (assignment of wages) •Provide a payday loan to a borrower who is indebted to the lender under an existing payday loan, unless the new loan is a replacement loan and, immediately after the initial advance under the new loan is made, the borrower is no longer indebted under the existing loan (no rollovers) •Discount the principal amount of a loan •Make a loan contingent on the supply of other goods or services (tied selling) •Charge a fee for the first copy of the agreement requested by the borrower, if the request is made within one year after the end of the term of the payday loan • Attempt to process repayment to a financial institution more than once
SK	A lender shall not: •Directly or indirectly, charge any amount, fee, rate, penalty or other charge for, or as a consequence of, the cancellation of a payday loan agreement pursuant to this section. •Charge a penalty or other fee for the early repayment of a payday loan. •Accept, directly or indirectly, any form of security (real/personal property, interest on said property, or a guarantee) for the payment of a payday loan. •Enter concurrent payday loans (multiple loans with the same borrower) •Make a payday loan contingent on the purchase of insurance or another product or service (tied selling) •Ask for or accept payment by automatic deduction from your paycheck (assignment of wages) •Enter into a payday loan agreement with a borrower that is in excess of 50% of the borrower’s net pay during the term of the payday loan. •Grant rollover loans

Appendix A Tabular Overview of Current and Proposed Provincial Regulation

Province	Max Cost of Borrowing	Max Interest on outstanding principal	Max Penalty Chargeable for Default	Permit / Licence Fee	Permit / Licence Expiry	Time Records Must Be Retained	Rescission Period	Timing of Internet Advances
AB	$23 per $100 loan As of August 1, 2016: $15 per $100 loan	2.5% per month of amount of default, not to be compounded	$25 per dishonoured cheque or pre-authorized debit	•$1000 per year for head office / primary location • $500 per year for each additional location the licensee conducts business		3 years	2 days	Same day as when the agreement was entered.
BC	$23 per $100 loan	30% per annum of principal	$20 for a dishonoured cheque or pre-authorized debit (one-time fee only)	•$1500 per year for head office / primary location • $750 per year for each additional location the licensee conducts business	3 years	2 years	2 days	

Appendix A

Province	Internet Display Regulations	Terms of Repeat / Multiple Loans
AB	•The payday lender must display a copy of the licence, prominently at or near the top of the introductory page of the website •Display information set out in the sign requirements for a lender’s physical place of business must be on a page of the lender’s website that precedes the payday loan application	•No rollover loans As of August 1, 2016: •The loan agreement must contain a term requiring the borrower to repay the payday loan through an instalment plan over a period of at least 42 days and no more than 62 days regardless of any other term stated in the agreement •If the borrower is paid bi-weekly, semi-monthly, or a more frequent basis, the agreement must specify that repayment is to be spread over at least three pay periods •If the borrower is paid on a less frequent basis, the agreement must specify that repayment is to be spread over at least two pay periods
BC	•Display information set out in the sign requirements for a paylender’s physical place of business must be on a page of the paylender’s website that precedes the payday loan application, and also be near or at the top of the introductory page of the website	•Lenders are prohibited from having more than one outstanding loan with a borrower If a borrower enters into a third payday loan agreement within 62 days of having entered into the first payday loan agreement the lender shall ensure that: •The borrower is given at least 3 pay periods to pay off the third loan (if income is received on a bi-weekly, semi-monthly, or more frequent basis) •The borrower is given at least 2 pay periods to pay off the third loan (if income is received on a less frequent basis than bi-weekly or semi-monthly) •Subsequent loans taken out after the third loan are subject to the same rules as the third loan, as long as the timing between loans is within a 62 day time period. Otherwise, they will be treated as if they were the first payday loan.

Appendix A

Province	Disclosure Terms & Provision of Information for Borrower
AB	•When entering a payday loan agreement, the lender must provide a copy of the loan agreement and cancellation notice form to the borrower On receiving payment, a payday lender shall immediately give the borrower a receipt for that payment that specifies: •The name of the borrower, •The date of payment, •The agreement number of the payday loan on which the payment was made, •The amount paid, •The amount still owing on the payday loan, if any
BC	A payday loan agreement must include a statement that reads as follows: •"Payday loans are regulated under the Business Practices and Consumer Protection Act. For information on the requirements relating to payday loans, please contact the Business Practices and Consumer Protection Authority."

Appendix A

Province	Prohibitions
AB	A lender shall not: •Charge any penalty fees for repayment of the loan before it is due •Discount the principal amount of a loan •Grant rollovers •Require a loan to be due less than one full banking day after you receive your pay or other income •Publish or threaten to publish a borrowers failure to pay •Ask for or accept payment by automatic deduction from the borrowers paycheck (assignment of wages) •Attempt to collect an outstanding payday loan more than 3 years after. •Make a loan contingent on the supply of other goods or services (tied selling) •Charge a fee for the cancellation of a payday loan within the rescission period) •Giving false, misleading or deceptive information in advertisements, solicitations or negotiations with respect to a payday loan.
BC	A lender shall not: • Issue more than one loan to a borrower at the same time •Grant rollovers •Issue a loan for more than 50% of the borrowers paycheques / net income to be received during the time of the loan •Collect a repayment directly from an employer of the borrower • Gain unrestricted access to a borrowers bank account •Charge a penalty for repayment of the loan before the required date •Make a loan contingent on the supply of other goods or services (tied selling) •State or imply that a payday loan will improve the borrowers credit rating if it will not do so

Appendix A

For a full listing, see References

Sources:

PEI; Payday Loans Act: Regulations (2015)
NS; Nova Scotia Utility and Review Board Decision (2015)
NS; Nova Scotia Utility and Review Board Order (2015)
NS; Nova Scotia Utility and Review Board Payday Loans – Decision and Recommendations (2015)
NS; Consumer Protection Act: Payday Lenders Regulation (2015)
NB; Bill 4: An Act Respecting Payday Loans (2008)
NB; Chapter 5: An Act to Amend an Act Respecting Payday Loans (2016)
NB; Chapter 31: An Act to Amend an Act Respecting Payday Loans (2014)
NB; Payday Lending Regulation – Cost of Credit Disclosure and Payday Loans Act (2016)
ON; Bill 156: Alternative Financial Services Statute Law Amendment Act (2016)
ON; Payday Loans Act (2008)
ON; Payday Loans Act, Ontario Regulation General (2013)
MB; The Consumer Protection Act (2015)
MB; The Consumer Protection Act: Payday Loans Regulations (2015)
SK; The Payday Loans Act (2012)
SK; The Payday Loans Act: Amended (2013)
AB; Bill 15: An Act to End Predatory Lending (2016)
AB; Fair Trading Act: Payday Loans Regulation (2016)
BC; Business Practices and Consumer Protection (Payday Loans) Amendment Act (2009)
BC; Business Practices and Consumer Protection Act: Payday Loans Regulation (2009)