

Protecting Canadians' Interest

Reining in the Payday Lending Industry



A Special Report by:

 **ACORN Canada**

November 2004

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Executive Summary

The payday lending industry is unique in Canada. In most of the country, this billion-dollar business is completely unregulated. And it makes money by openly breaking the law against criminal interest rates. While the Criminal Code clearly states that annual effective interest rates must not exceed 60%, payday lenders typically charge between 300% - 900% and, not infrequently, more than 1,000%. And yet, in spite of this flagrant violation of the law and the harm done to those who regularly borrow from Money Mart and its less well-known competitors, virtually nothing is being done to crack down on this rapidly growing industry.

It's estimated that there are more than 1,200 payday lending "stores" across Canada. Some have more reprehensible lending and collection practices than others. But all of them share the same core business practice of breaking the law every single day.

In no small part, the payday lending business has undergone explosive growth as a result of the banks (and other traditional financial institutions) abandoning the small loan market and closing literally hundreds of branches. This report contains a series of innovative maps which overlay where bank branches have closed with where payday lenders operate. The maps go on to fold in the income, linguistic (immigration) and family status characteristics of these neighbourhoods. The story told by the maps is striking and confirms that payday lenders target particular communities as they ply their unregulated trade.

Both the federal and provincial governments have long studied the problems posed by the payday lending industry. But all of the meetings, committees, reports and working groups have not been translated into action. In light of the damage inflicted by the industry, the time for study is over and urgent action is required.

Implementation of the full suite of policy mechanisms listed below would result in an effective and reliable regulatory structure that would provide strong consumer protection. Until a comprehensive regulatory structure is in place, governments must enforce the law on criminal interest rates and ensure that it applies fully to all small loans, including sham transactions used to cloak loans; loans made via the Internet and other distance selling technologies; and loans made in partnership with other financial institutions.

Interest Rate Caps:

This is clearly one of the most important issues in developing an effective regulatory structure.

No Rollovers, Extensions, Back-to-Back Loans:

As important as the interest rate cap, strict regulation of repeat payday loans is pivotal in preventing more and more Canadians from falling victim to the debt traps set by payday lenders.

- Rollovers to be prohibited
- Loan extensions (for a further fee) and back-to-back loans without a cooling off period also prohibited
- Cooling off period must be longer than one pay cycle
- Regular and aggressive prosecution of rollover violations

- Severe penalties for rollover violations with repeat offences leading to permanent license suspension

Ability to Repay:

Money Mart, the industry “leader”, will lend borrowers up to 40% of net pay. Other payday lenders have no such qualms and will enter into loan transactions where borrowers have little to no ability to repay without resorting to ever more loans to pay off ever more loans.

- Limit on amount of loan to 25% of borrower’s net income from next paycheck. However, this alone does not guarantee ability to repay. Regulators may wish to require that lenders base loans on a more comprehensive definition of ability to repay, which would include the other financial obligations and a credit check.

Licensing:

At present, anyone can enter the lucrative, unregulated payday loan industry in most of Canada. In preparing this report and, in particular, in mapping the locations of payday loan operations, it was evident that there is no clearinghouse for data.¹ Apart from the phonebook and the targeted Internet searches, the only comprehensive way to know who’s doing what where is to walk the streets block by block. For a billion dollar industry, this is simply unacceptable.

By requiring payday lenders to license their operations, consumers will have confidence that the government is tracking the industry and granting/revoking licenses based in regulatory compliance.

- All lenders subject to mandatory licensing
- Fines, license refusal or revocation for failure to meet regulatory requirements
- Publication of complaints history
- Public disclosure of corporate structure and governance
- Regular detailed reporting of transactions to regulator

Regulator Powers:

Because provincial governments are responsible for consumer protection issues, the larger provinces with the biggest populations should have a regulator expressly focused on payday lending. Smaller provinces may wish to house this function in existing oversight bodies but, regardless of where the power is housed, it must be endowed with broad oversight and enforcement powers and resources.

- Jurisdiction over all payday lenders in province
- Prosecution of lenders not complying with registration requirements
- Management of 1-800 complaints line Complaint investigation and mediation
- Power to levy fines
- Require transaction data from lenders
- Educate borrowers about cost of credit
- Annual report on industry to Legislature

¹ The industry lobby’s one page, members only website is of no use in this regard.

Cost of Credit Disclosure:

Many payday lenders do not provide documentation for loan transactions. Or they provide incomplete or misleading documentation. This must stop and standard, clear, multilingual documentation must be developed and approved by the regulator.

- All fees and charges detailed in contracts, advertising and promotional materials
- Loan application and agreement provided before completion of transaction
- Reference to complaints mechanism in documents
- No fees or charges to be excluded from definition or calculation of interest
- Annual percentage rate (APR) must be calculated on all loans and displayed on loan documentation
- Must show total cost of all fees and charges

Contract Based Not Cheque Based:

To better protect borrowers from potentially unscrupulous manipulation of their bank accounts, loan transactions should be conducted via written contract rather than post-dated cheque, present-day cheque held for future deposit, or electronic access to the borrower's bank account.

Limits on Specific Charges and Fees:

Some payday lenders charge outrageous rates for NSF fees far beyond any reasonable cost associated with collection. An industry standard needs to be developed geared to the real cost of administration or the fee charged to the lender by the bank that returns the check. Since the lender isn't holding a check as security for the loan, this would apply to the check that a borrower would bring in or send to make payments.

- Electronic NSF charge collection limited to one attempt
- No default or delinquency charges
- Interest not to accrue after default
- No "broker" or "agency" fees permitted

Advertising:

- Must not be deceptive or misleading
- Must detail typical APR of standard loan amount for typical term in clear conspicuous type
- Must detail all applicable charges and fees

Education and Awareness Campaign:

Payday lenders should fund consumer borrowing education either through license fees or specific levies. Educational outreach efforts to be provided either by governments or third parties, not the industry.

Other Borrower Rights:

- Right of rescission immediately following a loan – close of business on the day following the loan as a minimum period
- Right of prepayment of loan at any time; payable in increments of \$5 or more without any penalty
- Prohibition of secondary marketing of information collected for loan transactions; distribution of information to third parties also prohibited

Collection and Litigation Limits:

Currently the industry often requires that borrowers waive their rights to legal action in the event of disputes. This infringement on consumer rights must end.

- Regulator administered tribunal or small claims court for borrowers to contest amounts illegally demanded by lenders
- No mandatory pre-dispute private arbitration clauses
- Private right of action, right to bring class action lawsuits
- No assignment of wages
- No security (cars, boats etc.) or contingent security such as holding bank cards, PINs etc.
- No personal guarantees from third parties
- No interest in land

Introduction

Canada's payday lending industry is estimated to generate more than \$1 billion in annual revenue. This is only an estimate because there is no hard data on any aspect of the industry. No one really knows how many payday lenders there are. No one knows what the real cost structure of providing small loans is in Canada. And no one knows how many lives have been devastated by payday lenders and the debt traps they create.

No one knows any of the above with any certainty because the payday lending industry is a rare animal in the world of financial services: it is unregulated, unaccountable and, according to many observers, out of control.

While it is unusual for a billion dollar+ business to operate beneath the regulatory radar, the payday lending industry is all the more remarkable since its core business model rests on violating the Criminal Code of Canada every single day. In particular, payday lenders violate the usury provisions of Section 347 of the Criminal Code, which places a 60% annual interest rate limit on loans.

Actuarial analyses, payday lending victim sworn affidavits, public policy experts and a number of legal decisions are all in agreement that payday lenders charge between 300% and 900% in annual interest (and, not infrequently, quite a bit more) once all the different charges, fees and insurance costs are put together. And the language in the Criminal Code is crystal clear that these costs all constitute interest.

So what's being done to rein in an industry that bears a striking resemblance to loan sharking? The short answer to that question is: nothing at all.

The longer answer is that the provincial and federal governments have been studying the problem for almost five years. Ministers have met. Public servants have written reports. Committees have given birth to sub-committees and, quite likely, some good will has been invested in trying to figure out what to do. But, after all the study and all the secret ministerial discussion, the reality is that the industry is growing like wildfire, no one is on the verge of implementing a comprehensive regulatory system for payday lenders and no one is enforcing the law.

The time for study is over and it's now time to act. The nature of the problem is well understood, if not its scope,² and excellent work has been done (by the Public Interest Advocacy Centre, amongst others) in terms of describing very detailed policy prescriptions to cure this social ill. The only piece missing is one of political will. Surely after such a long delay, governments can find the necessary resources to discipline an industry which preys on some of the most vulnerable people in our society.

² This is, in fact, one of the many arguments for comprehensive regulation, licensing and registration: As recent federal/provincial discussions made abundantly clear, "you can't manage what you can't measure."

In the following pages we will briefly describe the major problems that characterize payday lending. We'll discuss the big players and outline their efforts to avoid regulation and/or shape any regulatory effort to their advantage. And we'll talk about the modest-to-glacial steps governments are taking or considering.

We'll provide new data on bank closures and the possible relationship between these closures and the payday lending industry.³

And we'll argue both for enforcing the law and robust implementation of a comprehensive regulatory system that closely adheres to the work of the Public Interest Advocacy Centre (and others). Only with the best of public oversight can we hope to effectively put an end to what is now an unethical, unaccountable and unacceptable status quo.

³ Money Mart is Canada's biggest and best-known payday lending company. Wholly owned by Dollar Financial Group (DFG) in the United States, DFG's own filings with the Securities Exchange Commission trumpet this point and claim that the failure of the banks to meet the needs of the small loan market has been very good for their business. This point will be discussed in greater detail in the body of this report.

What's the Problem?

There are a few major problems with payday lending as it is now conducted. One of them is that it is illegal according to Section 347 of the Criminal Code of Canada, salient sections of which read as follows:

“Criminal rate” means an effective annual rate of interest calculated in accordance with generally accepted actuarial practices and principles that exceeds sixty per cent on the credit advanced under an agreement or arrangement;

“Interest” means the aggregate of all charges and expenses, whether in the form of a fee, fine, penalty, commission or other similar charge or expense or in any other form, paid or payable for the advancing of credit under an agreement or arrangement, by or on behalf of the person to whom the credit is or is to be advanced, irrespective of the person to whom any such charges and expenses are or are to be paid or payable, but does not include any repayment of credit advanced or any insurance charge, official fee, overdraft charge, required deposit balance or, in the case of a mortgage transaction, any amount required to be paid on account of property taxes.

When Section 347 of the Criminal Code was passed into law in 1980, it received unanimous support in Parliament. And the reason all parties and all members voted for the legislation is that it is a very carefully thought out law that focuses clearly on protecting Canadians from predatory and unscrupulous practices.

Current estimates suggest that there are over 1,200 payday lending “stores” in Canada and that the business continues to expand. In light of the Criminal Code’s remarkably clear definition of criminal interest rates, it is obvious that every single one of them breaks the law every single day. And many of them break the law at night too, with 24 hour/day internet payday loans.

And yet not one Attorney General or Solicitor General in Canada has directed significant law enforcement resources to the investigation and prosecution of payday lenders who routinely violate the Criminal Code.⁴ Looking back over the last hundred or so years of commercial history, perhaps the raucous and wildly profitable speakeasies of the Prohibition Era are the only close comparison with the brazenly illegal payday lending business.

ACORN’s concern about the industry is not rooted in any arcane focus on technical aspects of the law and the philosophical importance of enforcing it. Our concerns are for those Canadians who fall into debt traps through repeated cycles of payday loans and their spiraling costs, fees, charges and bogus insurance schemes, all of which, section 347 tells us, are interest.

⁴ At the time of this report’s writing, the B.C. Government has just launched a criminal investigation of Stop N’ Cash, an Ontario based payday lender with limited operations in British Columbia. It is unclear how long this investigation will take or whether it will ever result in charges being laid. Stop N’ Cash is widely considered to be one of the worst in the business, with effective annual interest rates in the range of 900%.

The social and economic impacts on the lives of vulnerable Canadians are the most insidious feature of the industry. As the Toronto Star's excellent investigative series in June 2004⁵ made abundantly clear, repeated use of payday lenders has wreaked havoc in the lives of many; some of whom have coalesced around a handful of class action lawsuits now pending against a variety of payday lenders.

Of course, most Canadians are outraged and appalled when they learn that payday lenders break the law with every breath they take in charging 300%-900% (or more) interest. They are even more appalled when they hear heartbreaking stories like the one told by class action plaintiff Margaret Smith (featured in the Toronto Star series). Mrs. Smith, an elderly pensioner in poor health living solely on her monthly CPP check, fell prey to a crippling Money Mart debt trap sprung by multiple payday loans and their compounding costs. By the time Mrs. Smith realized she was in trouble, Money Mart was first in line when her pension check arrived.

The big problem posed by the payday lending status quo: broken laws and broken lives.

A VICTIM'S STORY...

Peggy Davis, retired city director⁶

Peggy Davis can describe in minute detail the front page that almost ruined her. It was Feb. 16, 2002. She shared the newsprint with Canadian skating pair Jamie Salé and David Pelletier. They had just been handed a gold medal after a scandal of international proportion at the Salt Lake City Olympic Games. She had just been ousted as a top city official with a gambling addiction.

"Windsor social services audited; senior director seeks treatment" read the headline in the Windsor Star. Davis, a director in the city's social services department, was reported to be in a rehab program and under investigation for possible financial improprieties. What the paper didn't know is that Davis wasn't stealing from work to feed her addiction. She was turning to payday lenders, and was in over her head with them as well. "They brought in auditors where I worked because I guess they figure if you gamble, then you steal," Davis says.

After a year, the auditors found no money missing. But the damage was done. "It was awful, it was terrible for my family," says Davis, 59, who is now retired. "But two years ago, even a year ago, I couldn't sit here and talk to you about this." Her addiction started after a visit to the casino with friends. Depressed because of her mother's death, Davis found escape in the mindless slot machines. The game soon consumed her savings and maxed out her credit. With nowhere else to turn for money, Davis found herself at the only place she could think of where she could get a quick cash infusion to fuel her habit.

⁵ *A Matter of Interest* can be found on the newspaper's website at: www.thestar.com

⁶ Toronto Star, *Caught in the loan trap: Paying it back can become a vicious circle*, June 19, 2004

An initial loan at Stop `N' Cash led to multiple loans, many coming in the same week. She says she became such a good customer she was soon allowed to borrow nearly her entire paycheque. Forging over as much as \$300 in fees and interest every time, Davis soon owed up to \$1,400 on her next payday.

Davis feared her secret debt would be made public if she didn't keep up with payments. She says she overheard employees on the phone to other customers and didn't doubt they'd call her workplace to tell her boss about her outstanding loans, should she miss payments.

Though on a first-name basis with Stop `N' Cash employees, Davis was careful to slink in and out of the business, hoping no one would see. "I would park way in the back, and in between the buildings. I would take this little rocky pathway. I would climb over a wall that was a couple of feet and then I'd go in. I'd never park in front." Even when she finally sought help for her gambling addiction, Davis still made weekly trips to the payday lender.

"At that point, I was busy paying off whatever I could. Everything that I had coming in was going to pay bills that I hadn't paid. And I wasn't gambling anymore, I was just trying to get out of this huge financial debt that I was in," explains Davis. Davis turned to Windsor lawyer Harvey Strosberg when she got her debt down to \$650, and the collectors were still after her. Now the main signatory in a class action against Stop `N' Cash, she hasn't heard from the payday lenders in months. They stopped asking for money after her lawyer called them and requested loan documents. With help, Davis has also overcome her gambling addiction.

"I was in a vulnerable position in my life and I was taken advantage of," she says. "That wouldn't happen now. But I think they know that when people go there, they're desperate, that they don't have any other avenue."

The ABCs of Payday Loans

Here's how Money Mart's owners and directors describe the tens of thousands of people who regularly make use of payday loans:

Our core customer group generally lacks sufficient income to accumulate assets or to build savings. These customers rely on their current income to cover immediate living expenses and cannot afford to wait for checks to clear through the commercial banking system. We believe that many of our customers use our check-cashing and short-term lending services in order to access cash immediately without having to maintain a minimum balance in a checking account and to borrow money to fund living expenses and other needs. ⁷

It's not difficult to understand how habitual users of payday loans get caught in ever more painful debt traps. If your income isn't sufficient to get by and you look to payday loans to make ends meet, it's not long before Money Mart (or whomever) is looking less and less like a friend at a time of need and more and more like a loan shark.

Assume your net bi-weekly paycheck is \$1,000. Assume you can't wait for that check because you have immediate expenses that can't be delayed. You walk into Money Mart and ask them to loan you the maximum amount that you qualify for. They then ask what your net income is and, since you'll be paid \$1,000 in 2 weeks, they'll lend you \$400, or 40% of your net income. For that \$400, you'll sign a contract that commits you to paying about \$450 on or before the day your paycheck is due. Given that you need the money to make it to your paycheck, you're likely not going to be in a position to pay before the "due date".

Knowing that most borrowers will be unable to pay on or before the official "due date", Money Mart structures their loans so that all the extra fees (again, interest according to the Criminal Code) kick in the day after the "due date", when your paycheck has landed in your account.

And so Money Mart has the first crack at 40% of your check. In the words of Money Mart's American owners:

I think it's important to note that we are essentially first in line when it comes to our customer spending. We get paid either out of the paycheck or on payday.⁸

According to the very clear wording of Section 347 in the Criminal Code, the \$50 (or so) that you're paying for the loan is interest at an effective annual rate of roughly 1,000%⁹: Money Mart calls their different fees a range of things which, when placed cheek by jowl with the

⁷ From *Dollar Financial Group's 2004 Annual Report* filed with the United States Securities and Exchange Commission.

⁸ From a transcript filed with the United States Securities and Exchange Commission: *Dollar Financial Group, FY 2004 Year-End Operating Results Conference Call*, August 30th, 2004.

⁹ See Appendix 2 for an actuarial analysis of a recent Money Mart loan and the effective annual rate of interest charged.

unambiguous phrasing of the law, look precisely like what they are: disingenuous words crafted in the hope of avoiding prosecution for usury and criminal interest rates.

Having paid back your loan, you're more than welcome to take out another one at the very same store or at any of Money Mart's other 311 Canadian locations (or, any of the other estimated 1,200 payday lending stores across Canada). And, of course, many people do exactly that – unless they can somehow get by on the little more than half of their net income left over from paying off the previous loan.

A VICTIM'S STORY...

One of ACORN Canada's new Vancouver members recently took out a loan for \$400 from Money Mart. She was charged the following:

Item fee	\$9.99
Discount	\$32.69
Interest	\$9.16
Total	\$51.84

She paid \$51.84 in fees and "interest" for a \$400 loan over a 17-day loan term, amounting to a total repayment amount of \$451.84.

What Money Mart fails to mention in its 1 page Fast Cash Advance™ loan agreement is that Section 347 of the Criminal Code defines all of the fees itemized above as interest, including the "discount" fee which, when the individual in question called for an explanation of the "discount" charge, she was told was another check cashing fee. See Appendix 2 for an actuarial analysis and certificate regarding this transaction which confirms an effective annual interest rate of more than 1,000%.

For borrowers and potential borrowers somewhat aware of the prohibition on effective annual interest rates in excess of 60%, it appears on face value that Money Mart is in compliance with the law. Nothing could be further from the truth in light of the relevant language regarding all fees and charges associated with the loan as interest.

The Players

Far and away the biggest player in Canada's payday lending industry is Money Mart, with 311 outlets. As discussed above, Money Mart is 100% owned by the enormous American company, Dollar Financial Group (DFG), which presides over an empire of 1,110 payday loan operations in Canada, the U.S. and the U.K.

DFG's 2004 Annual Report provides a range of information that is helpful in understanding Money Mart's business:

- **Our Canadian business had revenues of US\$84.8 million for fiscal 2004 and US\$67 million for fiscal 2003;**
- **We believe that significant opportunities for growth exist in our industry as a result of: 1) growth of the service sector and; 2) failure of commercial banks and other traditional financial service providers to address adequately the needs of lower and middle income individuals;**
- **Net charge offs of company funded loans as a percent of total funded loan originations – 1.8%**
- **While we believe that we enjoy almost 30% market share by outlet in Canada, our research estimates our market share by volume of business to be closer to 50%.**

And from the transcript of DFG's 2004 year-end operating results conference call referenced earlier, the following brief comment suggests that Money Mart's owners are very pleased with their Canadian operations:

Well, I think we've spoken to this before. In Canada, we essentially have the only national brand; we're the only national provider. The Canadian stores have made a terrific return for us. They ramp up very rapidly.

In the foregoing, it's important to note that the sophisticated players at DFG credit the "failure of commercial banks and other traditional financial service providers" to meet the market need for small loans as a significant element in the bonanza they currently enjoy. Ironically, though the banks are virtually absent from the front lines of this billion dollar business, some big banks are doing well by financing the operations of payday lenders. For example, the much-maligned U.S. banking giant Wells Fargo has invested in DFG, and therefore Money Mart, to the tune of hundreds of millions of dollars.

Money Mart is the self-appointed industry leader (as well as being, in fact, the industry's largest player) and is increasingly at rhetorical pains to distinguish itself from its more blatantly unethical competition. The reality though is that Money Mart breaks the law every day just like every other payday lender. And they are guilty of many of the same dubious business practices that characterize the worst of the worst.

As the class action lawsuits against payday lenders and the harshly critical press coverage began to mount over the course of the last several months, the payday lending industry began to organize to fend off possible regulation. They cobbled together a one page website and an

industry lobby association and then they hired a lobbyist to work the halls of the federal Department of Finance on their behalf. As luck would have it, that lobbyist is Barry Campbell, the former Parliamentary Secretary to a former Minister of Finance who now happens to be the Prime Minister.

Along with Money Mart, other players include: Cash Money, Instalozans, The Cash Store and Cash N' Stop. Of these, all but Cash N' Stop are members of the recently minted lobby group, euphemistically known as the Canadian Association of Community Financial Service Providers (CACFSC).

Predictably, the two key tasks for the lobbyists are: 1) to head off any government effort to regulate their very profitable world and; 2) to mount and maintain a public relations effort so that disturbing words like "loan shark" don't find their way into the media too often.

On the regulatory front, the payday lenders follow in the not so proud footsteps of many industries that have gone before them: they propose to self regulate, saving governments all the bother and expense of putting a meaningful regulatory structure in place to protect the public.

And the CACFSC has made some headway with the self-regulation project. They have developed an 8-point plan (that would apply only to members of the association and not to the hundreds of other payday loan operations across the country) and are in the process of shopping it hard to both the provincial and federal governments. If accepted as currently proposed, the plan would have the industry home and dry, safely away from the scrutiny of those who might take issue with such things as criminal interest rates.

The industry plan is nothing if not succinct, consisting of eight key points and a terse thirteen sentences. Without restating the whole "code of best business practices", the following is a brief summary (the text below each of the following headings is ACORN Canada's brief assessment):

Full and Accurate Disclosure

- Meant to ensure that borrowers actually know what it is they're borrowing and what the terms of the loan are.

Promote Consumer Responsibility Through Education

- Sounds good. And if governments require a significant investment in such a program and implement that program, rather than the industry, could be a modest good step.

Right to Rescind

- Allows borrowers to rescind the loan transaction on or before the close of the following business day.

Advertising Standards

- Requires members of the CAFSC not to be misleading or deceptive in their advertising. Definitely a good idea but raises a question about the nature of current advertising and policing the enforcement of false advertising.

No Rollover Policy

- This is worth quoting: "Members will not allow rollovers, being the extension of an outstanding loan for a fee." But, of course, members would be allowed to provide a new loan as soon as the most recent loan has been paid off – thereby doing nothing about the debt trap and dependency issue.

Privacy Protection

- Requires members to obey the law.

Fair Collection Practices

- Requires members to obey the law.

Self-Policing and Consumer Redress

- Non-binding language about allowing borrowers to complain to the industry association in the hope that the association formed to protect the lenders will defend them.

The industry's recommendations would provide modest help but do little to solve basic problems with the industry as it operates now. They would not change the outrageous interest rates now being charged. And they would not change a business structure which encourages people to contract debts which they will not be able to pay without taking on additional (equally or even more costly) loans.

To cap off their current initiative, the CACFSC has retained the blue chip services of Ernst & Young to produce a soon to be released "study" which will, presumably, justify the "cost structure" of the industry. If all of these steps weren't so predictable and cynical, they would be impressive for the discipline with which they follow what is now a long tradition of industry seeking to dodge any meaningful oversight.

Mapping the Money

In 2001, the federal government created an oversight body known as the Financial Consumer Agency of Canada (FCAC). Under the terms of its mandate, the FCAC is empowered to collect a wide range of information from financial institutions about their operations and impacts on consumers. One of the data sets that the agency tracks is that of bank closures. The agency does not house any information on the number of bank closures prior to its creation but it just recently published a brief report about the number of bank branch closures between 2001 and 2003. Over that two-year period, more than 700 bank branches closed across the country.

We analyzed the geography of these closures and its relation to the sites of payday lenders in Toronto and Vancouver.¹⁰ In general, bank branch closures have been concentrated in lower-income neighborhoods (see Figures 1 and 2). And payday lenders are moving aggressively into this competitive vacuum. The location and distribution of payday lending operations is closely, although not perfectly, related to significant concentrations of low-income families (Figures 1 and 2). The pattern closely follows the residential concentration of those without knowledge of one or both official languages (Figures 3 and 4). And the pattern also closely follows concentrations of single parents (Figures 5 and 6).

In looking at where payday lenders choose to locate their businesses, we examined the median income¹¹ (in 2000) in Metro Toronto neighborhoods with at least one payday lender - and then we compared this figure to the income of all other neighborhoods in the metropolitan area (see Figure 7). On average, neighborhoods with at least one payday lender have a median annual income of about \$23,000, compared with a bit more than \$27,000 for all other neighbourhoods in the area.

The correspondence between payday lenders and communities marginalized from mainstream financial institutions should come as no surprise. The industry is clearly targeting a particular market, and DFG has expressed its intention to reach - or to “serve” - particular groups of customers. Our initial analysis of the geography of payday lenders is a best-case scenario of sorts: in the absence of a registration or licensing system, it is impossible to know how many payday lenders there are or where they are all located. As a result, it is only possible to find and map the larger, more established operations.

The storyline behind the maps: Every year for living memory, the big banks have made astounding profits. Some of those profits are garnered from service cutbacks and branch closures. Closing branches in predominantly low-income areas has opened the door for the payday lending industry to move in and become the financial institution of last resort for low income Canadians. The result has been a boon to the wild west industry of payday lending and

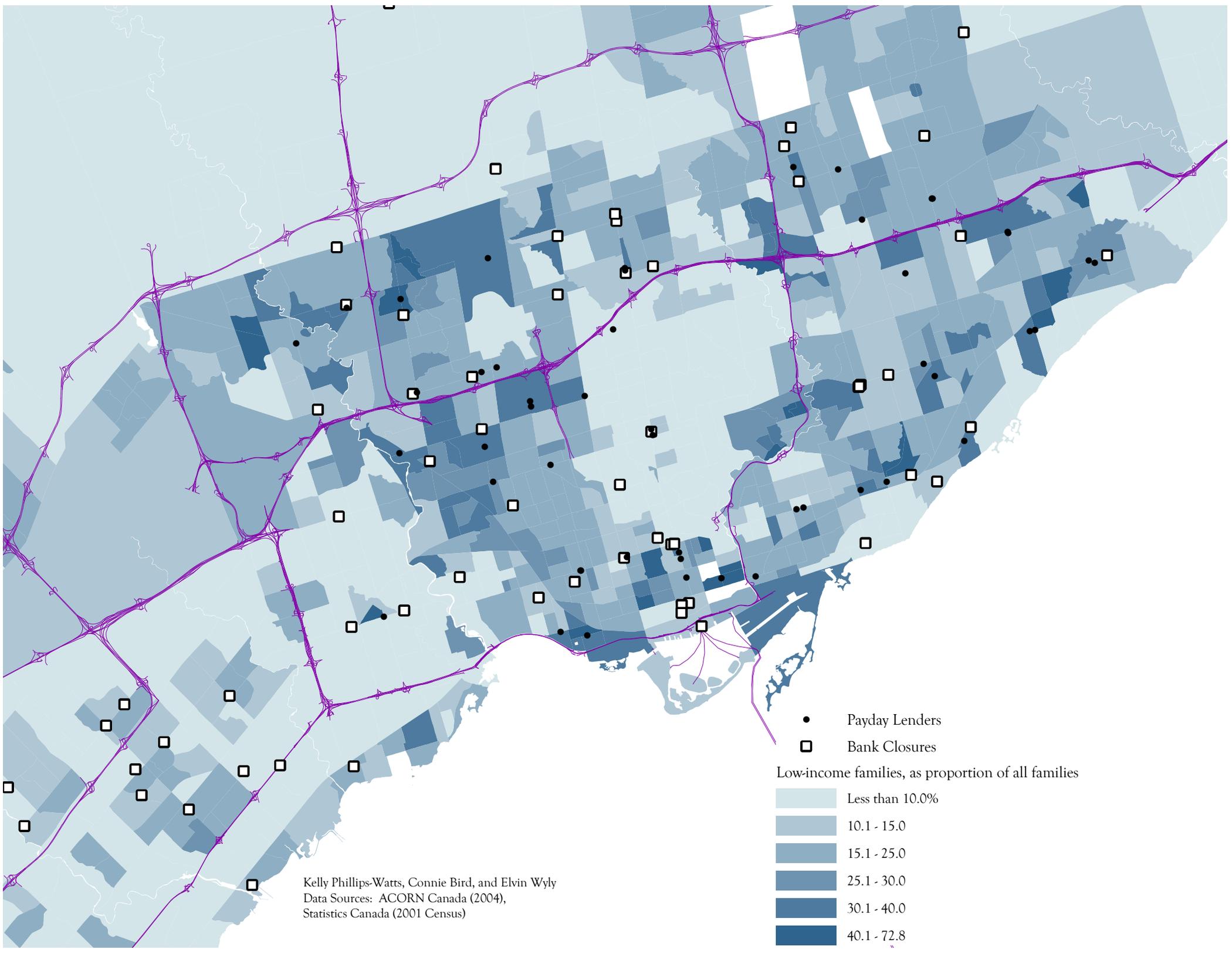
¹⁰ Maps are drawn from FCAC data about bank closures from 2001-2003; Statistics Canada data on income, language and family type; and from Internet research on payday lending operations. It is this last piece of the mapping that is likely not comprehensive as payday loan shops are notoriously difficult to track as a result of the complete lack of registration, licensing and regulation in Ontario and British Columbia.

¹¹ The median income is the mid-point of a ranked distribution: half of the people have incomes above the median, and half of the people have incomes below the median.

its billion dollar+ business while the outcome for low and moderate income Canadians has been decidedly less rosy.

Clearly there is a significant market need across the country for small loans. And payday lenders have leapt into that market and built it to meet their business objectives. However, the failure of the banks to meet demand is no excuse for predatory lending. Instead what's needed are initiatives from lenders and support from government for products that are both fair and workable

Rather than focusing on the needs and desires of the big banks (mergers), the federal government should use its influence to convene a meaningful process that would have the fair and accessible provision of small loans as its core objective. And there may well be a significant role for payday lenders in this equation. But that role must look very different from what is now on offer.



● Payday Lenders

□ Bank Closures

Low-income families, as proportion of all families

Less than 10.0%

10.1 - 15.0

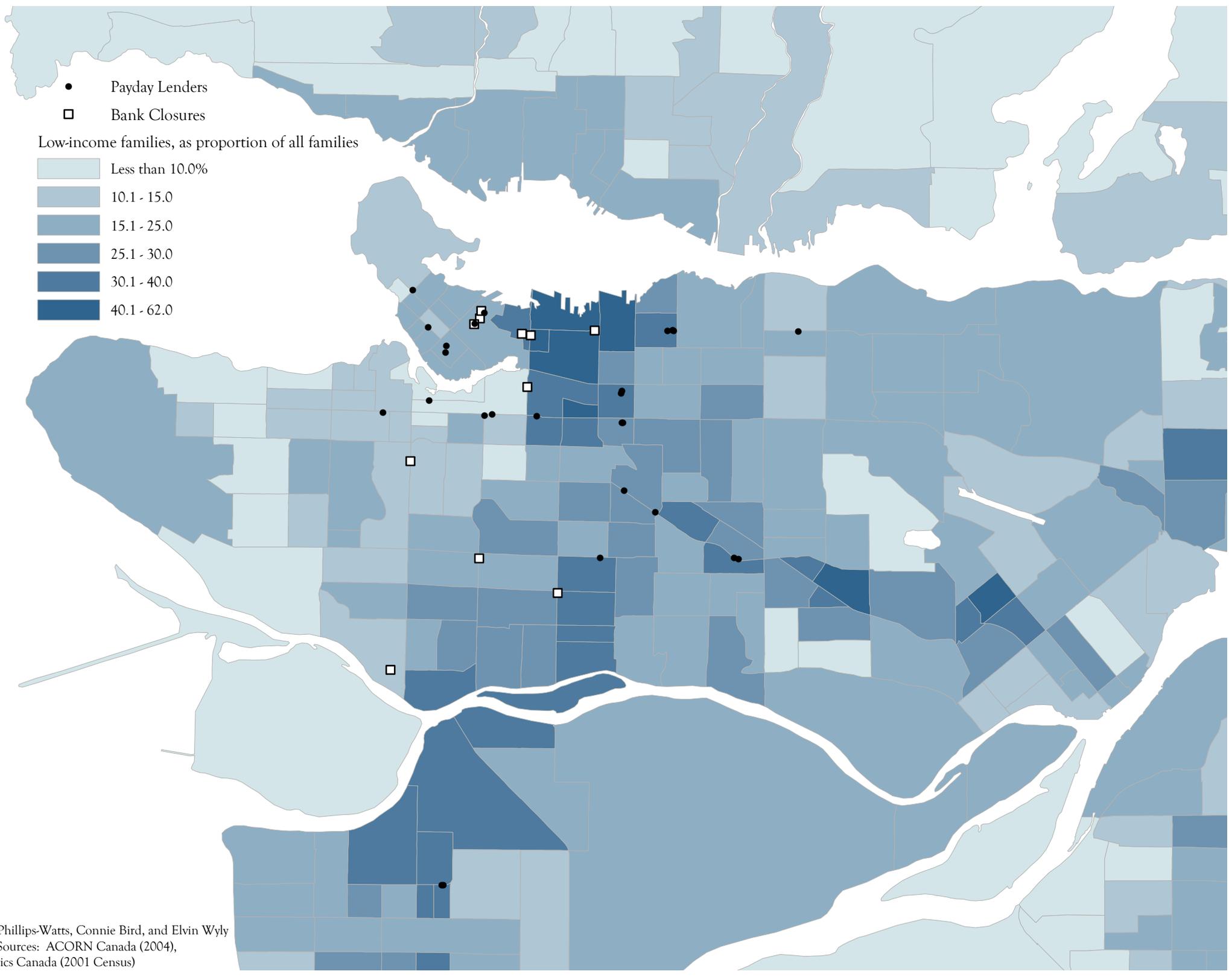
15.1 - 25.0

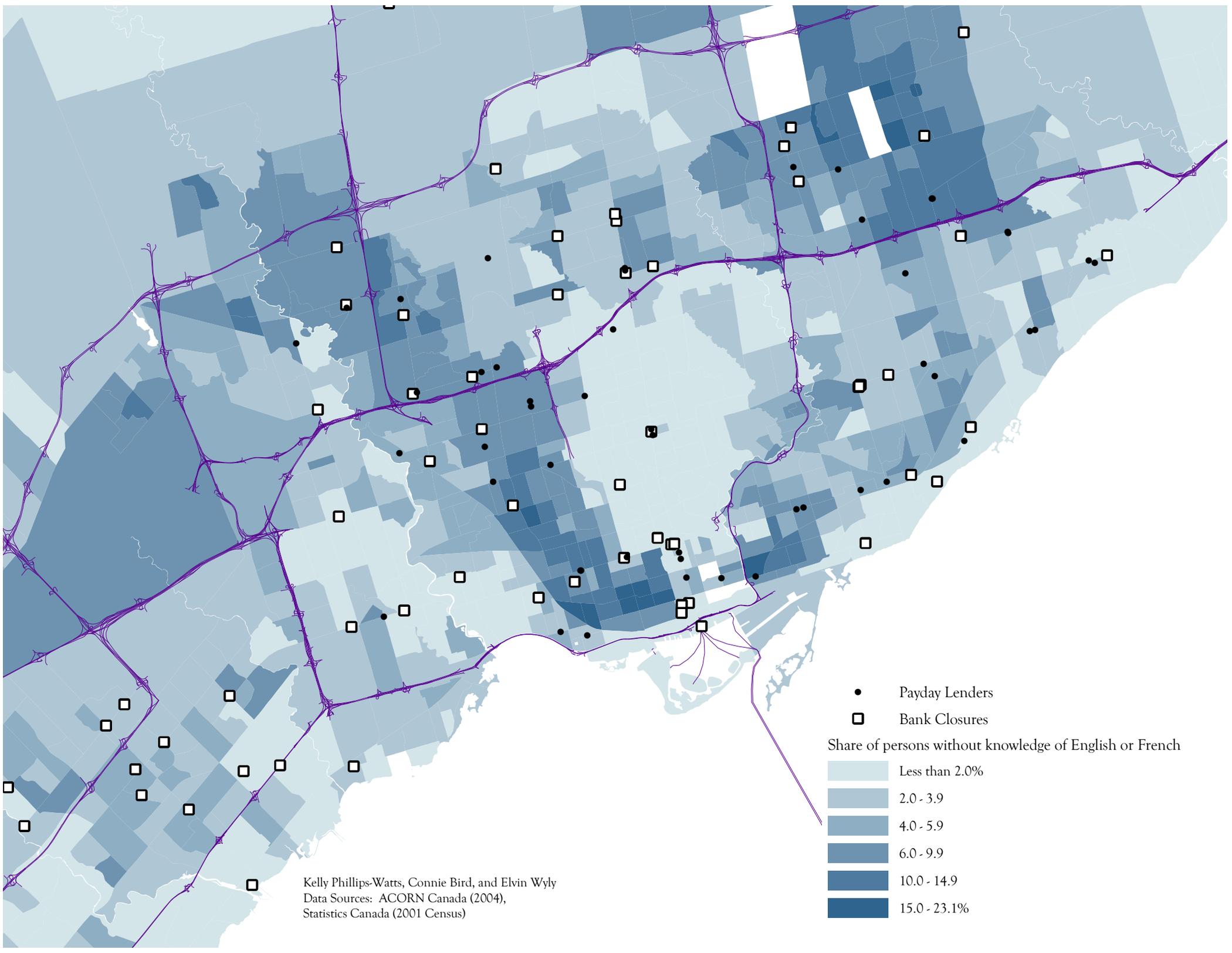
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30.1 - 40.0

40.1 - 72.8

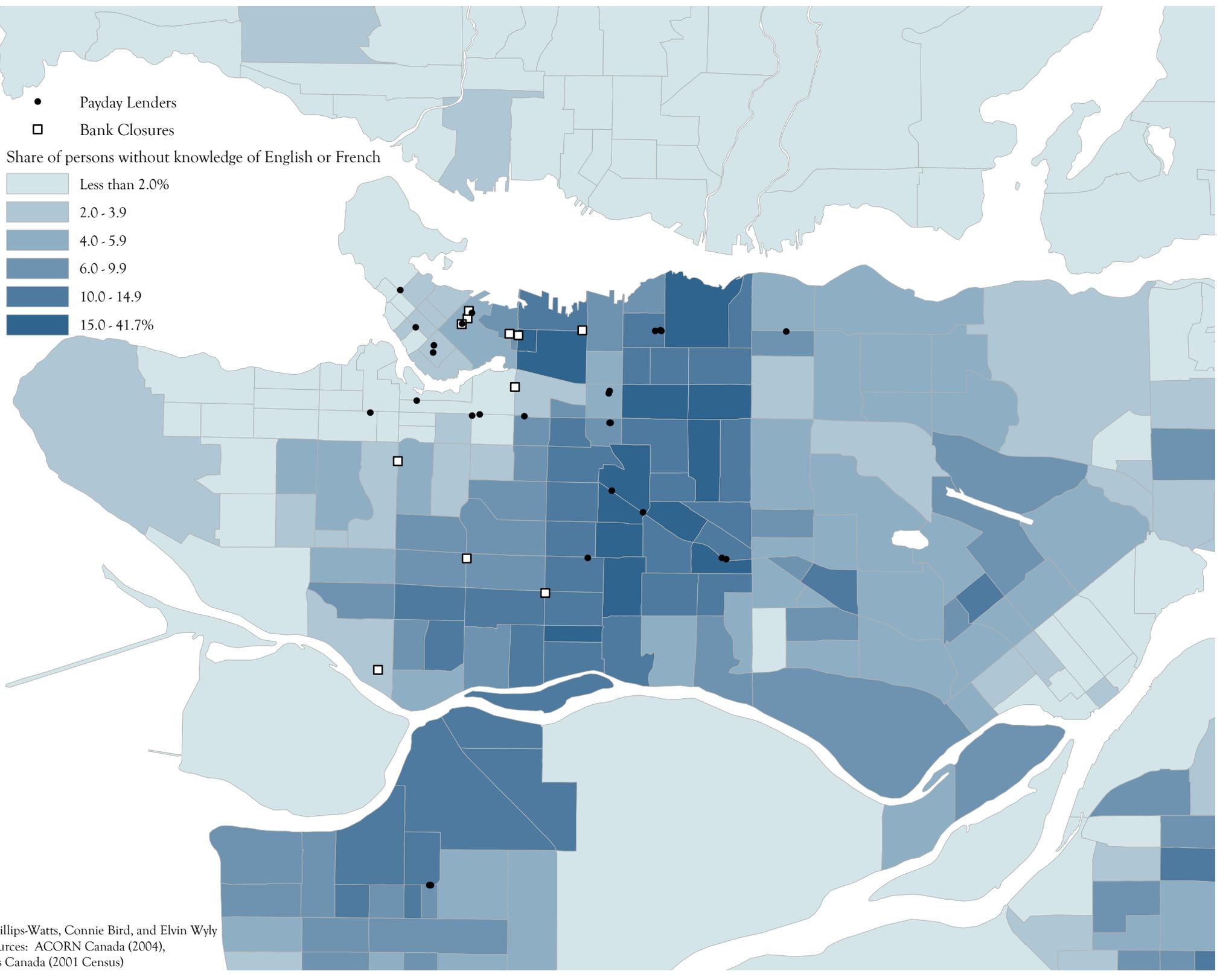
Kelly Phillips-Watts, Connie Bird, and Elvin Wylie
Data Sources: ACORN Canada (2004),
Statistics Canada (2001 Census)





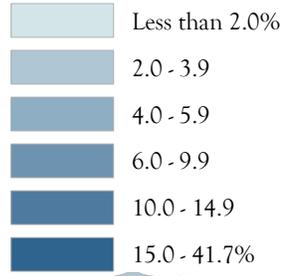
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Data Sources: ACORN Canada (2004),
Statistics Canada (2001 Census)

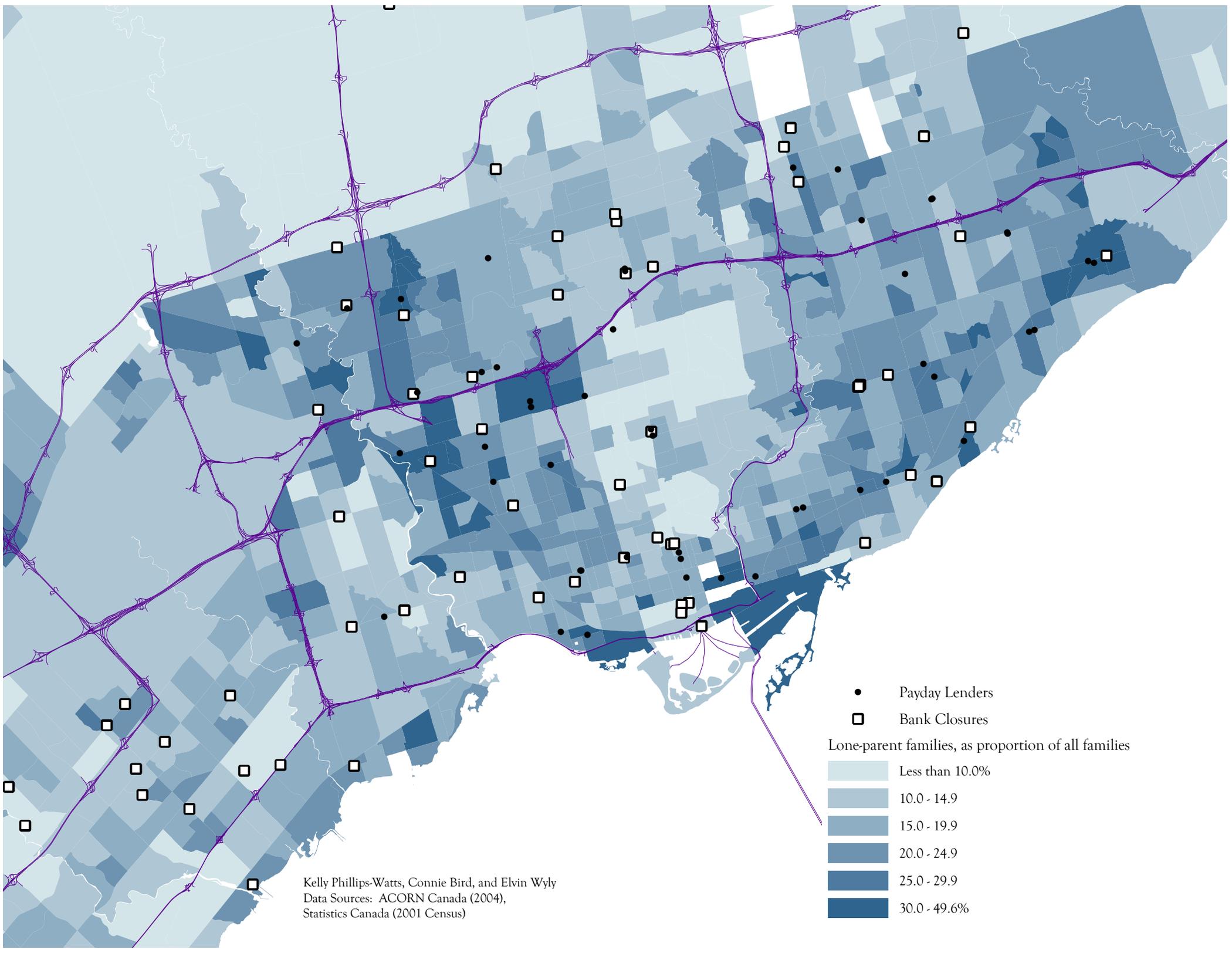
- Payday Lenders
 - Bank Closures
- Share of persons without knowledge of English or French
- Less than 2.0%
 - 2.0 - 3.9%
 - 4.0 - 5.9%
 - 6.0 - 9.9%
 - 10.0 - 14.9%
 - 15.0 - 23.1%



- Payday Lenders
- Bank Closures

Share of persons without knowledge of English or French



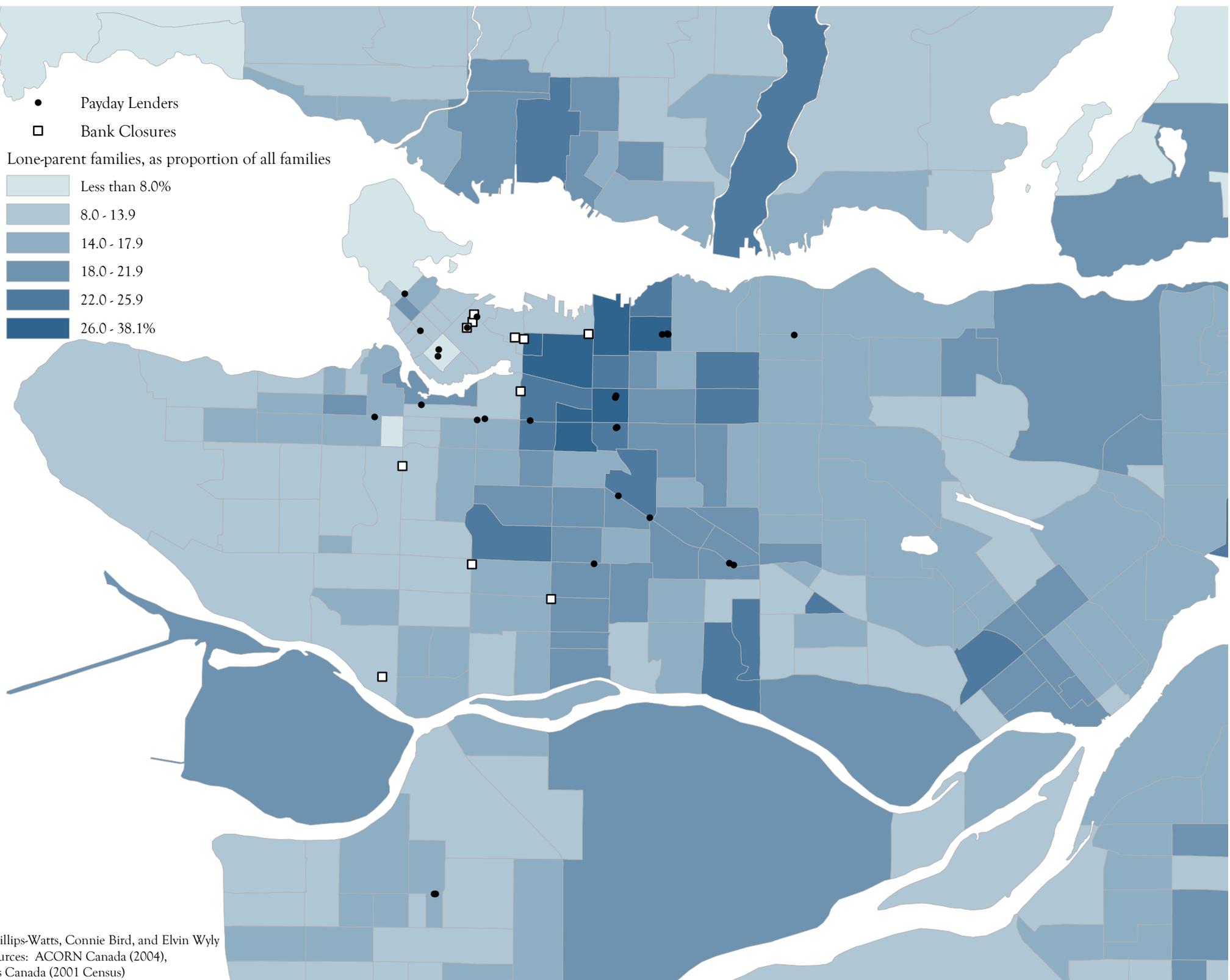


- Payday Lenders
- Bank Closures

Lone-parent families, as proportion of all families

- Less than 10.0%
- 10.0 - 14.9
- 15.0 - 19.9
- 20.0 - 24.9
- 25.0 - 29.9
- 30.0 - 49.6%

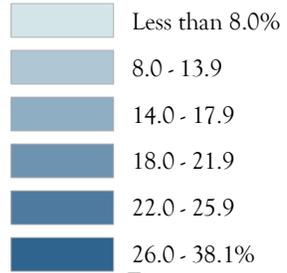
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Data Sources: ACORN Canada (2004),
Statistics Canada (2001 Census)

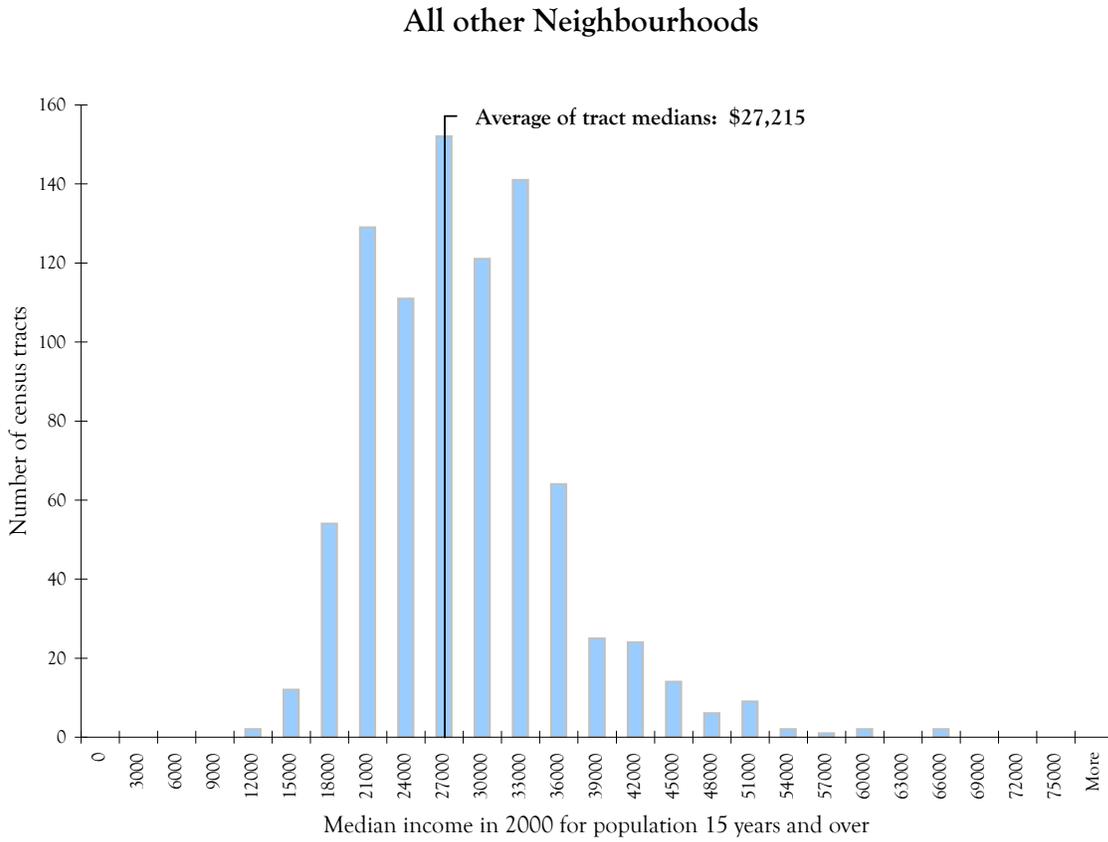
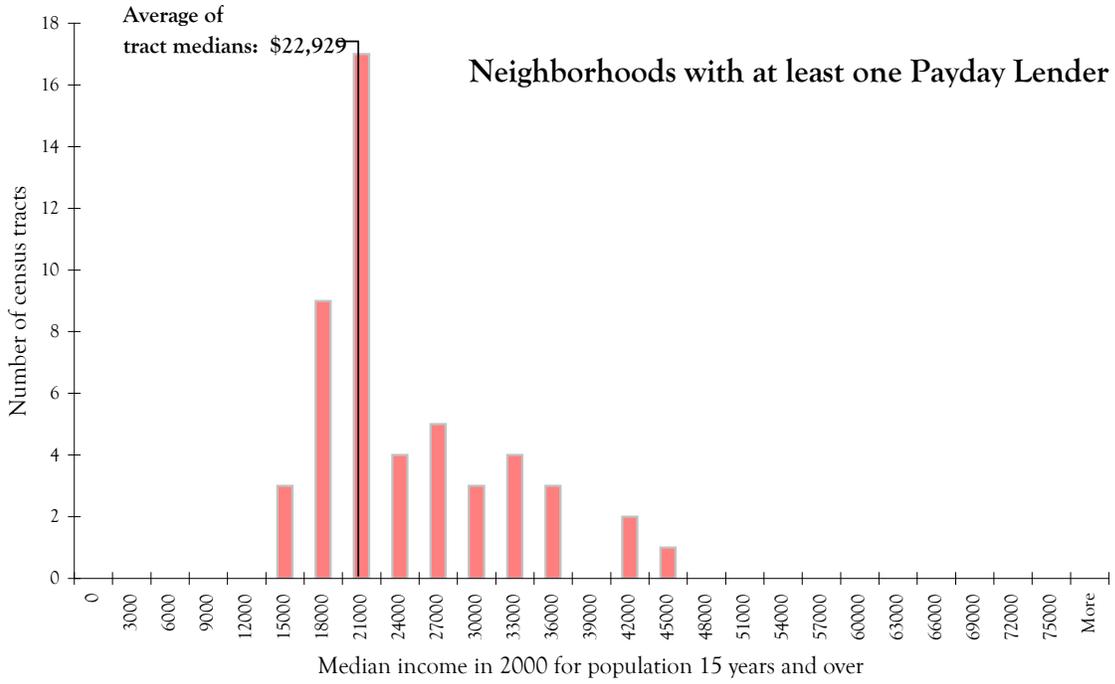


● Payday Lenders

□ Bank Closures

Lone-parent families, as proportion of all families





What Government Is and Isn't Doing

Sometimes we would fare better if our governments took more time in careful deliberation before determining a course on complex policy issues. But then there are those rare instances where the public policy choices and the opportunity for wise political leadership are obvious and sound when looked at through the public interest lens.

In meetings ACORN Canada has held with the British Columbia and Ontario Governments, it is clear that both civil servants and senior political advisers agree that the public policy and political case for moving swiftly and comprehensively on the payday lending issue is compelling.

And yet these same officials have a tendency to look distinctly uncomfortable when asked about the likelihood of imminent and comprehensive regulation of an illegal and unaccountable industry.

Challenging as it is to work with one government at a time to overcome bureaucratic inertia, it is even more daunting to move issues along at the intergovernmental level. But that is precisely where some significant part of the process governing discussions of payday lending now seems to awkwardly reside.

The Consumer Measures Committee (CMC) is chaired by the federal Industry Minister and includes all provincial and territorial consumer affairs ministers. The CMC meets periodically to discuss a wide range of consumer issues, including payday lending. This body last met in January 2004. At that meeting, the Ministers committed to another meeting this fall and they also committed to “establish a consumer protection framework” that would address payday lending.

In 2000, the CMC gave birth to the Alternative Consumer Credit Market (ACCM) working group to focus specifically on payday lending and associated issues like pawn transactions. Staffed by public servants from governments across Canada, the ACCM has not been able to drum up anything that looks like coherent, forceful ministerial action. In a paper produced by the working group in the fall of 2002, the ACCM made the following rather startling observation:

Enforcement [of section 347] difficulties include a lack of victims willing to aid prosecutions, a low level of harm done in relation to each individual ACCM loan, costly evidentiary requirements, and the uncommon requirement for specific Attorney General consent for actions (taken by some prosecutors to mean that this section is to be applied only in special circumstances).

This passage seems to suggest that law enforcement is predicated on some kind of critical mass of a visible, audible and litigious victim population. It also seems to suggest that annual effective interest rates not infrequently in the range of 1,000% aren't a matter of burning urgency. And judging by the pace with which the regulatory agenda has crawled along, it appears that governments and ministers responsible for consumer protection may agree with that assessment. As fall heads toward winter, the CMC has now indicated that it won't meet again until some unspecified time in the spring of 2005. And the “framework” for payday lending remains elusive.

Moreover, when the commitment was made to producing a framework, no words were publicly uttered about how that framework would be binding and enforceable or how it would deal with the very large elephant in the room; constant, repeated violation of the criminal code by every payday lender in the country.

While the CMC may well do good work on a range of issues, there is no reason for provincial governments to wait for it to move forward with regulation of the industry. The CMC has no jurisdictional powers and appears simply to be about information sharing and coordination. To date, it has exhibited neither appetite nor capacity to tackle difficult issues and drive them at either the federal or provincial level.

Given Ontario's economic powerhouse role, its large population and the McGuinty Government's public commitments to progressive policies, ACORN Canada believes that the province is well placed to lead the way and send a strong signal by implementing a comprehensive regulatory system.

The Regulatory Agenda

Many of ACORN's recommendations flow from the work of the Public Interest Advocacy Centre (PIAC) in Ottawa and, in particular, PIAC's November 2003 report, *Pragmatic Solutions to Payday Lending: Regulating Fringe Lending and "Alternative" Banking*.

Implementation of the full suite of policy mechanisms listed below would result in an effective and reliable regulatory structure that would provide strong consumer protection. Until a comprehensive regulatory structure is in place, governments must enforce the law on criminal interest rates and ensure that it applies fully to all small loans, including sham transactions used to cloak loans; loans made via the Internet and other distance selling technologies; and loans made in partnership with other financial institutions.

Interest Rate Caps:

This is clearly one of the most important issues in developing an effective regulatory structure.

No Rollovers, Extensions, Back-to-Back Loans:

As important as the interest rate cap, strict regulation of repeat payday loans is pivotal in preventing more and more Canadians from falling victim to the debt traps set by payday lenders.

- Rollovers to be prohibited
- Loan extensions (for a further fee) and back-to-back loans without a cooling off period also prohibited
- Cooling off period must be longer than one pay cycle
- Regular and aggressive prosecution of rollover violations
- Severe penalties for rollover violations with repeat offences leading to permanent license suspension

Ability to Repay:

Money Mart, the industry "leader", will lend borrowers up to 40% of net pay. Other payday lenders have no such qualms and will enter into loan transactions where borrowers have little to no ability to repay without resorting to ever more loans to pay off ever more loans.

- Limit on amount of loan to 25% of borrower's net income from next paycheck. However, this alone does not guarantee ability to repay. Regulators may wish to require that lenders base loans on a more comprehensive definition of ability to repay, which would include the other financial obligations and a credit check.

Licensing:

At present, anyone can enter the lucrative, unregulated payday loan industry in most of Canada. In preparing this report and, in particular, in mapping the locations of payday loan operations, it was evident that there is no clearinghouse for data.¹² Apart from the phonebook and the targeted Internet searches, the only comprehensive way to know who's doing what where is to walk the streets block by block. For a billion dollar industry, this is simply unacceptable.

¹² The industry lobby's one page, members only website is of no use in this regard.

By requiring payday lenders to license their operations, consumers will have confidence that the government is tracking the industry and granting/revoking licenses based in regulatory compliance.

- All lenders subject to mandatory licensing
- Fines, license refusal or revocation for failure to meet regulatory requirements
- Publication of complaints history
- Public disclosure of corporate structure and governance
- Regular detailed reporting of transactions to regulator

Regulator Powers:

Because provincial governments are responsible for consumer protection issues, the larger provinces with the biggest populations should have a regulator expressly focused on payday lending. Smaller provinces may wish to house this function in existing oversight bodies but, regardless of where the power is housed, it must be endowed with broad oversight and enforcement powers and resources.

- Jurisdiction over all payday lenders in province
- Prosecution of lenders not complying with registration requirements
- Management of 1-800 complaints line Complaint investigation and mediation
- Power to levy fines
- Require transaction data from lenders
- Educate borrowers about cost of credit
- Annual report on industry to Legislature

Cost of Credit Disclosure:

Many payday lenders do not provide documentation for loan transactions. Or they provide incomplete or misleading documentation. This must stop and standard, clear, multilingual documentation must be developed and approved by the regulator.

- All fees and charges detailed in contracts, advertising and promotional materials
- Loan application and agreement provided before completion of transaction
- Reference to complaints mechanism in documents
- No fees or charges to be excluded from definition or calculation of interest
- Annual percentage rate (APR) must be calculated on all loans and displayed on loan documentation
- Must show total cost of all fees and charges

Contract Based Not Cheque Based:

To better protect borrowers from potentially unscrupulous manipulation of their bank accounts, loan transactions should be conducted via written contract rather than post-dated cheque, present-day cheque held for future deposit, or electronic access to the borrower's bank account.

Limits on Specific Charges and Fees:

Some payday lenders charge outrageous rates for NSF fees far beyond any reasonable cost associated with collection. An industry standard needs to be developed geared to the real cost of administration or the fee charged to the lender by the bank that returns the check. Since the

lender isn't holding a check as security for the loan, this would apply to the check that a borrower would bring in or send to make payments.

- Electronic NSF charge collection limited to one attempt
- No default or delinquency charges
- Interest not to accrue after default
- No "broker" or "agency" fees permitted

Advertising:

- Must not be deceptive or misleading
- Must detail typical APR of standard loan amount for typical term in clear conspicuous type
- Must detail all applicable charges and fees

Education and Awareness Campaign:

Payday lenders should fund consumer borrowing education either through license fees or specific levies. Educational outreach efforts to be provided either by governments or third parties, not the industry.

Other Borrower Rights:

- Right of rescission immediately following a loan – close of business on the day following the loan as a minimum period
- Right of prepayment of loan at any time; payable in increments of \$5 or more without any penalty
- Prohibition of secondary marketing of information collected for loan transactions; distribution of information to third parties also prohibited

Collection and Litigation Limits:

Currently the industry often requires that borrowers waive their rights to legal action in the event of disputes. This infringement on consumer rights must end.

- Regulator administered tribunal or small claims court for borrowers to contest amounts illegally demanded by lenders
- No mandatory pre-dispute private arbitration clauses
- Private right of action, right to bring class action lawsuits
- No assignment of wages
- No security (cars, boats etc.) or contingent security such as holding bank cards, PINs etc.
- No personal guarantees from third parties
- No interest in land

Conclusion

Over the last several years, the payday lending industry has experienced explosive growth. That growth has taken place as the big banks have steadily pulled out of low and moderate-income communities across the country. The result appears to be that more and more Canadians are looking to unregulated payday lenders as their financial institutions of last resort. And the impacts have been disastrous for many.

With effective annual interest rates between 300%-900% (not infrequently in excess of 1,000%), payday loans have wreaked havoc in the lives of those who have become habitual borrowers as poignantly illustrated in both the Toronto Star series, *A Matter of Interest*, and in supporting materials to the pending class action lawsuits.

After years of study, government must act in the immediate future in order to protect Canadians from what is now an unaccountable and unethical industry. Whether Ontario is the first government to move off the dime or not doesn't ultimately matter. What does matter is that the political will is found, focused and manifested in effective regulation.

APPENDIX 1

What Is ACORN?

ACORN is the Association of Community Organizations for Reform Now. Incorporated as a nonprofit in the summer of 2004, ACORN Canada has offices in Toronto and Vancouver. ACORN Canada is a democratic, multicultural, grassroots organization with members electing local, provincial and national representatives to a Canadian Board of Directors. Members decide what issues to campaign on and how best to move campaigns forward to benefit ACORN Canada's members and the community at large.

ACORN is a new national nonprofit organization in Canada. It is also the largest low and moderate-income membership organization in the United States, with a thirty-four year history of winning power through campaigns, advocacy, action and negotiation.

With over 150,000 members in seventy-five cities in the U.S., ACORN is a powerful organization that commands the respect of governments, corporations and others. Our goal is to build an equally powerful organization in Canada so that the voices of low and moderate-income people can be joined together in building better lives for their families; families that are too often ignored or mistreated by governments at all levels and by corporations.

Believing that real power can only come from roots deeply planted in the communities where ACORN works, ACORN has developed a systematic, bottom-up approach to organizing at the neighbourhood level. Based on the experience gained from campaigning on local issues as small as a stop sign on the corner, ACORN groups have come together to win important victories on the critical issues of social and economic justice that affect the lives of low and moderate-income families every single day.

ACORN Canada will build on the strengths of its sister organization in the U.S. in targeting corporations that operate in both countries – often using unfair practices that exploit low and moderate-income families.

ACORN has developed expertise on a number of different fronts over many years:

- Negotiating community reinvestment agreements with major financial institutions including some of the United States' biggest banks. These agreements have brought billions of dollars of loans to low and moderate-income neighbourhoods.
- Organizing broad-based community and labour coalitions in support of a living wage. More than 100 cities have now passed living wage laws requiring employers that receive government contracts or subsidies to pay their employees at least enough to lift a family of four above the poverty level.
- Working to end the predatory lending practices of companies like H & R Block and their high-priced tax refund anticipation loans.
- Organizing those affected by “welfare reform” in demanding that workfare workers have the same rights as other workers as well as the childcare, transportation and job training necessary to make the transition to work.

- Fighting privatization in the public school system, winning equitable funding for lower income schools and smaller class sizes.

ACORN Canada brings an unquestioned commitment to working with low and moderate-income families in the ongoing struggle for social and economic justice.

KARP ACTUARIAL SERVICES LTD.

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www.karpactuarial.com

November 3, 2004

BY FAX AND MAIL (5 pages, including this page)

Mr. Christopher J. Foy
McGrady, Baugh & Whyte
Lawyers
400 - 2695 Granville Street
Vancouver, B.C. V6H 3H4
Fax (604) 734 - 7009

Dear Mr. Foy:

**Re: Payday Loan Transaction between Ms. Kathryn Colby and
National Money Mart Company September 27, 2004; Our File 2283ROI**

You act for the borrower, Ms. Kathryn Colby. Pursuant to your request, I have determined the effective annual rate of interest inherent in the transactions described below.

Transaction A

1. The lender pays to the borrower \$400.00 on September 27, 2004.
2. The borrower pays to the lender \$451.84 on October 15, 2004.

You indicated that the above represents the actual transaction which took place between the parties.

Transaction B

1. The lender pays to the borrower \$400.00 on September 27, 2004.
2. The borrower pays to the lender \$451.28 on October 14, 2004.

The \$451.28 is determined as the sum of the following amounts, calculated in accordance with the original contract between the parties, a copy of which you provided to me:

- i. \$400.00 principal amount.
- ii. \$ 8.64 interest.
- iii. \$ 9.99 item fee.
- iv. \$ 32.65 first party cashing fees equal to 7.99% of (i. plus ii.) ; i.e. 7.99% of (\$400.00 + \$8.64), equals 7.99% of \$408.64, equals \$32.65.

\$451.28 is the total of \$400.00, \$8.64, \$9.99, and \$32.65.

**RESULTS OF CALCULATIONS ; EFFECTIVE ANNUAL RATE OF INTEREST
INHERENT IN TRANSACTIONS DESCRIBED ABOVE**

I calculate that the effective annual rate of interest inherent in each of the above transactions is as follows:

Transaction A: **1,092%**
(one thousand and ninety - two percent)

Transaction B: **1,242%**
(one thousand, two hundred and forty - two percent)

EXPLANATION OF CALCULATION PROCESS

Transaction A

-The ratio of the amount repaid by the borrower (\$451.84) to the amount advanced by the lender (\$400.00) is 1.1296.

- The transaction spans 18 days. The ratio of the length of the year 2004 (366 days) to this 18 - day period is 20.3333.

- 1.1296 raised to the power 20.3333 is 11.92.

- The effective annual rate of interest inherent in the transaction is 11.92 minus 1, or 10.92, or 1,092%.

Transaction B

-The ratio of the amount repaid by the borrower (\$451.28) to the amount advanced by the lender (\$400.00) is 1.1282.

- The transaction spans 17 days. The ratio of the length of the year 2004 (366 days) to this 17 - day period is 21.5294.

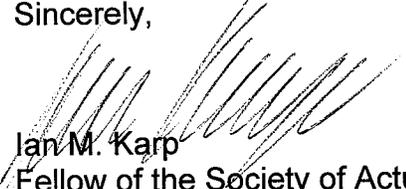
- 1.1282 raised to the power 21.5294 is 13.42.

- The effective annual rate of interest inherent in the transaction is 13.42 minus 1, or 12.42, or 1,242%.

CONCLUDING COMMENTS

This report has been prepared, and the results of calculations cited herein determined, according to generally accepted actuarial practices and principles. I, Ian M. Karp, am the person solely responsible for the content of this report. I am available to provide any clarification required concerning this report. I have attached an Actuarial Certificate. I enclose a summary of my experience and qualifications.

Sincerely,



Ian M. Karp

Fellow of the Society of Actuaries
Fellow, Canadian Institute of Actuaries

Enclosures: Actuarial certificate (page 4)
Summary of Ian Karp's experience and qualifications (1 page)

2283roi: 2145roi:

ACTUARIAL CERTIFICATE

**Re: Payday Loan Transaction between Ms. Kathryn Colby and
National Money Mart Company dated September 27, 2004; Our File 2283ROI**

I hereby certify that I have determined that the effective annual rate of interest inherent in each of the transactions described in my report of today's date is as follows:

Transaction A: **1,092%**
(one thousand and ninety - two percent)

Transaction B: **1,242%**
(one thousand, two hundred and forty - two percent)

I further certify that, in my opinion:

1. The above - described results are based on information supplied to me which was sufficient and reliable for purposes of my calculations.
2. The assumptions and methods applied are suitable for the purposes of such calculations.
3. Such calculations have been performed in accordance with generally accepted actuarial practices and principles.


Jan M. Karp
Fellow of the Society of Actuaries
Fellow, Canadian Institute of Actuaries

November 3, 2004

IAN M. KARP - SUMMARY OF EXPERIENCE AND QUALIFICATIONS

- Fellow of the Society of Actuaries (1979).
- Fellow of the Canadian Institute of Actuaries (1979).
- B.A. (Hons.) in Economics from the University of Manitoba (1975).

- 1976 - 1978 : actuarial student, Monarch Life Assurance Company.
- 1978 - 1979 : actuarial assistant, Paterson, Cook Ltd.
- 1979 - 1985 : consulting actuary, William M. Mercer Ltd., Peat Marwick.
- May, 1985 to present: president and consulting actuary, Karp Actuarial Services Ltd.

- Considerable experience of , and specialization in, actuarial work in connection with legal actions.

- Qualified as an expert in the Supreme Court of British Columbia ; oral testimony and written evidence submitted before the Supreme Court of British Columbia.

- Speaker / panelist re actuarial evidence work at various meetings of the Canadian Institute of Actuaries.

- Speaker / panelist re actuarial evidence work at various Continuing Legal Education courses.

- Past Chairperson (1998 - 2000) of Canadian Institute of Actuaries' Committee on Actuarial Evidence.

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