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Swimming with the sharks

Poverty, pandemics and payday lenders

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Swimming with the sharks

Poverty, pandemics and payday lenders

Introduction

A broad consensus exists on the harmful impact payday loans have on financially insecure individuals and families. In recent years, Canadian governments have enacted necessary but insufficient measures to protect consumers. The sharks are still circling, and COVID-19 is throwing thousands of people into the water every day, making them easy prey.

Canada's response to COVID-19 ought to include strict regulation on payday lenders. This is crucial in ensuring that families facing economic hardship don't fall into debt traps, and that public funds made available for income supports don't end up in the wrong hands.

The good news is that we know what needs to be done. There is a rich body of research on payday lending in Canada, conducted by a wide range of anti-poverty groups, faith-based and left-leaning think-tanks, municipal and federal governments, journalists and academics. This research has examined the practices of predatory payday lenders, as well as the characteristics and attitudes of payday loan users, and presented concrete ways to enhance consumer protection. This knowledge is more pertinent than ever.

This report assembles recent findings on this topic into one paper, and builds on it.

The first section answers the question, ***What is a payday loan and how much does it cost?*** It includes a chart comparing the cost of borrowing from payday lenders in each province with the average cost of using a line of credit, overdraft protection, or cash advance on credit cards. In some provinces, payday loans cost 20 times more than cash advances, which aren't cheap.

The second section addresses the question, ***What do we know about payday loan borrowers?*** It includes two parts: an original analysis of the types of households most likely to resort to payday loans, and a summary of three recent surveys that examine the attitudes and behaviours of payday loan users. While lone-parent tenant households are most likely to use payday loans, a growing share of insolvent, moderate-income households are taking loans of $2,500 and more.

The third section asks, ***What do we know about payday lenders?*** It discusses the geographically targeted proliferation of payday outlets, the expansion of online services and the profitability of all payday businesses. There are as many payday outlets in the country as there are Starbucks; which comes first depends on the neighbourhood you're in.

The final section tackles the question, ***How do we curb payday lending immediately?*** It looks at five types of regulations that have been implemented with this aim. And it argues that while it is important to make ads more transparent, loan rollovers more difficult, and stores less numerous, at a time of COVID-19, governments need to axe interest rates at once and require banks to offer adequate and inexpensive services to low-income households.

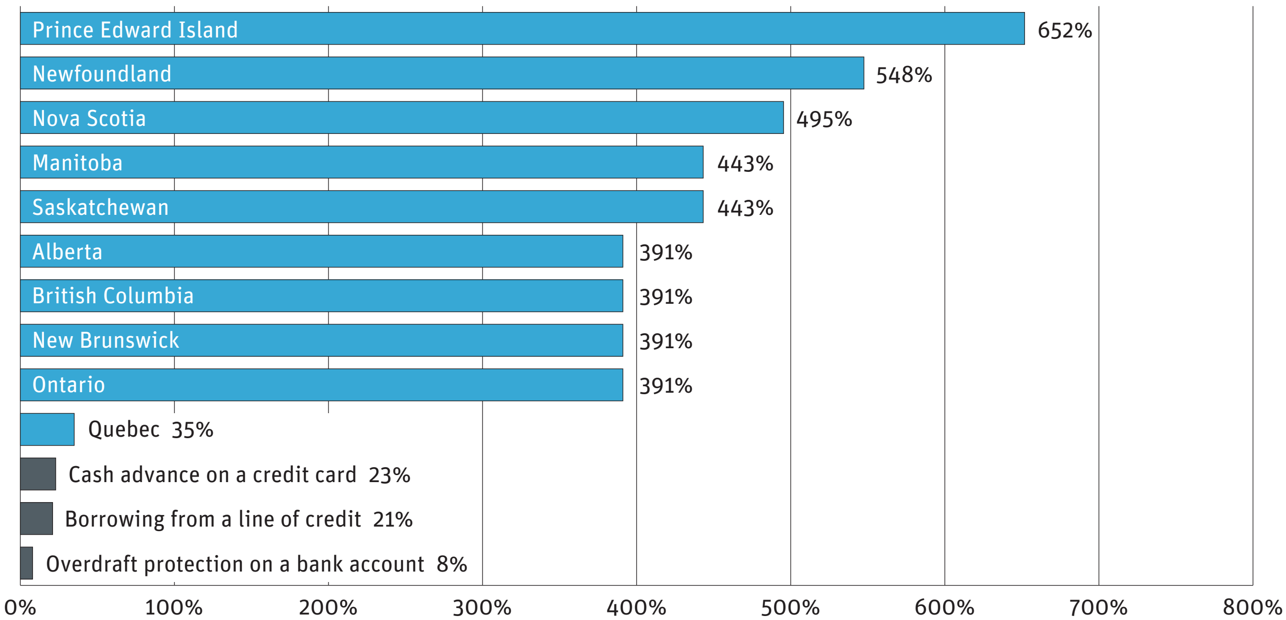
What is a payday loan and how much does it cost?

The Financial Consumer Agency of Canada (FCAC), the federal agency in charge of consumer protection, succinctly describes payday loans as:

> *a short-term loan that you promise to pay back from your next paycheque, usually within 14 days. Generally, you are able to borrow between 30 and 50 percent of your take-home pay. Payday loans are very expensive compared to other ways of borrowing money.* [1]

To get a loan, a borrower usually needs to provide lenders with proof of address and regular income and the details of a bank chequing account. The loan agreement authorizes the lender to draw the money directly from

FIGURE 1 Maximum interest rates on payday loans, by provice, compared to other credit products



Source Financial Consumer Agency of Canada, "Payday loans"; Newfoundland & Labrador Regulation 11/19; Office de la protection du consommateur (Québec); calculations by the author.

the borrower's bank account or deposit a postdated cheque provided as part of the application. Late payments are penalized with additional fees on top of recurring interest charges. In the case of bounced cheques, banks may charge additional fees. In the case of default, payday lenders may resort to suing the borrowers, seizing their property, and garnishing their wages.[2]

Traditionally, payday lenders have advertised loan costs as the total interest paid on a particular amount for a limited amount of time (usually 14 days), as in the widely seen ads that say "Get $300 for $20." (Recent changes to advertisement rules are discussed below.) The real cost of loans, however, is only visible when we calculate annual interest rates and compare them with other options, as in *Figure 1*.

The FCAC warns Canadians that, "If you can't make your payday loan payment on time, it can be easy to get stuck in a debt trap."

What do we know about payday loan borrowers?

Using Statistics Canada's most recent (2016) Survey of Financial Security (SFS),[3] this section describes the main characteristics of payday loan borrowers across the country. Next, it complements this information with findings from surveys that have looked at their attitudes and behaviours.

In 2016, the SFS estimated that in 3.4% (520,000) of all Canadian households, at least one family member had used a payday loan over the past three years. This figure varied from province to province, from 1.8% of households in Prince Edward Island and Quebec to 5.5% of households in Nova Scotia and Alberta.

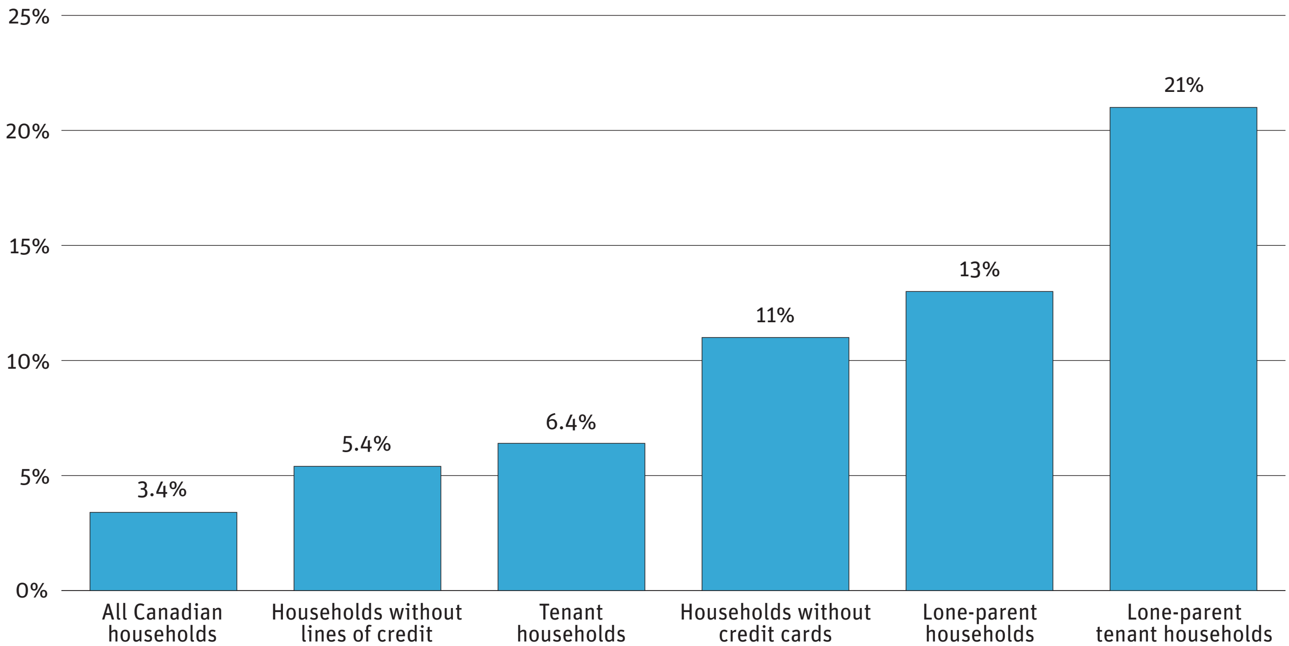
At first, these figures may look small, but that's because these services are targeted. The more economically vulnerable a family, the more likely it is to resort to payday loans.[4]

- Tenant households were four times more likely than home-owning households to use payday loans; 76% of all borrowers were tenants (against 38% of all households).
- Lone-parent households were almost four times more likely than two-parent households to use payday loans, with female-led households more at risk than male-led households.
- Lone-parent tenant households were six times more likely than the average household to use a payday loan (one in five had used them).
- Other family types[5] were 1.5 times more likely than the average household to use a payday loan, and three times more likely if they were tenants.

The FSF also provides valuable insight into the financial choices available to payday loan users.

- 80% of payday loan borrowers didn't have a line of credit, compared to 49% of households who didn't use these services.
- Households without a line of credit were almost four times more likely to use payday loans than households with lines of credit.
- 43% of payday loan borrowers didn't have credit cards, compared to 12% of the households that didn't use these services.
- Households without credit cards were five times more likely to use payday loans than households with credit cards.
- Nearly half (46%) of payday borrowers had been refused a credit card.

FIGURE 2 Share of households who borrowed from payday lenders



Source Statistics Canada, Survey of Financial Security: Public Use Microdata File, 2016; calculations by the author.

Many smaller surveys have looked beyond the demographic and financial characteristics of payday loan users, also focusing on their attitudes and behaviours. We briefly review the findings of three recent surveys, which were conducted by very different organizations.[6]

In the spring of 2016, the FCAC conducted a national survey with 1,500 payday loan users (random sample).[7] The survey found that:

- only 43% of respondents knew that a payday loan was more expensive than an outstanding balance or a cash advance on a credit card;
- 45% of respondents took a loan to pay for a necessary and unexpected expense (e.g., car repair), while 41% used it to pay for a necessary but expected expense (e.g., rent); and
- when asked why they used a payday lender instead of other financial institutions, 27% said a bank or credit union would not lend them money, 55% said payday lenders offered the best customer service, and 90% said payday lending was the fastest or most convenient option.

In 2016, ACORN, a national anti-poverty group, surveyed 286 of its members, 52% of whom had used financial services offered by payday lenders.[8] Among other things, the survey found that:

- 43% of respondents who used payday loans didn't have a line of credit, 45% didn't own credit cards, 45% didn't have overdraft protection, and 20% had a maxed-out credit card;
- 30% spend payday loans on food, 17% on housing, 16% on bills, 5% on "bank issues," and 5% on medical-related expenses;
- 60% reported they had a major bank branch less than five blocks away from home; and
- 73% said they would change banks if they knew of one that offered services targeted to low- and moderate-income earners.

Insolvency trustees Hoyes, Michalos & Associates Inc. conduct an annual survey of insolvent debtors that looks at payday loans. The 2019 analysis, which reviewed 5,800 personal insolvencies in Ontario within that year, shone a light on a different group of borrowers: those who had access to credit but, on their way to insolvency, used payday loans as a last resort.[9]

- Over time, insolvent debtors have become more likely to have taken out payday loans, from 12% in 2011 to 39% in 2019.
- The value of loans has also increased, with loans of $2,500 or more jumping from 1% of all loans in 2011 to 21% in 2019.
- In 2019, on average, insolvent debtors had outstanding loans with 3.6 different lenders. On average, only 20% had only one loan; 4% had at least 10 different lenders.
- Among debtors who filed for bankruptcy, those most likely to have used payday loans had a monthly income between $2,000 and $4,000.

Combined, these findings provide a sobering picture of payday loan borrowers. Households in economically vulnerable situations are much more likely than others to use these services, in part due to lack of options, in part lack of knowledge, but almost always out of extreme necessity. Payday lenders also extend high-interest loans to moderate-to-high earners on their way to insolvency. Overall, financial insecurity is the common feature of all payday loan users.

What do we know about payday lenders?

The Conference Board of Canada put the estimated number of licensed payday lenders in 2016 at 1,408,[10] or one payday lender for every four bank branches.[11] Toronto has one payday lender for every Tim Hortons.[12]

The first payday lenders appeared in the mid-1990s, initially as an additional service in stores that cashed cheques. But then small loans became the main service of these stores and the driving force behind their fast proliferation. The total number of outlets is believed to have peaked around 2011, possibly suggesting the market has reached a saturation point.[13]

A closer look, however, points to corporate consolidation, with fewer independent stores. Today, one chain (Money Mart) owns nearly half of the market, and the five largest chains own as much as 65% of it.[14] Corporate consolidation—and the economies of scale and higher profit margins it brings—suggest payday lenders are not planning to go anywhere. The sharks are getting bigger.

Traditionally, payday lenders cluster in low-income neighbourhoods, while mainstream bank branches relocate from poor to better-off neighbourhoods.[15] A 2015 *Toronto Star* data analysis mapped a clear overlap between the densest pockets of lenders and the city's low-income areas.[16] A similar analysis conducted by Momentum found the same in Calgary.[17] For ACORN, a key battleground in the Greater Toronto Area is Weston, a low-income neighbourhood where banks are being completely replaced by payday lending outlets.[18]

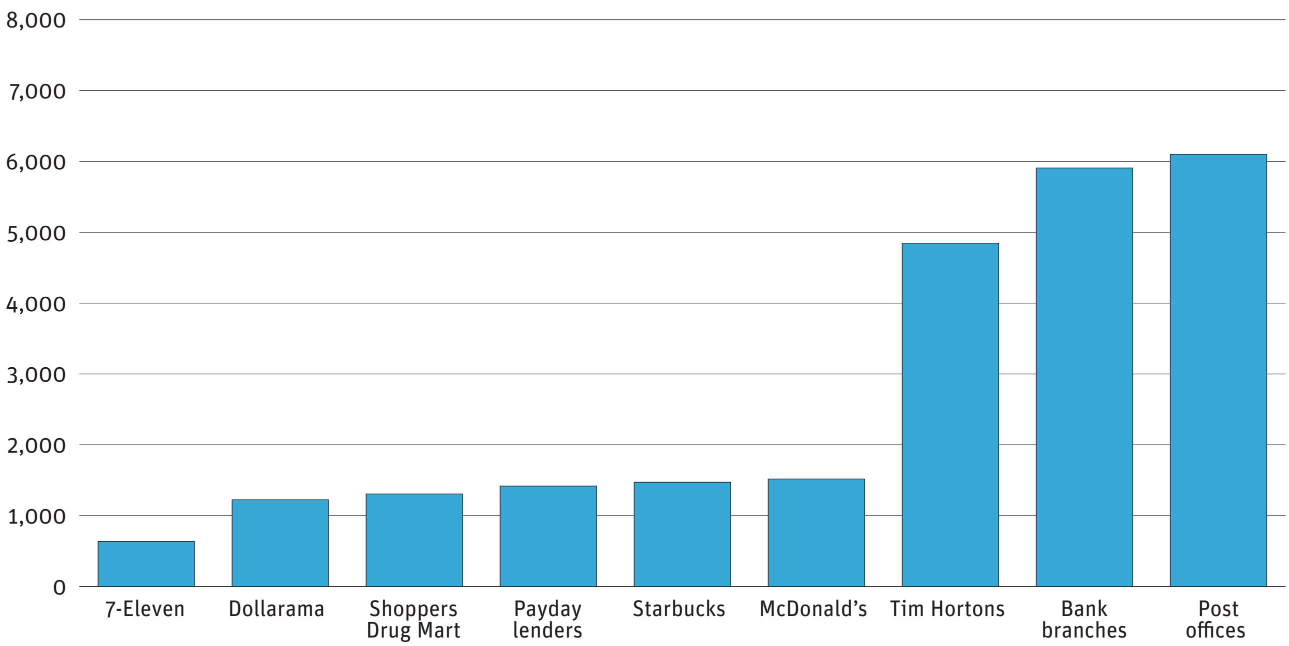
While low-income areas remain the geographical target of payday lenders, online services represent a growing share of payday loan transactions. The Conference Board of Canada shows that between 2010 and 2014, the value of loans advanced online grew by 49%, compared to a 15% growth in regular stores.

A survey conducted by the FCAC found that nearly 50% of users who took loans over $1,500 did so in an online platform. The prominence of online services has direct consequences for regulation, as it limits the impact of regulations aimed at controlling the proliferation of outlets, which has been the major focus of municipal governments (more on this below).

To sum up, payday lenders are everywhere, especially in low-income neighbourhoods and increasingly online.

Little attention has been paid to the profit margins of payday lenders, with the notable exception of economic analyses by Chris Robinson, of York University, whose work shows that lending rates could be significantly

FIGURE 3 Number of payday lender outlets in perspective



Source Various online sources for the years 2016 to 2019; for illustrative purposes only.

reduced without driving these firms out of business.[19] Robinson has also argued that corporate consolidation is driving fixed costs down and profits up, allowing lending rates to be capped at even lower levels without affecting the feasibility of these businesses.[20]

In turn, Jerry Buckland, of the University of Manitoba, contends that the profit margins of these firms are not so relevant. The broader context is that low-income people pay high fees for bad financial services, while middle-income people pay less for high quality services.

Exploitation, in this case, goes beyond the margin of profit of the lender; it has "more to do with the lack of general support from social and economic institutions and an absence of appropriate financial services from mainstream banks."[21] Fringe financial institutions are filling a void.

How do we curb payday lending immediately?

Regulations aimed at protecting payday loan borrowers fall into five large buckets listed below. They are all useful and complementary, but in the context of the financial insecurity brought by COVID-19, there is no time for policy tweaks. Governments must pull the big levers.

Advertising

Some jurisdictions (e.g., British Columbia) have passed legislation requiring ads to be less deceitful and include phrases like "Annual Percentage Rate= __%". These are positive changes, especially in light of the FCAC's findings about lack of knowledge among payday loans users. But such measures do not alter the need for such loans or the terms on which they are offered.

Number of outlets

Municipalities (including Hamilton and Toronto) have created caps on the number of payday business licences and minimum distance limits for new outlets. This is a clever use of municipal power and it may have a positive impact, especially on land use and development. But this change also doesn't alter the need for such loans nor their terms. The increased use of online platforms also limits its impact. And a possible unintended consequence is the creation of local oligopolies of existing outlets that no longer face growing competition.[22]

Rollovers

The Alberta government, among other jurisdictions, has tightened the rules about rollover loans and lending to borrowers who have outstanding loans. In practice, these measures have proved hard to implement, as borrowers simply walk to a different store. Central databases of borrowers would make such measures more effective, but at too great a cost to privacy.

Interest rates

In recent years, Alberta, Ontario, British Columbia and New Brunswick have approved a lower fee ceiling of $15 per $100 borrowed on a two-week loan. That's still a 391% annual interest rate. In Quebec, the annual interest cap on payday loans is 35%. There is no reason for this limit not be implemented nationally. There are many reasons to implement it now, including a skyrocketing unemployment rate and the fact that up to one-third of unemployed Canadians may not be eligible for employment insurance or the Canada Emergency Response Benefit.[23]

Access to banks

Financially insecure families need access to banks. The literature has emphasized access to credit unions as an alternative to payday lending. While that is not a bad option, these families should have access to all financial institutions. Canada's largest banks, which post extravagant profits year after year, should be required to have more and better products for low-income customers, including free overdraft protection, free financial advice, very-low-interest lines of credit, and very-low-interest credits cards. While it is encouraging that banks are willing to discuss mortgage deferrals and low-interest lines of credit, these are measures for their best clients, i.e., middle-class families, and won't improve conditions for low-income households.

For years, a consensus has been building on the need to regulate predatory financial practices further. The government response has been slow and timid. Now the time is up. There is blood in the water, and the sharks look hungrier than ever.

Notes

1 Financial Consumer Agency of Canada, “Payday Loans: An Expensive Way to Borrow,” September 2012. Retrieved from http://publications.gc.ca/collections/collection_2012/acfc-fcac/FC5-3-2012-eng.pdf

2 Ibid.

3 Statistics Canada has two surveys that ask respondents about payday loans: the Survey of Financial Security (SFS) and the Canadian Financial Capability Survey (CFCS). The most recent public use microdata file (PUMF) for the SFS is from 2016, whereas the CFCS PUMF is from 2014. Statistics Canada has published a report with the key findings of the 2019 CFCS, but it doesn’t contain information about payday loans.

4 The SFS doesn’t collect data on race, immigration status or gender identity, which prevents us from conducting a detailed intersectional analysis.

5 In this survey, Statistics Canada defines “other families” as “all other economic families where the major income recipient was aged 64 or under at the time of the interview and not included in the couples, couples with children, or lone-parent family types.”

6 A review of earlier surveys is found in Brian Dijkema and Rhys McKendry, “Banking on the Margins: Finding Ways to Build an Enabling Small-Dollar Credit Mart.” CARDUS. February 2016. Retrieved from https://www.cardus.ca/research/work-economics/reports/banking-on-the-margins/

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10 The Conference Board of Canada, “Filling the Gap: Canada’s Payday Lenders.” November 2016. Retrieved from https://canadiancfa.com/wp-content/uploads/2016/11/cboc-filling-the-gap_final-nov-2016.pdf

11 According to the Canadian Bankers Association, there were 6,190 bank branches in 2016 and 5,907 in 2017. Banks included: BMO, CIBC, Canadian Western Bank, HSBC, Laurentian Bank of Canada, National Bank of Canada, Royal Bank of Canada, Scotiabank, and TD. Retrieved from https://cba.ca/bank-branches-in-canada

12 There are 190 Tim Hortons outlets in Toronto and between 187 and 212 payday lender outlets.

13 Dijkema and McKendry, “Banking on the Margins.”

14 Jerry Buckland and Brenda S. Visano, “Introduction,” in Jerry Buckland, Chris Robison, and Brenda S. Visano (eds.), *Payday Lending in Canada in a Global Context: A Mature Industry with Chronic Challenges*. Springer, 2018.

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21 Jerry Buckland, *Hard Choices,* p. 143.

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