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Sent via email: consumerpolicy@ontario.ca

Payday Loan Cost of Borrowing Review
Consumer Policy and Liaison Branch
Ministry of Government and Consumer Services
5th Floor, 777 Bay Street, Toronto ON
M7A 2J3

RE: Potential Reductions in the Maximum Total Cost of Borrowing a Payday Loan

Dear Minister:

We are writing in response to your request for comments on potential reductions in the maximum total cost of borrowing a payday loan, and other suggested changes in proposed Bill 156. Hoyes, Michalos & Associates Inc. is a firm of Licensed Insolvency Trustees based in Ontario, and we have observed very directly the impact of payday loans on insolvent debtors.

While the cost of borrowing a payday loan is an issue, our data indicates that the cost of borrowing is a *symptom* of the problem, and not the actual problem faced by payday loan borrowers. The actual problem, and the reason borrowers resort to high interest short term loans, is that they are carrying significant debt. The real issue is high levels of consumer debt.

Based on a study of our clients, 18% of residents of Ontario who file a consumer proposal or personal bankruptcy have a payday loan, owing an average of $2,749 on an average of 3.5 payday loans at the time of their insolvency. These same individuals owed an average of $35,799 in other unsecured debt including credit card debt, bank loans, student debt and tax debts.

While the majority (63%) of these debtors have an average after tax monthly family income between $1,000 and $3,000, 27% of debtors with payday loans have income in excess of $3,000 per month. Our client study proves that payday loans are an issue for both lower and higher income households.

Our just completed Harris Poll survey of Ontario residents confirms our supposition from our internal data: customers of short term lenders already carry significant debt, often from traditional lenders, and appear to be using payday lenders to "top up" their borrowing needs.

Our new study shows that, for residents of Ontario:

- 83% of payday loan users had other outstanding loans at the time of their last payday loan;
- 72% of payday loan users explored a loan from another source at the time they took out a payday/short term loan;
- 48% of payday loan users agree they seek a short term/payday loan due to the amount of debt they carry;
- 46% of those who obtained a payday loan in the last 12 months agree that a short term/payday loan made it easier to keep up with their other debt servicing;
- More than half of payday loan users (55%) took out more than one loan in 12 months, and of those, 45% say their debt load increased post payday loan, with only 14% saying their debt load decreased.

Short term and payday loans may solve a short term cash flow crisis, but they are adding to the overall debt burden of payday loan users in Ontario and exacerbate their financial difficulties. While this study did not explore the interest rates on other debt, it would appear that borrowers are taking out high interest payday loans to assist with making other, presumably lower interest, debt payments.

This study also debunks the myth that the typical payday loan borrower turns to payday loans because they do not have access to traditional lending sources. Our payday loan survey indicates that the average unsecured debt owed by a borrower who obtained a payday loan in the last 12 months is $13,207, and for frequent users their total unsecured debt is $17,501.

Ontario payday loan users are borrowing from payday loan lenders not because they can't access any other credit, but because *they have exhausted all other options.* 73% of Ontario residents agree that payday/short term loans are a last resort for those who need them.

We are, therefore, of the opinion that the cost of borrowing does not have a significant impact on the borrower's decision to utilize the services of a short term lender. Whether the cost of the loan is $21 per $100 borrowed, or $19, or $15, lowering the cost of borrowing would not significantly influence the decision of the typical debtor we see, with one caveat: one-time promotional loans. When payday lenders offer a drastically reduced borrowing cost as an introductory incentive, they may cause some borrowers who are sensitive to interest rates to consider a short term loan.

We have reviewed various other possible changes to existing payday loan legislation in Ontario, including:

- Limiting loan sizes based on income; loans could be limited to a fixed percentage of the next paycheque (in Saskatchewan the limit is 50% of the next paycheque);
- A limit on the number of short term loans a borrower can obtain in a fixed period of time;

- An extension of the time permitted for repayment.

While these alternatives may ease the burden on borrowers, we view these approaches as treatments of the symptoms, not as a solution to the underlying problem. Limiting loan sizes may simply induce borrowers to deal with multiple lenders simultaneously (as observed in both of our studies). Limiting the number of loans may encourage borrowers to seek non-regulated alternatives, and extending the time for repayment may cause borrowers to be in debt for a longer period of time, actually increasing the overall cost of borrowing.

The underlying problem, based on our research, is excessive levels of consumer debt, and none of these solutions address this issue.

While we do not necessarily object to the previously noted solutions, we do recommend two simple changes that we believe will help debtors evaluate the true nature of their indebtedness and begin to address their overall level of debt: proper disclosure of the cost of borrowing, and enhanced credit bureau reporting.

Cost of Borrowing
Based on discussions with our clients, debtors do not fully understand the cost of payday borrowing. When compared to $100, a borrowing cost of $21 appears reasonable, because the borrowing cost is viewed in comparison to the loan value.

A more accurate and comparable metric would be to express the cost of borrowing using the same metric used by all other lenders: an annual interest rate. If a debtor borrows $100 for two weeks for $21, repays it and then continues to re-borrow the original $100 every two weeks for a year, the borrower will have paid, in a year, $21 x 26 = $546, so the annual interest rate is 546%. Compared to a high interest credit card at 29%, a payday loan is very expensive, a fact that would be better emphasized by *advertising* the true annual interest rate, and not simply disclosing it in the fine print of a loan document.

Credit Bureau Reporting
Based on a review of our client's credit bureau reports, most short term lenders do not report active payday loans to the credit reporting agencies. As a result, a short term lender is not aware of other short term loans that may be outstanding, or may not recognize a pattern of repeated short term borrowing. This may be to the detriment of the lender in terms of added loan losses.

The absence of credit bureau reporting is also harmful for the debtor. If a debtor has insufficient credit capacity to warrant even a high cost payday loan, being denied credit may speed up the time in which they take action to deal with their underlying problem – too much debt. It would also help the debtor who does borrow and repay their short term loan as agreed to have this information appear in their credit report as it should have a positive impact on their credit score. An improved credit score may allow borrowers to eventually obtain credit at traditional financial institutions, and at a more reasonable cost.

Recommendations

While we have no specific objections to other changes, based on our research we recommend three changes to enhance consumer protection in Ontario:

1. A requirement to advertise the annual percentage rate cost of borrowing;
2. A requirement to report all short term loans to the credit reporting agencies; and
3. A prohibition against 'introductory rates' for payday lenders.

We thank you for considering these suggestions, and would be pleased to provide additional supporting documentation and testimony as required.

Yours truly,

Hoyes, Michalos & Associates Inc.
Licensed Insolvency Trustees

Per: J. Douglas Hoyes, CA, CPA, CBV, LIT   Ted Michalos, CA, CPA, LIT