Short-term Loans with Long-term Consequences:
An analysis of payday loan policy for British Columbia

by

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Abstract

Payday lending has grown in popularity among British Columbians. It remains an expensive form of consumer credit, which can lead borrowers into a cycle of debt. Alarmingly, the majority of people who access payday loans are borrowing repeatedly to meet financial shortfalls and not enough has been done to ensure these consumers are protected. This capstone seeks to explore various ways of reducing repeat payday loan use and improve borrower outcomes. The topic is explored by compiling relevant literature, speaking with experts, and examining the policy actions of three distinct jurisdictions. The advantages and disadvantages of four policy options are assessed relative to a set of criteria. The proposed solution is for the government to promote more affordable credit alternatives and stringently regulate licensed payday lenders.

Keywords: Payday loans; payday lending; short-term credit; small-dollar loans; consumer debt

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Executive Summary

Too many British Columbians rely on payday loans to meet their basic expenses. High fees and chronic borrowing lead users into a harmful cycle of debt (Ernst, Farris, & King, 2004). This study focuses on the implications of chronic borrowing on British Columbians. The underlying assumption is that reductions in repeat payday loan use, or the burdensome elements of the payday loan product itself, leads to improved financial standing and reduced harms to British Columbians. Based on British Columbia's maximum payday loan fee ($23 per $100 borrowed, over a term of 10 to 14 days), the simple uncompounded APR is approximately equal to 600% to 840% – and much higher when accounting for compounding. For comparison, credit cards offered by CIBC range from 13.99% to 19.99% APR on standard purchases (CIBC, 2016). Regrettably, payday lenders disclose the price in fee-per-$100-borrowed, which continues to impact consumer perception of borrowing costs.

A review of the literature and interviews with experts reveals that there are several recurring themes surrounding the payday loan issue. Firstly, the popularity and growth of payday loans shows that demand for short-term consumer credit exists but may not be accessible through more affordable avenues. Therefore, access to better credit options and the means to make informed decisions are essential to improving the outcomes of payday loan borrowers. A focus on financial literacy education and the promotion of credit alternatives will help achieve this goal. Secondly, borrowers face multiple cognitive biases, which prevent them from making optimal choices. These biases are difficult to overcome without regulatory intervention. As well, many consumers have a poor understanding of the true cost of payday loans. More accurate disclosure of fees allows the consumer to weigh the relative cost of payday loans against other similar financial services. Finally, a fundamental theme throughout discussions related to payday loans is an uncertainty regarding the cost of providing a loan. I rely on a number of studies and public consultations on the matter to identify the lowest fee that can be charged before it becomes unprofitable for a payday loan company to offer its

product. The lowest acceptable fee rate is near $15-$17 per $100 borrowed, but more data is required to accurately fix a maximum rate.

Three cases are investigated where policy actions were taken to thwart the harms of repeat payday loan use. The jurisdictions considered were: British Columbia, Colorado, and Washington. Focusing on approaches taken in these jurisdictions and observing the impact on the payday loan industry and borrowing behaviour helps in understanding how market forces respond to policy changes. For instance, Colorado enacted an instalment plan, which extended the payday loan term to 6 months or longer. This action substantially reduced the burden of repayment by spreading the cost over time. Nevertheless, the unintended consequence was a decrease in payday loan supply that left many borrowers with less access to credit and large outstanding debt from their previous borrowing activities. Overall, the case analysis revealed that, comparatively, British Columbia has ineffectually protected consumers from the harms of payday loans.

After compiling data from the literature, expert interviews, and case analysis, I identify several objectives, criteria and measures for an evaluation of four distinct policy options aimed at addressing chronic payday loan borrowing. The objectives are:

- Efficiency: reducing the cost and frequency of borrowing for as many borrowers as possible
- Development: improving access to alternative credit
- Stakeholder Acceptance: attaining support for the policy response
- Administrative Ease: Considering the number of processes introduced through the implementation of each option

The four policy options measured are:

1. Promoting credit alternatives through government funding and collaboration
2. Enacting a mandatory instalment plan for all payday loans
3. Reducing the fee cap to 17% and the maximum amount borrowed to 30% of the borrower's net monthly pay
4. Developing a financial literacy fund by levying a fee on licensed lenders and improving cost information disclosure.

Each option is ranked against the societal and governmental objectives listed before recommending a policy approach for the government to adopt. The policy chosen is to promote credit alternatives and enact a mandatory instalment plan. These two policy options are considered critical to transitioning repeat payday loan users away from their dependency. They are also the most amenable options to existing stakeholders and administrative processes. By pursuing these options and future iterations, the government will be taking steps to eventually eliminate the viability of payday loans as a form of short-term consumer credit

Along with the final recommendation, it is strongly encouraged that the government pursue better information collection and a more transparent governance structure. Regardless of the decision taken in regard to reducing the use and harms of payday loans, the implementation of a transactional database would significantly enhance the regulatory mechanisms in place and support knowledge-driven decision-making.

Chapter 1. Introduction

The rise of payday loan borrowing has been a contentious issue, with Canadian provinces and American states taking steps to reduce or prohibit the predatory elements of the industry. However, many of these changes were made without appropriately considering the outcomes to industry and to borrowers. This study seeks to explore the issues surrounding payday loan use and the various policy responses aimed at reducing the accompanying harms. My research contends that too many British Columbians rely on payday loans to meet their basic expenses. High fees and chronic borrowing lead users into a harmful cycle of debt (Ernst, Farris, & King, 2004). In order for these individuals to be better off, they must transition away from payday loan use.

1.1. What is a payday loan?

A payday loan is a small-sum short-term form of consumer credit. Payday lenders will typically offer the unsecured loan for a term equal to the length of the consumer's pay period (10 to 14 days or longer) and charge them a fee based on the amount borrowed. For approval, borrowers are required to provide proof of "regular income, a permanent address and an active bank account" (FCAC, 2012, p. 2). Based on the information provided, the lender and borrower will come to an agreement on the loan terms and fees.

The agreement states that the loan must be paid back on or before the due date. Yet, in most jurisdictions, if the borrower is unable to repay the loan on time, they face additional fees and remediation measures. The Criminal Code of Canada limits the loan amount to the lesser of $1500 or 50% of the borrower's biweekly income (Bill C-26, 2007, p.3), and BC legislation imposes a dollar cap on the fee charged for each loan.

The cap has recently changed from 23% to 17% of the loan principal (Public Safety & Solicitor General, 2016). Even with this reduction, the maximum fee remains high relative to the cost of other forms of credit, like credit cards, lines of credit, and overdraft services.

1.2. Scope & Purpose

This study focuses primarily on the payday loan industry in British Columbia, with implications for similar regions. Approaches from other jurisdictions are explored to understand the impact of policy responses on the payday loan industry and on borrowing behaviour. Specifically, the research focuses on chronic rather than occasional borrowing. The underlying assumption is that reductions in repeat payday loan use, or the burdensome elements of the payday loan product itself, leads to improved financial standing and reduced harm to British Columbians. It is important to acknowledge that payday loans offer a product that is in high demand, and in some cases, consumers are unaware of, or unable to access, alternative forms of short-term credit. The research objective is to find policy options that can improve the wellbeing of British Columbians within the context of this high-cost credit market.

1.3. Research Questions

The following research questions are inferred from an initial review of the literature. They help to refine the policy problem and guide subsequent sections of my research.

- Why do so many people turn to payday loans when they are an expensive form of borrowing?
- What are the harms of borrowing and how have policy actions been effective in reducing these harms?
- What are some of the challenges policy makers face in implementing effective change?
- What credit alternatives exist, and are they viable substitutes for payday loans?

Chapter 2. Background

In 1980, the federal government amended the Criminal Code of Canada, making it illegal for anyone to charge more than 60% annual interest on a loan of any size and for any term. This was a usury law meant to protect consumers. In doing so, they repealed the Small Loans Act, which had been the primary legislative provision for provincially and federally incorporated small-dollar lenders. In other words, the federal government repealed the laws that sanctioned the licensing and regulation of loans for $1500 or less (Letwin, 1967).

After the 1980 amendment, when payday loans arose as a form of short-term consumer credit, it was unclear whether their fees should be considered interest and remain subject to usury law. In 2006, the Supreme Court of British Columbia helped settle this ambiguity by determining that the fees charged by a major lender in the region (Ok Payday Loans Inc.) constituted interest, and that many of the actions taken to procure these loans were unconscionable practices (Kilroy v. A OK Payday Loans Inc., 2006). This decision, along with the growth of the industry and mounting public concern, highlighted the need for a policy response to ensure consumers remained protected from unscrupulous and exploitative practices. In 2007, section 347.1 of the Criminal Code of Canada, which dealt with interest rates on loans, was amended to include a definition of payday loans and to set some basic rules. The amendment bill (Bill C-26) added to the criminal code that, in order to be excused from usury law, the loan must be for $1,500 or less, the term of the agreement must last 62 days or less, and the lender must be "licensed by the province to enter into the agreement" (Bill C-26, 2007, p.3).

The payday loan product was offered to Canadians notwithstanding the interest provisions in the criminal code, so amending the code was a way of legalizing existing market practices. It allowed the federal government to avoid enforcing the criminal code provisions (industry advocate, personal communication, February 7th, 2017). Essentially, to permit small-size short-term loans, certain concessions were made: so long as the province provided the appropriate legislative framework for the industry to be regulated, payday loans could be offered with fees in excess of the usury rate of interest set by the Criminal Code of Canada. From this point on, provinces were responsible for the administration and regulation of the payday loan industry, and soon after they began developing payday loan legislation.

Why did Canada amend the Criminal Code instead of upholding and enforcing the existing criminal rate of interest? Primarily, the payday loan business model, in one form or another, had existed for several years. It was a successful and growing industry that met a demand for short-term credit. As stated at the time, “proponents point to the growth of payday loan companies as evidence that the industry is fulfilling an unmet need for short-term credit and/or convenience” (Parliament of Canada, 2006, p.1). Unfortunately, thorough and impartial assessments of the short-term credit market were sparse at the time, and there was an imperative to find a solution (Public Utilities Board of Manitoba, 2008, p. 61). By establishing parameters under which the payday loan industry can operate, the federal government chose to balance the supposed need for these products with the responsibility to ensure consumer and public interests remained protected.

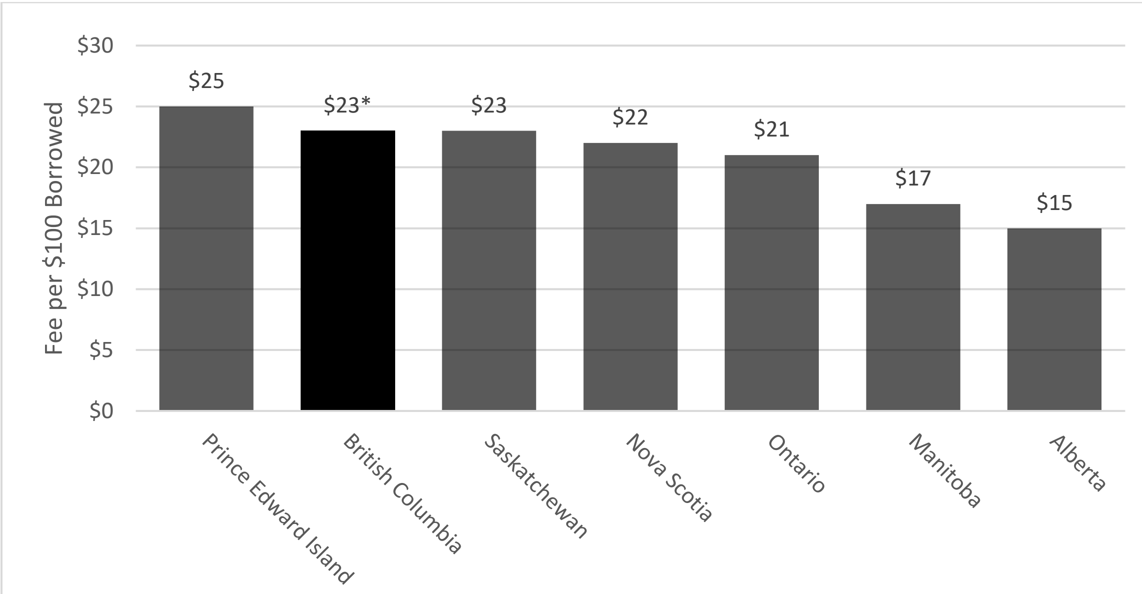
Why did they choose to delegate responsibility to the provinces? Minister of Justice and Attorney General of Canada, Vic Toews, who sponsored the criminal code amendment bill, stated that the change was “enabling the regulation of an industry which, for better or for worse, has come to occupy a very real place in Canadian cities and towns” (Toews, 2007, par. 2). However, Toews and the governing conservative party argued that the provinces and territories had constitutional authority over property and civil rights, and would be most suited to deal with payday loans in their respective communities (Toews, 2007).

2.1. Legislative and Regulatory Framework

Bill C-26 left many aspects of payday loan regulation up to the discretion of the provinces. In subsequent years, provinces began enacting legislation and developing regulations to capture payday lending practices. Typically, these laws were developed with the help of stakeholder and expert consultations, and administered through the provincial consumer protection branch. In some cases, jurisdictions did not integrate payday loan regulation into their consumer protection regime. For instance, Newfoundland & Labrador and the Territories have been reluctant to enact payday loan legislation. On the other hand, Quebec has outright banned payday loans from charging rates at or above 35% annually. This annual interest rate cap makes payday lending an unprofitable venture (Momentum, 2014, p. 8-9). Quebec has removed the viability of a payday loan market, whereas Newfoundland & Labrador has chosen not to prosecute payday lenders, essentially allowing the lenders to exist outside the parameters of federal law until payday loan legislation is developed (Antle, 2013).

Because the responsibility to regulate payday lending was transferred to the provinces, there are marked differences in each jurisdiction's regulatory approach. The figure below shows the range of fee limits across the country.

Figure 1: Payday Loan Fee Caps by Province (2016)



Note. Data for Alberta from Bill 15: An Act to End Predatory Lending (2016.), for B.C. from Business Practices and Consumer Protection Act: Payday Loans Regulation (2009), for Manitoba from The Consumer Protection Act: Payday Loans Regulation (2015, sec.137-138), for Nova Scotia from Access Nova Scotia (2015), for Ontario from the Payday Loans Act (2008, C.9), for P.E.I. from Payday Loans Act: Regulations (2015, Sec. P-2.1), and for Saskatchewan from the Financial and Consumer Affairs Authority (n.d.)

Note II. British Columbia's fee is now $17 per $100 borrowed or 17% of principal, and some other jurisdictions are pursuing similar reductions

To add to the complexity, payday loan rules and regulations in all jurisdictions extend beyond fee caps to include the designated activities and terms of the license, as well as various prohibitive practices. All of these elements are meant to protect consumers and ensure compliance amongst licensed lenders.

Recently, some provinces chose to take additional steps aimed at improving consumer protection. For example, Alberta's new bill, *the Act to End Predatory Lending*, altered the repayment of payday loans so that borrowers can pay back their outstanding debt in instalments (Bill 15, 2016). Additionally, Ontario's legislation includes an education fund[1] targeted at improving the financial literacy of borrowers (Payday Loans Act, 2008). These are only some of the examples of numerous actions taken to reduce the harms associated with habitual payday loan borrowing.

2.2. Consumer Profile

People turn to payday loans for a variety of reasons, but several common characteristics influence consumer demand. DFC Global Corporation, one of the largest global payday loan companies, created the acronym A.L.I.C.E. to describe the target demographic for their product. A.L.I.C.E. stands for **A**sset-**L**imited, **I**ncome-**C**onstrained, and **E**mployed (Wells, 2016). Individuals who fall into this category are ideal clients for several reasons: they lack better credit alternatives, they are underserved by mainstream financial services, and they have an immediate need for cash unmet by their employment income or savings. Unsurprisingly, the target consumer described by industry closely resembles the empirical evidence on payday loan borrowers. This section will examine this evidence in order to develop a better understanding of the typical consumer.

2.2.1. Income and Savings

Based on study findings, payday loan borrowers are generally between 25 and 54 years old, low-to-medium income-earners, and have moderate levels of education

[1] Ontario Payday Lending Education Fund was recommended by a panel and put into law, but has not been realized to date.

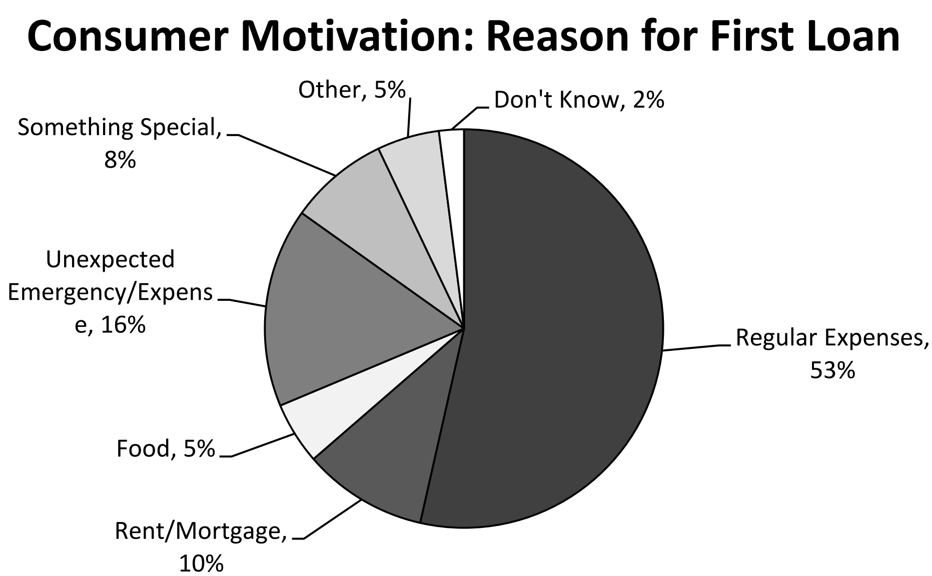
(FCAC, 2016; Simpson & Islam, n.d.). While most users are earning relatively low incomes compared to the average Canadian, they are not society's most destitute. In fact, to be eligible for a payday loan, customers must be employed or have a steady source of income. Results from the Canadian Financial Capability Survey (CFCS) found that respondents were more likely to use a payday loan in the past 12 months if they fell into the low-to-medium income categories rather than the very low-income category. However, of those surveyed by the FCAC, 20% had incomes exceeding $80,000. These findings suggest that, while low earners are likely to borrow, they are not the sole users of payday loans. Moreover, although an important factor, income is not the best determinant of payday loan use.

An analysis of Statistics Canada data found that an individual's level of savings and access to credit were stronger predictors of their likelihood to borrow. More precisely, a lack of financial substitutes makes some individuals more susceptible to payday loan use than others. The study states, "[individuals] that had been refused a credit card were 3.6 times more likely to have used a payday loan even after controlling for other factors such as income and savings" (Dijkema, B., & McKendry, 2016, p.20). Generally, payday loan borrowers have significantly lower access to credit cards than the general Canadian population. They also rent rather than own their home, with low-income homeowners less prone to usage than higher-income renters (Pew Charitable Trusts, 2012). In other words, payday loan users consistently fit the category of asset limited and income constrained, with income in this case referring to disposable income.

2.2.2. Attitudes and Behaviour

The precarious financial situation of payday loan users becomes more apparent when we consider *why* they borrow. A survey of payday loan users in British Columbia found that customers were turning to payday loans primarily to meet basic needs due to cash shortfalls (Environics, 2013). Figure 2 2 and 3 highlight the motivations and appeal of payday loans. It is especially worrying that only 16% of those borrowing are doing so because of an unexpected emergency expense (see: Figure 2 2), which suggests that for many people the shortfall is associated with their poor financial situation. For instance, a Pew Trust research study found that a majority of borrowers (58%) regularly have trouble paying bills (The Pew Charitable Trust, 2013, p. 9). Another study noted, “survey respondents from across the demographic spectrum clearly indicate that they are using the loans to deal with regular, ongoing living expenses” (The Pew Charitable Trust, 2012, p. 7). In fact, if they were to lose their main source of income, most users would only last 3 months or less before they would need to borrow or change their living situation (FCAC, 2016).

Figure 2: Payday Loan Survey Results



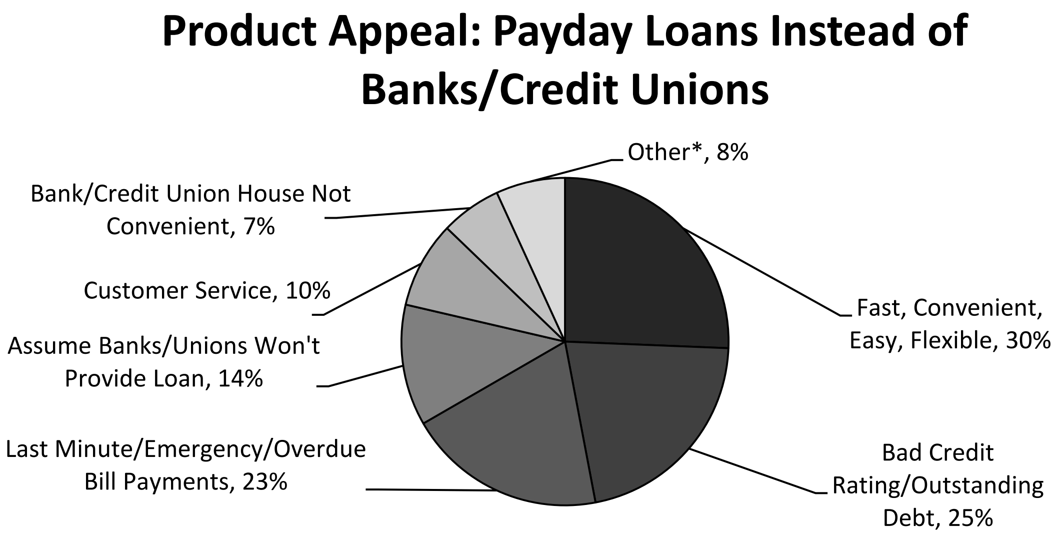
Source: Pew Charitable Trusts (2014). Payday Lending in America: Who Borrows, Where They Borrow, and Why. Safe Small Dollar Loans Research Project.

Unfortunately, for some borrowers the fear of incurring charges for non-payment of bills, outstanding debt, and bounced checks suggests that payday loans might be the lesser of two evils. These revelations regarding consumer motivations, and the numerous studies that have revealed a high frequency of repeat and back-to-back borrowing, challenge the position argued by the Canadian Consumer Finance Association (CCFA)[2]. The CCFA states that "[p]ayday loans are specifically designed to help customers with one-off, unanticipated expenses" and that "payday loans are not a form of 'revolving' credit designed to keep customers in a permanent debt position" (Canadian Payday Loan Association, n.d.). Yet the evidence simply does not support that narrative.

Figure 3 frames the motivations for borrowing in terms of the appeal of payday loans. We can see that the main appeal of payday loans is the ease and convenience of the service. Consumers turn to payday lenders because they do not check credit scores. More recent research into borrower motivations mirrors these findings (March, Dildar, & Janzen, 2010). Interestingly, an ACORN Canada (2005) survey found that users would switch to a bank or credit union if they offered a comparable product. Unfortunately, there are few incentives for mainstream financial institutions to offer similar products at lower fees, given the high default rates. In some cases, it is simply a matter of perception; the borrower believes that the bank or credit union won't provide them with a loan, and so, they do not consider approaching their local bank or credit union for help.

[2] The Canadian Consumer Finance Association (CCFA) is the primary industry association for Canadian payday loan companies. They advocate for their members, which include all the major lending companies in Canada.

Figure 3: Payday Loan Survey Results

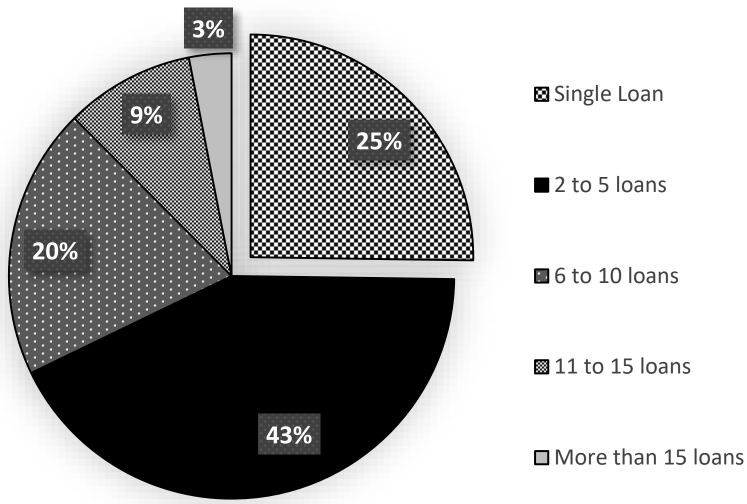


**Note: "Other" includes "Relative Promixity of Stores" (5%), "Dislike/Distrust Banks" (2%), & "Send Money / Δ Currency (1%)"*
Source: ACORN Canada (2005). Survey of Payday Loan Users in Toronto and Vancouver.

2.3. Payday Loan Impacts on Consumers

According to the CCFA the intended purpose of payday loans is "… to solve temporary cash-flow problems by bridging the gap between paydays" (Canadian Payday Loan Association, n.d.). However, many users have come to rely on frequent borrowing and developed a costly dependency. Several studies have found that the majority of payday loan clients are habitual borrowers. In fact, less than a quarter of borrowers take out a single loan in a year (FCAC, 2016, p.9). Figure 4 displays the composition of payday loan borrowing in British Columbia based on aggregate data provided to the regulator by licensed lenders. Quite evidently, payday loans are rarely a one-off product.

Figure 4: Composition of Borrowing British Columbia 2015



Source: Industry Aggregate Data Report 2015 (n.d.). Consumer Protection BC.

The main concern with repeated borrowing is that consumers develop a dependency that is "injurious to [their] financial health … and a contributor to economic lives being kept outside the much lower-cost financial mainstream" (Public Utilities Board of Manitoba, 2008, p.9). Of the individuals that filed for bankruptcy in Ontario during 2015, 2 in 10 had taken out at least one payday loan and the average payday loan debt was $2,749, or 113% of their monthly take-home pay (Hoyes & Michalos, 2015). These findings suggest that the fees imposed are leading to severe debt for borrowers.

2.3.1. Payday Loan Fees (Cost of Borrowing)

To understand the concerns regarding repeat use, we need to examine the cost of borrowing. Lenders typically state their fees in the "fee-per-$100-borrowed" format (e.g. $17 per $100 borrowed), and charge fees near the maximum allowable by law. For example, British Columbia requires that loan fees not exceed $23 per $100 borrowed (to be reduced to $17 per $100 borrowed in 2017), and data shows that lenders in BC consistently charge a little over $21 per $100 borrowed (Industry Aggregate Data Report 2015, Consumer Protection BC, n.d.). It should be noted that there are considerable limitations in displaying the cost in this forma, or as a simple interest rate (e.g. 17% of principal), since neither method considers the length of time a loan is held. Lenders prefer these methods of displaying fees because it understates the total cost of borrowing.

The conventional measure, annual percentage rate, is the standard method of disclosing costs in the United States (Wood, 2015). Having a standard disclosure makes it easier for consumer to compare a number of credit options and make informed decisions. For this reason, the legislation in British Columbia requires that lenders prominently display their fee in annual percentage rates (APR) (Statute of British Columbia, 2009, s.13). If we consider British Columbia's maximum payday loan fee ($23 per $100 borrowed, over a term of 10 to 14 days), the simple uncompounded APR is approximately equal to 600% to 840% – and much higher when accounting for compounding[1]. For comparison, credit cards offered by CIBC range from 13.99% to 19.99% APR on standard purchases (CIBC, 2016). Regrettably, even with the APR requirement, payday lenders can disclose the price in fee-per-$100-borrowed as well, which continues to impact consumer perception of borrowing costs.

Not only is the fee a concern, but if a borrower is unable to pay back the loan on time, they will face additional interest charges from the lender and potential penalties from their bank. According to BC law, the lender can charge "interest at a rate of 30% per annum on the outstanding principal" and "a one time fee of $20 for a dishonoured cheque or a dishonoured pre-authorized debit" (BPCP: Payday Loan Regulation, 2009;

[1] APR Calculation 1: $23/$100 = 0.23. APR = 0.23 X (365.25 days / 14 days) = 5.99 x 100 = 599%

APR Calculation 2: APR = 0.23 X (365.25 days / 10 days) = 8.40 x 100 = 840%

Sec. 17). Currently, bank fees for insufficient funds are approximately $45 per infraction.[2] Similarly, when a client has access to an overdraft, they incur penalties for being overdrawn on their account. The payday loan is issued to the consumer under the condition that the lender can withdraw the funds directly from the borrowers bank account after they receive their pay, so the borrower risks having their accounts overdrawn if they do not have money available in their account at the payday loan due date. In other words, the borrower will bear the cost of both the fee from the payday lender AND the bank charge for a dishonoured cheque.

2.3.2. Beyond Payday Loan Fees

A major concern with payday loan indebtedness is the associated harms to the livelihood of borrowers. Household debt is associated with poor psychological health. What is sometimes referred to as the "psychological cost of debt" – the impact of debt on a person's psychological wellbeing – can lead to additional physical and mental health issues. As stated by Sweet et al. (2014, p.2) "several empirical studies have found that financial strains…are strong predictors of depression, general psychological distress, mental disorders, and suicidal ideation and behavior." Payday loans can create or exacerbate indebtedness, with negative impacts on a borrower's psychological wellbeing. More importantly, "unsecured debt, as measured by outstanding (non-mortgage) credit, has a greater negative influence on psychological wellbeing than secured (mortgage) debt" (Brown, Taylor, & Wheatley Price, 2005, p. 659).

Most jurisdictions have explicitly outlined the actions lenders can take to recoup the loan principal from a delinquent borrower. They specify when and how to contact the borrower, their family or employer, and what actions can or cannot be taken to collect

[2] NSF fees based on online advertised rates of major Canadian banks

outstanding debts. Even with these regulations in place, an individual who is unable to pay back a loan risks harassment from debt collectors and the possibility of their borrowing habits being revealed to those in their social and work circle. Dealing with debt collectors, especially third-party companies, is a notoriously stressful process. The situation is made worse if the borrower is unaware of their rights, or if the debt is reported to a national credit bureau. Compounding the cost of borrowing is the fact that poor borrowing habits can hurt one's credit score, yet responsible payday borrowing does not lead to a better credit score since payday lenders are not members of the main credit-reporting agencies (FCAC, 2012).

More importantly, high-cost credit exacerbates income inequities. The large debt-service burden assumed by payday loan borrowers leads to increased economic hardships. For low-income households, "loan access increases households' difficulty in paying mortgage, rent and utilities bills" (Melzner, 2011, p. 550) and it also "increase[s] the likelihood of delaying needed medical care, dental care and prescription drug purchases" (Melzner, 2011, p. 519). Thus, the longstanding trope that payday loans are relieving consumers from unexpected expenses is problematic. Analysis of demographic data exposes the myth that predominantly middle class borrowers are accessing payday loans to meet unforeseen expenses (Martin & Longa, 2012).

Overall, the costs of payday loan borrowing and the risks of delinquency are quite high. Payday loans are far more expensive than other forms of credit (FCAC, 2016). Nonetheless, when a borrower is unable to pay their basic expenses, facing penalties for unpaid bills, and is desperately in need of credit, payday loans can be the best alternative at that moment. In addition, consumers may perceive a payday loan to be the least costly and most appealing option. As Dijkema and McKendry's analysis suggests, "those who are most likely to use payday loans are young families with few assets, limited savings, and constrained in their options for credit" (p.23).

2.4. Industry Profile

An industry incented to target a specific subpopulation based on their vulnerable financial standing is concerning. To understand the context within which consumers find themselves in a cycle of debt, we need to consider the lenders and the practices that have been infamously labelled “predatory” in nature. As we have seen, the payday loan industry is successful because it meets a need that is unmet elsewhere. Lenders offer a product that is convenient, easy to access, and underserved in mainstream financial markets. Moreover, the lending model is discreet, and the money is obtained by the borrower with few barriers.

Payday loan products are often categorized with other subprime/alternative financial services like cheque-cashing services, prepaid credit cards, rent-to-buy credit, and automobile or pawn loans. Available public data on subprime industries are difficult to come by; however a 2014 affidavit to the Ontario Supreme Court estimated that there are between 1.8 to 2.5 million payday loan consumers in Canada, with an annual loan volume of $2.5 billion (Affidavit of Steven Carlstrom, 2014). Of all jurisdictions in Canada, British Columbia has the highest rate of payday loan borrowing per capita and the fastest industry growth. In 2014, 5.56% of British Columbians accessed at least one payday loan. Between 2012 and 2014, the BC payday loan industry grew by 58 per cent (Vancity, 2016, p. 3). These figures suggest that the industry has thrived under provincial regulation.

2.4.1. Market Characteristics

Some experts have contended that the market is saturated and growth has recently stagnated (Affidavit of Steven Carlstrom, 2014; Dijkema & McKendry, 2016; Robinson, 2016). Aggregate data collected from licensed lenders in British Columbia (2012 to 2015) suggests that the payday loan industry may be reaching maturity, but it is unclear whether there has, or will be, a decline in borrowing (Aggregated industry data, Consumer Protection BC, n.d.). Furthermore, the industry consolidated, with several large lenders increasing their market share (Dijkema & McKendry, 2016, p.26; Robinson, 2016, p.6). Currently, the five largest firms – Money Mart, Cash Money, Cash4You, Cash Canada, and Speedy Cash – account for nearly two thirds of all licensed outlets, and an even higher portion of the overall sales volume (Robinson, 2016).

We can attribute market consolidation to the implementation of more restrictive regulatory environments, where firms are able to navigate tighter restrictions on their lending practices by streamlining their operations. As explained by Dr. Robinson in Manitoba's regulatory review:

> "[t]he opportunity for easy profits with high prices has vanished and efficiency becomes essential for survival. The large chains have economies of scale in their advertising, oversight and systems that keep their costs per loan lower than independent stores, and hence the largest chains are expanding while the smaller players are disappearing." (The Public Utilities Board of Manitoba, 2013, p. 49)

Buckland (2016) suggests that costs are reduced when lenders develop economies of scope (an increase in the number of services offered in addition to payday loans) and economies of scale (an increase in the volume of payday loans). He also observes that payday lenders have experienced corporatization – a consolidation process where smaller firms join together in order to take advantage of economies of scope and scale[3]. In fact, Money Mart echoed this point in the recent Manitoba payday loan public hearing and consultation in stating that lowering the fee cap would force firms to consolidate (Public Utilities Board of Manitoba, 2016, p.29). Additionally, Robinson's economic analysis of the payday loan industry found that "total growth has slowed in recent years and is being consolidated in the largest chain" (2016, p.5).

[3] Buckland's use of term "corporatization" varies from traditional use, which refers to the process of transitioning a government-controlled enterprise into a private firm. Nevertheless, the term can also refer to something taking the form of a large corporation.

2.4.2. Firm Characteristics

Nonetheless, even with improved market efficiency, the industry relies on a narrow range of products and a retail-branch business model, which carries high operating costs. Payday lenders do not offer a variety of products nor do they retain ongoing investments like most deposit-taking financial institution. Even in cases where they offer multiple services, lenders heavily rely on the revenue from payday loans (Dijkema & McKendry, 2016). There are two business models: Direct Lending, where the payday loan firm raises the capital to be lent out and for storefront operations, and Brokering, where the payday loan firm acts as an intermediary between a third party lender and the borrower. The broker model is less cost efficient since the payday loan company charges an intermediary fee (Manitoba Public Utilities Board, 2008). Regardless of the lending operations, the retail model requires high operating expenses and services very few consumers on a narrow range of products. Meaning, there is a limit to how effective firms can become at reducing costs.

Payday lending proponents argue that, in order to remain profitable, firms must charge high fees and encourage repeat borrowing. As stated in one study, the "financial performance of the payday loan industry … is significantly enhanced by the successful conversion of more and more occasional users into chronic borrowers" (Stegman & Faris, 2003, p.8). The costs involved with processing a loan for a first-time customer are much higher than for a repeat customer (Ernst & Young, 2004, p.7). Repeat borrowers are the ideal candidates for payday lenders; they do not require new application processing and have a lower risk of default. However, the issue of repeat borrowing is a key concern for policy makers when considering the harms of payday loan use. The use of expensive credit can further exacerbate the exact problems that drew consumers to the product. As we have observed, habitual lending can lead to severe indebtedness and have unintended consequences to a borrower's health, employment and welfare.

2.4.3. Unlicensed Lenders

Beyond the broad concerns about payday lending practices, there is growing unease over online unlicensed lenders and other high-cost sources of credit that fall beyond the scope of the regulated industry. As stated in Ontario's panel report (2014), "Strengthening Ontario's Payday Loans Act", "[o]nce a product is beyond the scope of the payday loan legislation, protections in the legislation are not available to consumer" (p. 15). The existence of these other products poses a challenge to regulator(s) and leaves borrowers vulnerable to additional risks such as high costs, privacy concerns, and extortive or predatory practices. Regional government representatives interviewed for this study alluded to a concern that overregulating and limiting the supply of payday loans will turn borrowers to more expensive, unregulated forms of borrowing (personal communication, January 12th, 2017). The fear that people will turn to more risky forms of borrowing in the absence of a balanced regulatory regime is echoed by industry advocates, and in some of the literature, as cause for less stringent regulation.

Licensed lenders are overwhelmingly compliant with fee disclosure requirements, whereas unlicensed lenders are rarely compliant (Consumer Council of Canada, 2015). The existence of unlicensed and risky lenders remains a major challenge in policy aimed at restricting high cost credit. However, a lack of substantive evidence suggests that borrowers will turn to more harmful forms of borrowing in the absence of payday loans. Without proof that consumers will turn to unlicensed and unregulated payday loan borrowing, this study simply acknowledges the existence of these concerns but does not attempt to measure their harms in any meaningful way.

Chapter 3. Methodology

This study makes use of several forms of qualitative analysis: an exhaustive literature review, nine expert interviews, and a 3-jursidiction case study analysis. This section provides a brief overview of each method and why they were chosen. The overall objective was to consider methods that were appropriate in answering the main policy problem.

3.1. Literature Review

The literature review serves to frame the problem, provide background information, and highlight relevant studies. It also helps in the development of the research questions that guide the study. Several elements of the payday loan industry are identified in the literature, which are then further explored in the expert interviews and case study examination.

3.2. Expert Interviews

In-depth interviews with experts who have extensive knowledge of the payday loan industry were conducted to reveal pertinent issues not readily available in the literature and to confirm the direction of the research. A semi-structured method was implemented because it offers the ability to explore ideas and probe the interviewee on specific issues. Through informal discussions, the interviewee can offer freely formed opinion, unconstrained from a rigid set of questions. Nevertheless, the interview questions and subject matter were guided by the study's main research questions. Because the topic is nuanced and payday loan operations are quite opaque, reliance on these interviews helps fill the gaps between what is known and what actually occurs in the market. Reference to the interview content appears throughout this study.

3.3. Case Study Analysis

Case studies offer a deeper examination of the policy problem while considering contextual conditions. By comparing various formulations of payday loan policies, I am able to observe outcomes of policy responses across jurisdictions. The cases selected offer measurable results from policy actions taken to protect consumers from certain payday lending practices.

3.4. Limitations

Payday lending is a relatively new phenomenon. A major limitation to my research is the lack of outcome evaluation for recent policy implementation. Many policy changes have occurred that have the potential to improve borrower outcomes, but without meaningful data on outcomes, they cannot be included here. For example, several jurisdictions have incorporated regulatory devices to reduce payday loan dependence or improve financial literacy. However, in many cases, not enough time has passed to accurately assess the impact of these changes on consumer borrowing. This is as much a limitation to my research as it is an obstacle for policy makers.

A problematic element of the data collected in the case analysis is that it is often self-reported by lenders, and therefore, less reliable than independently collected data. The data also do not account for borrowers who target multiple lenders, so the number of loans obtained by the average consumer could be even higher than reported. As Chessin's 2005 empirical analysis suggests, "[…] data collection and analysis so far does not entail a cross-referencing of consumers between or among several payday lenders" (p.411). Consequently, the data used in this study is only a modest estimate of borrower behaviour.

With more time and resources, I would have tested consumer receptiveness to each policy recommendation using multiple focus groups or a questionnaire survey, and then incorporated their responses in my evaluation of the policy options. Nevertheless, I am able to infer general feasibility of the policy options through other means. A wealth of research studies have investigated payday loan consumer attitudes, behaviour and demographics; these are incorporated throughout my study and help to reveal pertinent consumer characteristics. Unfortunately, scant data have been collected on how borrowing behaviour responds to changes in the market, and in the few cases where governments collect such data, as in Ontario, they are restricted from public access.

Chapter 4. Key Findings: Literature Review and Expert Interviews

Several key factors discovered in the literature and interviews noticeably affect consumer borrowing. These themes continuously arise in discussions related to reducing the harms associated with payday loan use and improving borrower outcomes. Each of these factors is discussed in further detail in this section. All of the themes highlighted below are especially beneficial for policy makers to consider when responding to the growth of payday lending.

4.1. Access to Credit & Financial Literacy

The first theme is access to credit. The popularity and growth of payday loans shows that demand for short-term consumer credit exists, but may not be accessible through other avenues. So, where this demand remains unmet by mainstream financial institutions, payday loans have filled the gap. Unfortunately, payday loans do not help a borrower build their credit nor do they help the borrower access less costly alternatives. Additionally, the knowledge of a borrower's payday loan use can act as a barrier to access to mainstream forms of credit (regional government representative, personal communications, December 30, 2016). The Public Utilities Board of Manitoba suspects that "taking out … a payday loan, if it becomes known to a bank or credit union, may actually dissuade mainstream lenders from lending to the borrower" (Public Utilities Board of Manitoba, 2008, p. 5). Generally, the ability to build one's credit score relates to their ability to gain access to more affordable forms of credit. Overall, a major challenge faced by policy makers is that payday loan use meets a consumer demand while simultaneously diverting consumers away from more affordable alternatives.

To ensure payday loan users can overcome their dependency, consumers must understand the costs of borrowing and have the means to make informed decisions. Sound decision-making requires financial literacy, which is typically measured through survey questionnaires and assessments. For instance, one measure is “consumer understanding of financial concepts and ability to correctly interpret financial data” (Gathergood, 2012, p. 590). Another measure is “the knowledge, skills, and confidence a person needs in order to make responsible financial decisions” (Hui et al. 2016, p. 3). The capacity to make informed decisions is heavily reliant on a consumer having the means to navigate and interpret complicated concepts, especially when it relates to sophisticated financial decisions. Yet, the use of alternative financial services (what were earlier labelled “subprime financial service/products”) is negatively correlated with financial literacy (Hui et al. 2016). Improved knowledge and confidence leads to better money and debt management, which in turn means consumers are better prepared for cash shortfalls and less reliant on payday loans. “[Payday loan borrowers] are younger and likely less financially literate than non-users” (Public Utilities Board of Manitoba, 2016, p. 41), which means there is scope for programs aimed at ameliorating literacy and weaning users off costly short-term credit products.

4.2. Credit Alternatives

Much of the literature and expert interviews recommended the expansion of affordable credit alternatives. Here are several existing alternatives identified:

- **Vancity’s Fair and Fast Loan**
  (Vancity, n.d.; Refresh Financial, 2015)
    - Standard loan product
    - 19% APR,
    - $100 to $2,500 principal loan
    - 2 to 24-month term
    - Eligibility:
        - Vancity membership
        - Requires client consultation session
        - Additional screening required

- **Momentum & First Calgary Financials' Micro-Loan Product**
  (First Calgary Financial, n.d.; Refresh Financial, 2015)
    - Collaboration
    - 12% APR
    - $500 to $1500 principal loan
    - 6 to 18-month term
    - Eligibility:
        - Enrolled in Debt Repayment Plan, including the Orderly Payment of Debt (OPD) program
        - Has an undischarged bankruptcy or is under a Consumer Proposal
        - Additional screening required
- **Causeway Work Centre's Micro-loan Product**
  (Causeway representative, personal communication, February 21, 2017)
    - Collaboration with private donor & credit union
    - Max. 8.7% APR
    - Loan size based on assessment of need
    - 12 to 24-month term
    - Eligibility:
        - Membership with a partner credit union
        - case-by-case assessment by Causeway employee
- **Desjardins' Mutual Aid Fund**
  (Union des Consommateurs, 2009)
    - Network of Financial institutions (Fédération des caisses Desjardins)
    - Incorporates consumer education, budgeting and financial literacy funding
    - APR varies, but falls below the usury limit (60%) or the Quebec limit (36%)
    - $500 to $2000 principal loan
    - Max 24-month term
    - Eligibility
        - Caisse membership
        - Assessment of repayment capability met
        - Additional requirements must be met

All of the alternatives listed above offer more affordable fees and better terms than payday loans. They also include repayment plans, and work closely with clients to develop better financial planning. In my interviews, several of these organizations emphasized asset-building and long-term consumer success as their primary objective (community lending representatives, personal communication, January 16, January 27, & January 31, 2017). Through these products, the individual is able to develop better borrowing habits and improve their credit standing. The downside is that these institutions have more exhaustive eligibility criteria than payday loan companies. Normally, the applicant must become a member and meet with staff for an individualized assessment before gaining access to credit. This dissuades individuals who enjoy the discretion afforded by payday loans. Nevertheless, these organizations typically rely on a holistic assessment of a consumer's ability to repay the loan beyond their credit rating, which allows them to capture many payday loan users with poor credit and limited options.

4.3. Market Failure: Bounded Rationality

Implicit in the public policy concern over payday loans is a framework regarding consumer choice. A large body of work in behavioral economics and law focuses on consumers' failure to make rational decisions regarding their credit use. The empirically verified hypothesis is that consumers, when facing complex financial considerations beyond their comprehension, with limited time and information, will rely on heuristics to govern their choices. These are mental shortcuts that help simplify and hasten the decision process. Regrettably, these shortcuts can cause the individual to take actions counter to their intended goal.

In the case of payday loans, many users turn to the product despite the existence of better alternatives. In such instances, the consumer is making a suboptimal choice partially as a result of cognitive biases – systematic errors in judgment that deviate an individual from rational thinking. These deviations can occur at any point in the decision-making process and run counter to an individual's best interests. The main biases discussed in relation to payday loans are over-optimism/overconfidence, and time-inconsistent preferences.

Firstly, consumers can exhibit overconfidence in their perceived financial knowledge. A recent study found that individuals with relatively low objective knowledge and high subjective knowledge (i.e. overconfidence) are more likely to use alternative financial services (Robb et al., 2015). In such a case, the borrower's knowledge deficiency creates a situation where they perceive an ability to repay the loan even though their actual ability to repay is much lower. This optimism bias can also manifest in an unrealistic expectation of future hardship (Francis, 2009). The consumer will perceive no obstacles to paying back their future debt obligations, when in reality they face many unknowns.

Similarly, some users are unable to moderate their borrowing behaviour due to a lack of self-control. As stated in a study on borrowing behaviour, "individuals with self-control problems make disproportionate use of quick-access credit products which facilitate impulse-driven purchases" (Gathergood, 2012 p. 591). Self-control problems are closely tied to impulsiveness and myopic thinking. One theory is that consumers are tempted by the design of payday loans to take actions that conflict with their long-term interests. For example, the consumer may turn to payday loan services under the assumption it is a one-time occurrence even though they are likely to borrow again. Their false sense of security and misperception of the product leads them into a dependency (Francis, 2009).

Finally, consumers will make present-day decisions at the expense of their future wellbeing. Several studies have found that consumers affected by time preference bias are more likely to borrow high cost credit. Most of these studies focus on credit card use, but the same fundamental argument can be made for payday loans. Meier & Spenger (2010) found that consumers demonstrating present-bias have significantly higher credit card debt than the typical borrower. Similarly, "consumers will both underestimate and heavily discount the total cost of the payday loan" (Francis, 2009, p. 631). This intertemporal inconsistency, coupled with over-optimism and a misunderstanding of risk, can lead a consumer to make an irrational decision regarding payday loan use.

A key assumption in neoclassical economic theory holds that consumers will make choices that maximize their utility. In the case of the credit market, this entails assessing the short-term and long-term consequences of borrowing, comparing products against a set of identified criteria, and then choosing the product that optimizes benefits over costs. Yet, as we have seen, payday loan borrowers are attracted to the product despite the relatively high cost and risks to their long-term financial wellbeing. If we agree with the arguments put forward by behavioural economics, what can be done to curtail poor borrowing behaviour?

From a policy perspective, it is unclear how to help consumers overcome these biases since they are interwoven in the human psyche. If the goal of the regulator is to mitigate harm to the consumer, one solution is to restrict them from making poor choices. However, a common argument against heavily restrictive policy focuses on an individual's right to self-determination and freedom from intervention. One ethical theorist argues that a paternalistic approach to policy is justified if individuals are acting irrationally and making misinformed decisions (Dworkin, 2017). Furthermore, libertarian paternalism contends, "it is permissible for the government to intervene in ways to retain freedom of choice but help consumers to act according to their 'real' or 'deep' preferences" (Tokeley, n.d., para. 33). This suggests that consumers can be nudged rather than coerced into better behaviour.

In the case of payday loan use, we know that repeat borrowing represents unsustainable behaviour and a major public concern. Therefore, decision makers are justified in protecting consumers on their behalf: whether that protection comes in the form of heavily prescriptive policy (e.g. outright ban) or more lenient policy (e.g. reduced cost, size, or frequency of borrowing) will be discussed in later sections. This study acknowledges that consumers are failing to act in their best own best interest and that policy interventions are justified.

4.4. Information Disclosure

Another major theme in the literature and interviews is the manner in which payday loan companies disclose the cost of borrowing. Most consumers do not accurately understand the costs they are facing. Users surveyed by FCAC dramatically underestimated the cost of payday loan borrowing, with a finding that "fewer than half of respondents understood that a payday loan is more expensive than an outstanding balance or cash advance on a credit card" (FCAC, 2016, p.5). One reason for the misperception of cost is that the APR and fee-per-$100 borrowed are inadequate formats of displaying the true cost of borrowing. Bertrand and Morse (2011) conducted a field experiment to determine how various ways of presenting payday loan cost-related information can influence borrowing behavior. They used three information treatments:

(1) Direct comparison: displaying the APR for payday loans in contrast with the APR for other forms of credit (rather than in isolation)

(2) Adding-up approach: showing the accumulated fees for an outstanding loan of $300 for varying term lengths (2 weeks, 1 month, 2 months, 3 months), comparing these costs with accumulated fees for credit cards

(3) Displaying the typical repayment profile of a payday loan borrower. For example, "2 ½ people will pay it back without renewing, 2 people will renew 1 or 2 times, [etc.]". (Bertrand & Morse, 2011, p.40)

- Additionally, a self-control treatment was introduced, where borrowers had access to a savings planner tool.

When all groups were compared, the second group (dollar adding-up treatment) was the least likely to borrow after the treatment. As well, each information treatment had a significant impact on a person's likelihood to borrow, whereas the savings planner had no effect on borrowing behavior. In other words, information disclosure methods that attempt to reduce information-related cognitive biases and limitations have an influence on an individual's borrowing decision. Moreover, the most significant difference in borrowing behavior is found in low-to-medium income earners with less than a completed college degree.

The empirical findings of this study reveal a measurable impact of information disclosure on borrowing behavior. And, while it might appear as though divulging the fees charged in the APR format is helpful, there are more effective ways of displaying information that overcome cognitive biases. In particular, providing information on total fees that will be incurred over time resonates the most with borrowers. We conclude that improvements in the disclosure of payday loan costs can help consumers overcome innumeracy issues and understand the harms of repeat borrowing.

4.5. Payday Loan Ban and Alternative Financial Service

As we have briefly mentioned in the section 4.3, a common manner of dealing with the "payday loan problem" is to outright ban its use. If the product leads to severe indebtedness and consumers are acting against their best interests, why not simply enforce the federal usury limit or regulate the market so stringently that lenders will be forced out of business? After all, there is a strong rationale for paternalism within a failed market.

Advocates of payday lending argue that heavily restrictive payday loan policies will turn consumers towards other expensive or risky forms of borrowing. One of the reasons this view is able to dominate the policy narrative is that "policy discussion has been hampered by a lack of empirical research on many of the most basic questions about demand for payday loans" (Bhutta et al., p. 2). In speaking with regional government representatives, it became apparent that decision makers are reluctant to pursue stringent policy actions out of fear of the consequences to the borrower. In order to better understand these perceived consequences, this section attempts to infer how consumers behave after payday loans have been banned, and reveal the alternative financial services that exist in the British Columbia market.

There is uncertainty surrounding the relationship between payday loans and other forms of financial services. Current literature on the matter provides conflicting and ambiguous results. Nevertheless, one comprehensive study found evidence that payday loan regulation is effective at reducing its use, but that payday loan borrowers will turn to other subprime financial services in its absence (e.g. pawn brokers, rent-to-own, and overdraft products). This paper suggests payday loan advocates are partially correct in assuming that there are risks associated with an outright ban.

The study (Bhutta et al.) looked at U.S. data from consumer finance surveys and a major credit bureau database to better understand why people borrowed, and to investigate the impact of a payday loan prohibition. Through econometric modeling, they were able to measure the impact of payday loan bans on several variables. Interestingly, a ban on payday loans does not motivate consumers to turn to traditional credit alternatives. Instead, consumers will turn to other forms of undesirable credit rather than change their borrowing behaviour for the better. As well, this trend remains unchanged in the long-term, and several years after the payday loan ban, consumers continue to look for short-term credit options outside the traditional financial sectors.

What are the substitutes to payday loans? British Columbia has a number of high-cost alternative financial services that borrowers might consider. They include cheque cashing services, instalment loans, vehicle title loans, and rent-to-own sales (B.C. Ministry of Public Safety and Solicitor General, 2016). These nonconventional financial services have emerged, to a certain extent, outside existing regulatory systems that were developed for mainstream financial institutions. As such, they are improperly captured by consumer protection legislation. Nevertheless, their fees and interest remain at or below the criminal code annual rate of 60%, which makes them a less expensive substitute for payday loans. Currently, Consumer Protection BC does not closely monitor and enforce the actions of these lenders.

Because these products are emergent and fringe financial services, we do not have data to determine whether payday loan borrowers would be better off if they transitioned to these products, nor can we determine to what extent the borrowers will face hardships related to unpaid bills, non-sufficient-fund penalties, and bank overdraft fees. It is also unclear whether payday loan borrowers will turn to less scrupulous and illicit products (see: section 2.4.3). Consequently, we can only recognize that payday loans are the most costly form of credit, even if the alternatives are far from ideal.

Based on our understanding of the subprime market and an inference of how payday loan consumers will behave after the product is heavily restricted, we can argue with certainty that credit-constrained consumers will continue to face financial hardship. Although these products tend to be cheaper than payday loans, they also fall outside the current regulatory system. Nevertheless, industry proponents and risk-averse decision makers exaggerate the harms of “overly restrictive” regulation. As a result, this report explores terminating the payday loan industry in the long-term, while acknowledging that borrowers need to be transitioned away from high cost credit entirely.

4.6. Maximum Fee Rate and Incentivizing Dependency

A major theme that is often discussed when considering payday loan regulation is the maximum charge. During public hearings and consultations in Manitoba, the CFCA, speaking on behalf of its industry members, argued that the fee cap should remain at or above $17 per $100 in order to avoid store closures, job losses, and restricted access to credit for those that rely on payday loans. On the other hand, the Consumer Association of Canada (CAC), an advocacy group, felt the fee cap of $15 per $100 is appropriate, and that more stringent regulation is necessary to reduce consumer harm (Manitoba Public Utilities Board, 2016). Additionally, several studies were conducted to evaluate the cost structure of payday lenders (Ernst & Young, 2009a; Ernst & Young, 2009b; Deloitte, 2008; Deloitte, 2007; Ernst & Young, 2004). Each study expresses the costs of payday lending in terms of $ per $100 borrowed for ease of comparison with state/provincial regulation. The table below provides a summary of the findings.

Table 1: Costs per $100 loaned (Multiple Jurisdictions)

Jurisdiction	Canada				USA	BC	Manitoba	Ontario
Year	**2004**				**2009**	**2008**	**2007**	**2009**
Type of Lender	Large	Medium-sized	Small	Multi-line	Multi-line	All types	All types	All types
Operating Cost	$15.31	$18.42	$21.57	$12.85	$9.41	$20.43	$24.27	$18.89
Capital Cost	$1.52	$1.54	$1.49	$1.35	$0.74	$2.09	$1.66	$1.10
Bad Debt Cost	$4.38	$6.16	$5.60	$4.96	$3.74	$2.69	$5.20	$4.65
Total Cost	**$21.22**	**$26.06**	**$28.68**	**$19.17**	**$13.89**	**$25.21**	**$31.12**	**$24.64**
Revenue					**$15.26**			**$25.25**
Profit					**$1.37**			**$0.61**[4]

Note: The US study provided much lower rates than the Canadian studies. All figures are converted to 2017 Canadian dollar values ($CAD)

All of the studies provide calculations for defaults and bad debt costs. However, there is a lack of clarity as to when defaulted repayment is unrecoverable, and therefore constitutes bad debt. This uncertainty exists because payday loan companies do not have a consistent and standardized method of accounting for bad debt. Nevertheless, a primary characteristic of the market is the inherent risk of non-repayment. Of the lenders surveyed in British Columbia, 10.6% of all loans went into default, with 80.2% collected after the due date. The remaining defaults were written off (2.6% of all loans) after being deemed unrecovered (Deloitte & Touche LPP, 2008, p. 11). Aggregate industry data shows that the initial default rate has ranged from a high of 24.95% in 2013 to a low of

[4] Revenue and profit per store were provided in the study in a pro forma statement (Table 4, p. 17). Source: Ernst & Young (2009). The Cost of Providing Payday Loans in Ontario.

13.79% in 2015 (Industry Aggregate Data Report 2015, Consumer Protection BC, 2015), so there is definitely a concern that borrowers will be delinquent on their repayments.

Unfortunately, the estimations of total cost in Table 1 are questionably high and display a wide variation. For instance, the estimated cost-per-$100-borrowed for Manitoba, Ontario, and BC are well above their respective fee caps, which suggests that they are overestimations of the true cost of providing a payday loan. Based on the financial performance filings of Dollar Financial (a parent company of Canadian lender: Money Mart), it was determined that lenders can profitably operate at fee rate limits as low as 15%. The study also argues that a “stricter underwriting regime, even one that raises costs, is still profitable” (Robinson, 2016, p.25). In other words, having good control of bad debts can help firms reduce the cost of providing payday loans.

A major challenge with determining the appropriate fee rate is the lack of transparency from industry lenders regarding the true cost of providing a payday loan. This knowledge gap inhibits policy makers from implementing effective cost reductions. A critical obstacle in the Manitoba hearings was the availability of data in the public domain. If we can collect better information on cost, policy decisions can be made that improve consumer protection without overregulating the payday loan industry.

Dijkema and McKendry’s (2016) analysis determined that a lender can break even only after a customer re-borrows, and that a store’s profitability depends on the dollar value of the loan and the number of transactions. The high fixed costs of operating a payday loan location creates an incentive to promote frequent and high volume borrowing by repeat customers. The design of their product and business necessitates revenue generation through predatory lending. To put it more diplomatically, “the economics of the traditional payday-loan business model raise concerns about misalignment between supplier incentives and consumer well-being” (Dijkema and McKendry, 2016, p. 34). These findings suggest that policy responses that focus primarily on capping the fees charged by payday lenders are overlooking inherent problems with the business model and failing to protect consumers.

4.7. Beyond the Scope of Study

Many regulatory measures were excluded from this study since they do not significantly influence payday loan borrowing behaviour (i.e. waiting periods, certain types of information disclosure, transactional databases, internal and external reviews, and minor prohibitive practices). These actions are mostly levers to ensure compliance with regulatory standards, but do not show evidence of improving the borrower's financial standing.

Finally, several considerations that would improve borrower outcomes are simply beyond the scope of my analysis. The need for mainstream financial institutions to replace the role payday lenders in consumer credit was mentioned throughout the expert interviews and in the literature, as is the Community Reinvestment Act – a United States federal law meant to incent deposit-taking institutions to invest in local communities – and other banking reforms. These approaches have much loftier ambitions than simply reducing the harms of payday loans. They seek to resolve endemic issues in financial markets and society. Similarly, financial literacy education for school-aged children is omitted because it does not directly address payday loan users.

Chapter 5. Case Studies

Multiple jurisdictions in Canada and the United States are considering and testing policy changes in response to increased concern over the harms of payday lending. This section investigates three of these jurisdictions in order to understand the motives behind each policy response, any positive or negative impacts that have arisen, and any solutions that have mitigated the negative impacts. Because most jurisdictions do not collect extensive data on the industry or borrowers, and because many of the policy responses to payday loans are relatively recent, the outcomes of policy implementation are difficult to assess. As a result, the content of publicly available reports and consultations help infer the motivations and outcomes of various policy measures.

5.1. Base Case: British Columbia

5.1.1. Background

British Columbia was the first province to experience a considerable growth in payday lending in Canada during the early 2000s (Lawford, 2003). My analysis begins after 2009, when the government drafted payday loan regulation into the Business Practices and Consumer Protection Act. The new regulation set the fee-rate limit at $23 per $100 of the principal (23% simple interest) and outlined the various rules, procedures and prohibitive practices (Payday Loan Regulation, 2009).

As of 2017, BC's loan fee cap has been reduced to $17 per $100 borrowed (Public Safety and Solicitor General, 2017). The Ministry of Public Safety and Solicitor General, the government department responsible for the legislative provisions and delegation of regulatory responsibility in British Columbia, made this decision after performing a 30-day closed consultation with stakeholders (regional government representative, personal communication, January 19, 2017). I acknowledge that these changes have occurred, but since they are quite recent, they are excluded from my analysis.

In terms of regulatory requirements, British Columbia has extensive point-of-sale information disclosure requirements, which includes displaying the annual percentage rate for a $300 loan for 14 days (Payday Loan Regulation, 2009). Other requirements include a maximum non-sufficient-fund fee of $20, 30% interest on defaulted loans (2.5% per month), and a two-business-day cancelation period. These restrictions are standard, and are commonly found in other jurisdictions that regulate payday loans (Consumer Council of Canada, 2015).

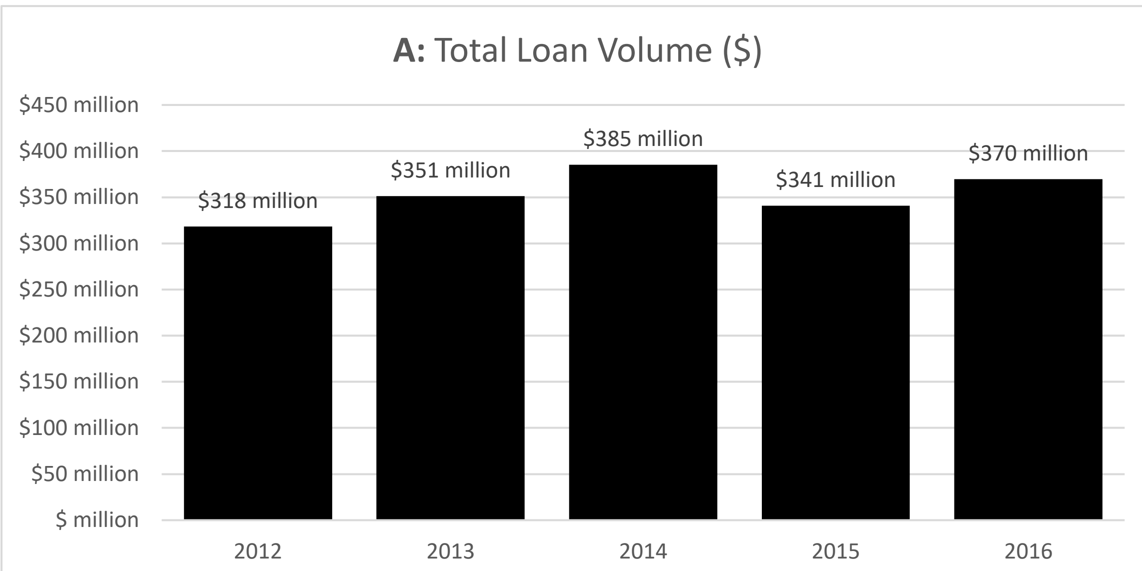
5.1.2. Policy Response

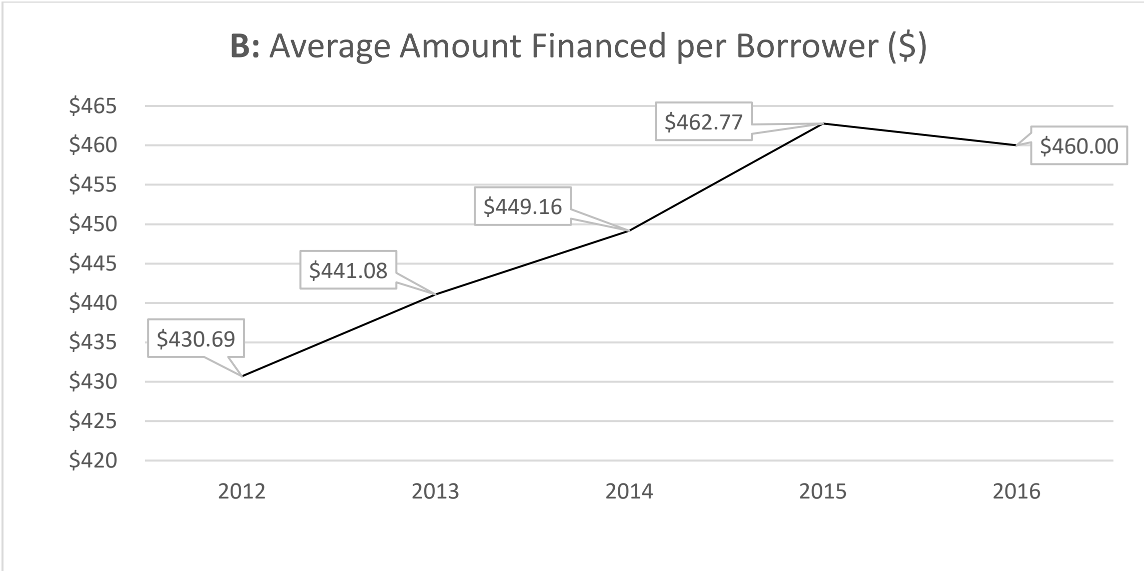
As part of its 2009 payday loan regulation, the BC government included an extended repayment plan to reduce the harm of repeat borrowing, especially among heavy borrowers. The repayment plan activates after a borrower enters a third or subsequent loan agreement with a lender within a 62-day period. At that point, the repayment of the principal and fees is spread over three bi-weekly pay periods or more. If the borrower is paid on a less frequent basis, then the repayment is spread over two pay periods (Payday Loan Regulation, 2009). Essentially, the aim is to relieve repeat borrowers of the burden associated with paying back their entire payday loan debt at one time. In concert with the extension plan, the government also mandated the collection of self-reported aggregate data from licensed lenders on an annual basis (Payday Loan Regulation, 2009). The objective was to better inform the government of the industry’s activities and highlight areas of concern for policy makers (Industry Aggregate Data 2015 Report, Consumer Protection BC, n.d.).

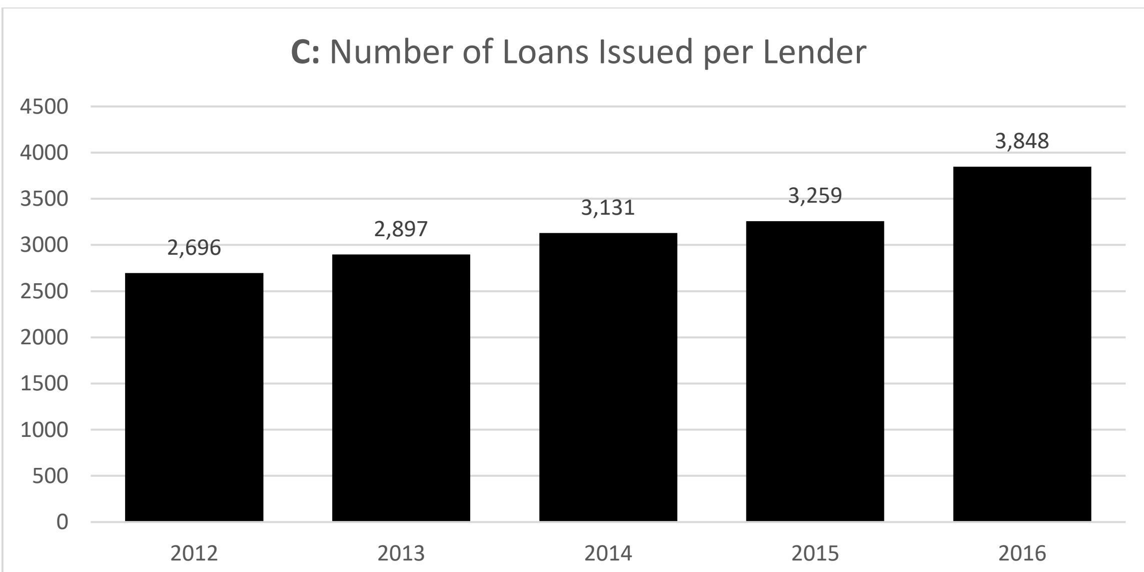
5.1.3. British Columbia Case Summary

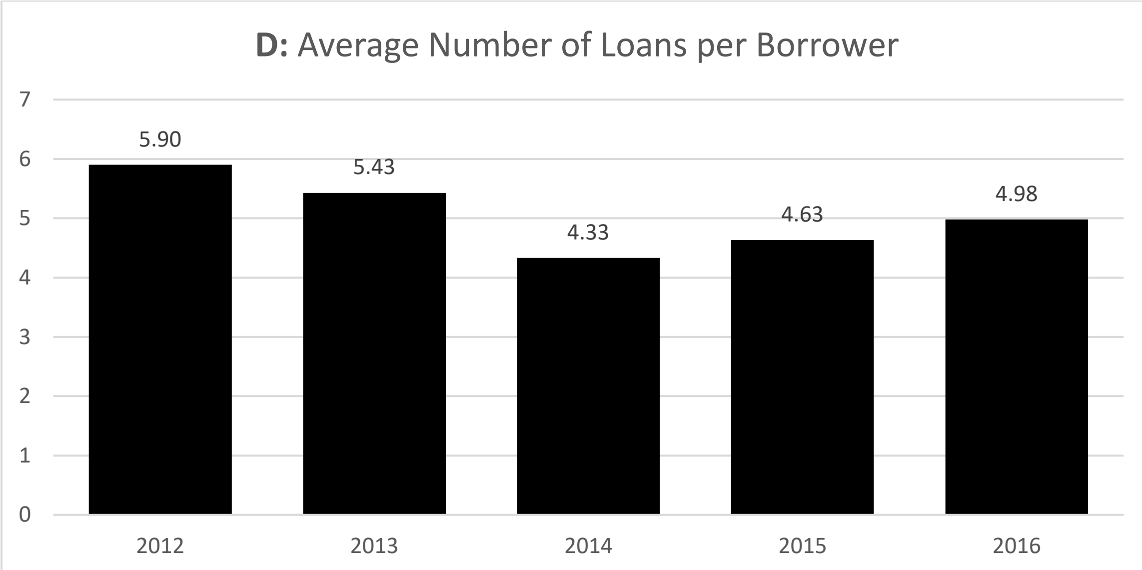
Based on the data collected since 2012, we observe that the industry grew significantly as shown in the panels of Figure 5. For instance, from 2012 to 2014 the total loan volume (Figure 5A), average amount financed per borrower (Figure 5B), and number of loans issued per lender (Figure 5C) all increased year-to-year. As well, the number of loans per borrower has remained high (Figure 5D).

Figure 5: British Columbia Industry Trends




B: Average Amount Financed per Borrower ($)
$465
$460
$455
$450
$445
$440
$435
$430
$425
$420
$430.69
$441.08
$449.16
$462.77
$460.00
2012
2013
2014
2015
2016

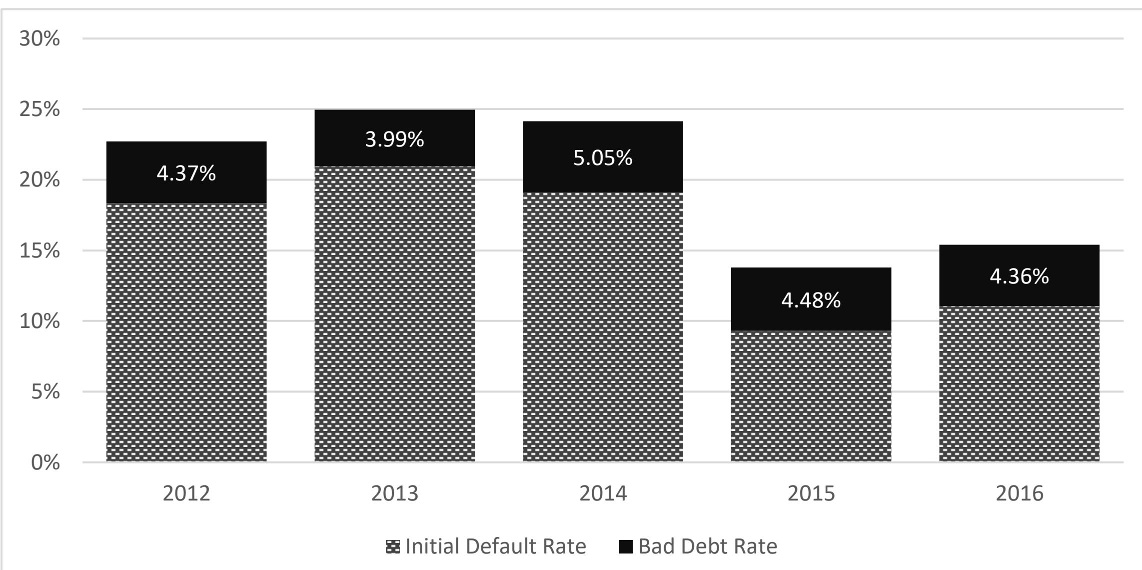

C: Number of Loans Issued per Lender
4500
4000
3500
3000
2500
2000
1500
1000
500
0
2,696
2,897
3,131
3,259
3,848
2012
2013
2014
2015
2016



Source: Data from Aggregate Loan Data Reporting 2016, Consumer Protection BC, n.d.

However, the loans ultimately written off (bad debt) remain at or above 4% of all loans issued, which suggests that the policy has not addressed the debt burden associated with payday loans (Figure 6).

Figure 6: British Columbia Initial Default and Bad Debt Rates



Source: Data from Aggregate Loan Data Reporting 2016, Consumer Protection BC, n.d.

Based on these findings, we can infer that the policy response in 2009 had a small impact on borrowing frequency, while also allowing the industry to flourish. The extended repayment plan has not drastically improved the outcomes to borrowers in any observable manner. All the same, it should be noted that 2015 figures show a move in the opposite direction in terms of overall industry volume, with a year-to-year decline in lending (Figure 4-A). This fall coincides with a loss of 49 licensed branches and 1 corporate entity, which is most likely associated with the fall of Cash Store Financial Services Inc., one of Canada's major payday loan brokers. Cash Store Financial was the target of a series of regulatory enforcement measures and class action suits in various jurisdictions over the years. They were never able to adjust to a regulated market, and it all came to head when they were unable to complete millions of dollars in refunds, forced to file for protective bankruptcy, and soon after, acquired by National Money Mart (Consumer Council of Canada, 2015). Altogether, the timeline of events suggests that the fall of Cash Store Financial explains the sudden drop in licensed lenders. Therefore, one benefit derived from a regulated market is that it forces firms to adapt their operations or risk insolvency. This finding closely resembles the literature on consolidation and cost efficiency discussed earlier.

In 2015 the average amount borrowed reached its highest level since data collection began at $463 (Industry Aggregate Data Report 2015, Consumer Protection BC, n.d.). The implication is that borrowing habits remain a major concern. Borrowers are taking out large amounts of money at fee rates near the price ceiling on a frequent basis. The lack of data on average length of a loan is worrying, especially when we consider the fact that British Columbia does not have a minimum loan term. Furthermore, the law does not offer safeguards for very short loan terms (less than 10 days), nor does the regulator collect data that could reveal pertinent information on borrowing behaviour. Overall, the British Columbia case shows the negative consequences of lenient policy responses that serve to perpetuate poor borrowing habits and allow the industry to retain high loan volume. Cash Store Financial was the only major payday loan company to be negatively impacted by the industry regulations and the industry continuous to flourish.

5.2. Colorado

5.3. Background

Colorado implemented state legislation regarding various payday-loan-like products as early as 1992, through their Uniform Consumer Credit Code (UCCC) (Udis, 2000). It was only after payday loan companies emerged as a prominent form of short-term credit among Coloradan borrowers that the State amended the UCCC to explicitly outline the legal provisions for payday loans, known as the Deferred Deposit Loan Act (DDLA) (Concerning the Regulation of Deferred Deposit Loans, 2000). At the time of the Code's revision, the considerations were two-fold: (1) the State wanted to ensure consumers were protected from predatory lending practices and (2) they wanted to ensure lenders were not unnecessarily disadvantaged by government regulation (Chessin, 2005, p.397). Through a committee review and legislative deliberations, the law settled on a maximum financing charge in the form of a "step rate", where the first $300 would have a maximum fee rate of 20% and any amount above that would have a maximum rate of 7.5% (Chessin, 2005). Lenders can charge a $25 fee, plus court costs and reasonable attorney fees for any defaulted loans. However, they may not charge interest on a defaulted payment (Deferred Deposit Loan Act, 2010).

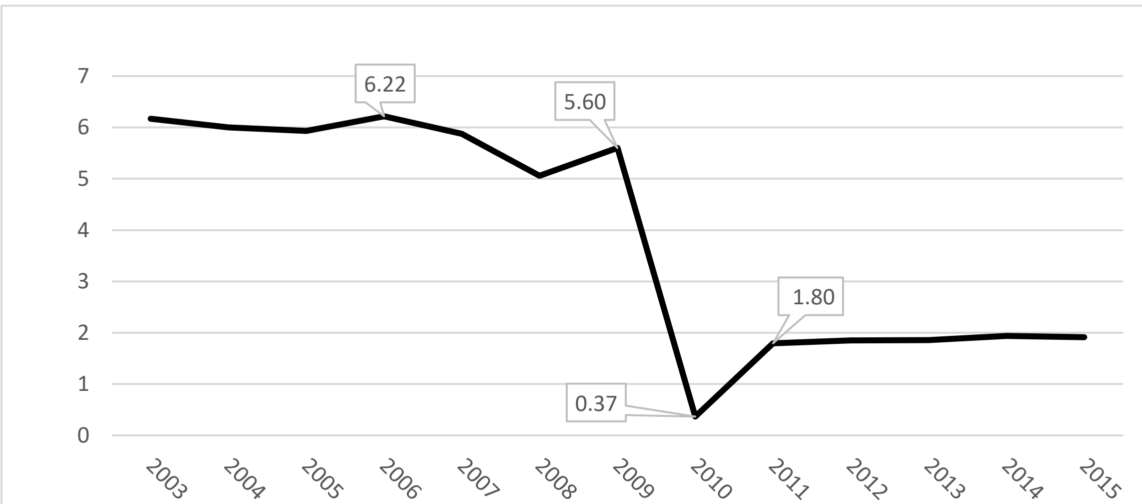
Bill 00-144 codified in 2000 the requirement for lenders to maintain records and file annual reports. The state has been collecting the data and disclosing annual reports to the public since 2003 (Chessin, 2005). By reviewing these reports, I was able to observe industry trends over time. Colorado's payday loan industry has undergone a series of changes since its inception. Each legislative reform has aimed to protect consumers from the harms of payday loans, especially as they relate to repeat borrowing.

5.3.1. Policy Responses

Mandatory Offer of a Voluntary Payment Plan

By 2007, payday lending had become rampant in Colorado, and the state government became aware of the harmful borrowing behaviour. It was also apparent that restrictions on loan renewals had not thwarted the tendency among borrowers to take out multiple repeat loans. In fact, same-day rollovers[7] had grown to account for more than a third of all payday loan transactions (Chessin, 2005). The average consumer obtained over six payday loans from one lender annually (Figure 7).

Figure 7: Colorado Average Number of Loans per Borrower



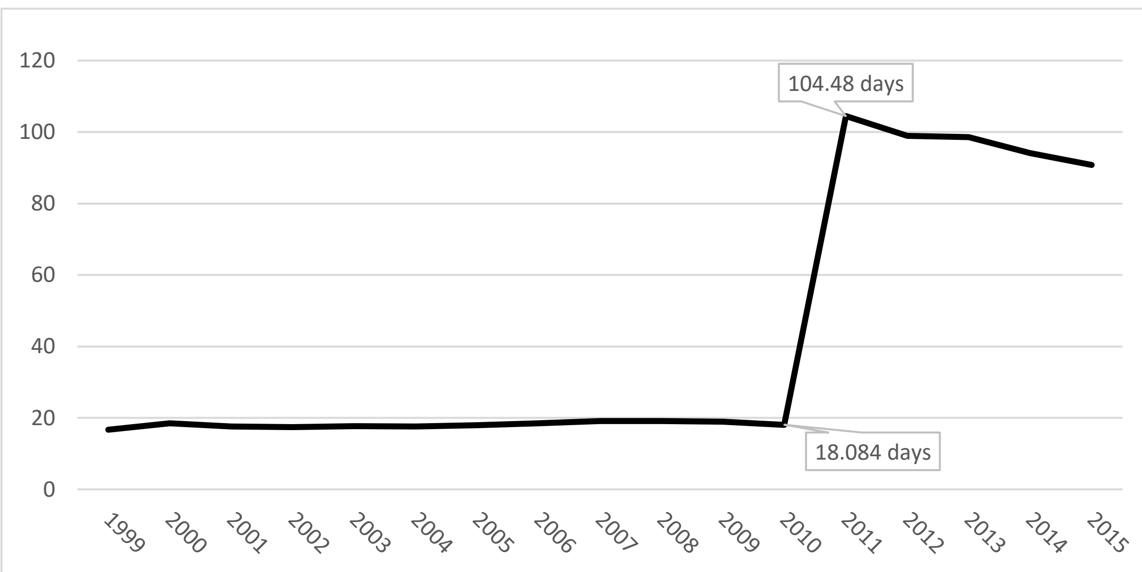
Source: Data from State of Colorado (2003-2015)

[7] A same-day rollover is a loan taken out immediately after a previous loan payment is due, whereas a renewal refers to extended, or “rolled over”, for a longer period of time. The renewal loan is subject to a new. In Colorado, a payday loan was allowed to be renewed one time before it had to be repaid. The major difference between a renewal and rollover is that rollovers were not prohibited by law at the time of the initial payday loan legislation. So, a lender could circumvent the renewal restriction by offering the borrower a new loan altogether instead of simply extending the term (Chessin, 2005, p. 415)

In order to combat high frequency borrowing, Colorado enacted a new policy that forced lenders to offer an extension plan to borrowers who had taken out multiple consecutive loans. The extension plan took effect after a borrower's fourth or subsequent loan. Of course, the borrower had the right to decline the extension and continue to pay their loans back as a lump sum. However, if they chose to enter the extension plan, they would repay the loan in at least six equal instalments coinciding with their normal pay period (House Bill 1261, 2007). Unfortunately, as shown in Figure 6, the new policy did not significantly reduce the frequency of borrowing in subsequent years, and by 2009 borrowers were still averaging approximately 5 ½ loans per year.

Not only were borrowers still taking out multiple loans, but they continued to hold the loans for short periods (Figure 8). Both figures suggest that users were opting not to enter into an instalment plan, and it was evident that the policy response had fallen short of its intended purpose.

Figure 8: Colorado Average Term a Loan was Held

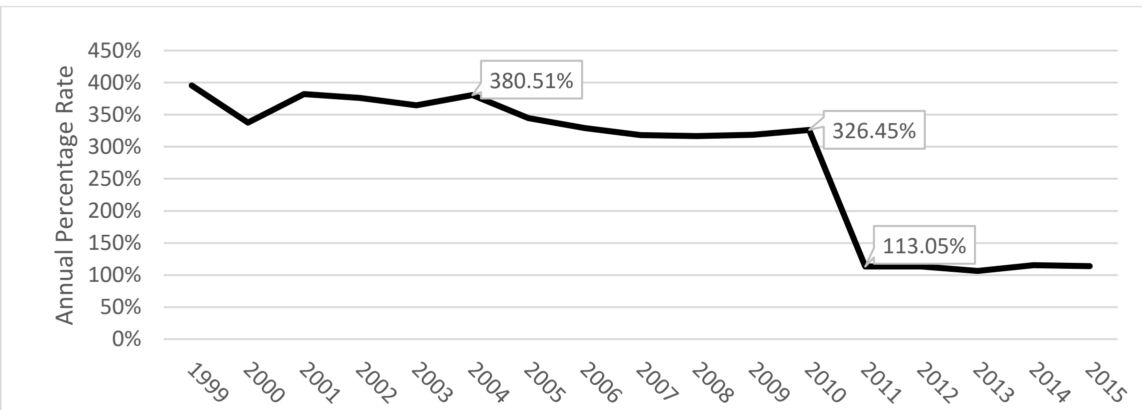


Source: Data from State of Colorado (2003-2015)

New Instalment Plan

The continued growth of the industry and the knowledge of harms to repeat borrowers hastened the need for a better response. In 2010, the Colorado Uniform Consumer Credit Code amended the payday loan rules once again. This time, Colorado fundamentally altered the nature of the payday loans by extending the term of the loan to 6 months or more. With this mandatory instalment plan, they implemented a new fee structure. Similar upfront maximum fee rates applied, where the user is charged 20% on the first $300 and $7.50 per additional $100 borrowed, and the maximum amount borrowed remains $500. However, now that the loan term is extended, lenders can charge a monthly fee of 7.50 per $100 loaned up to a maximum of $300 and an annual interest rate of up to 45% (House Bill 1351, 2010). Even though the new maximum charges are higher than before in absolute terms, they are dramatically lower overall since the costs are spread over a longer repayment period. Figure 9 highlights the differences in cost of borrowing before and after the new policy response.

Figure 9: Colorado Cost of Borrowing (APR)



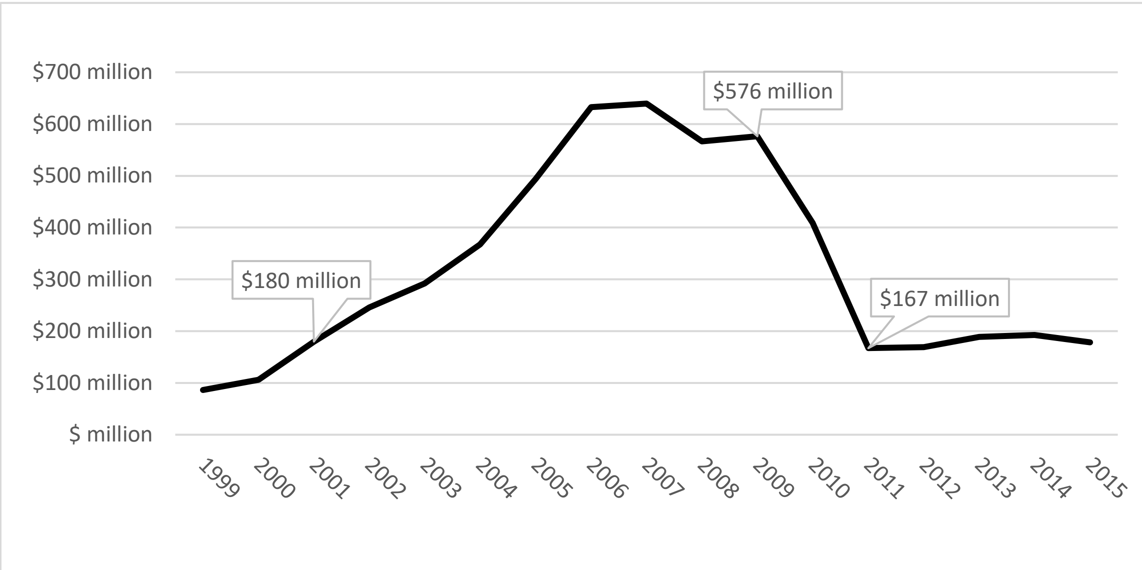
Source: Data for each year from State of Colorado (2003-2015)

5.3.2. Colorado Case Summary

The number of transactions and the number of storefront lenders has declined since their peak during the 2007-2008 period. Colorado was able to address weaknesses in their initial policy actions by enacting a mandatory instalment plan. By doing so, they reduced repeat borrowing and removed the burden of paying back debt in a single instalment. As a result, new borrowers are protected from the potential debt cycle associated with payday loans.

This policy change had consequences to the industry. Figure 10 shows that aggregate loan volume fell dramatically, from $576 million before the instalment plan to $167 million afterward, essentially contracting the industry to a decade-old market size.

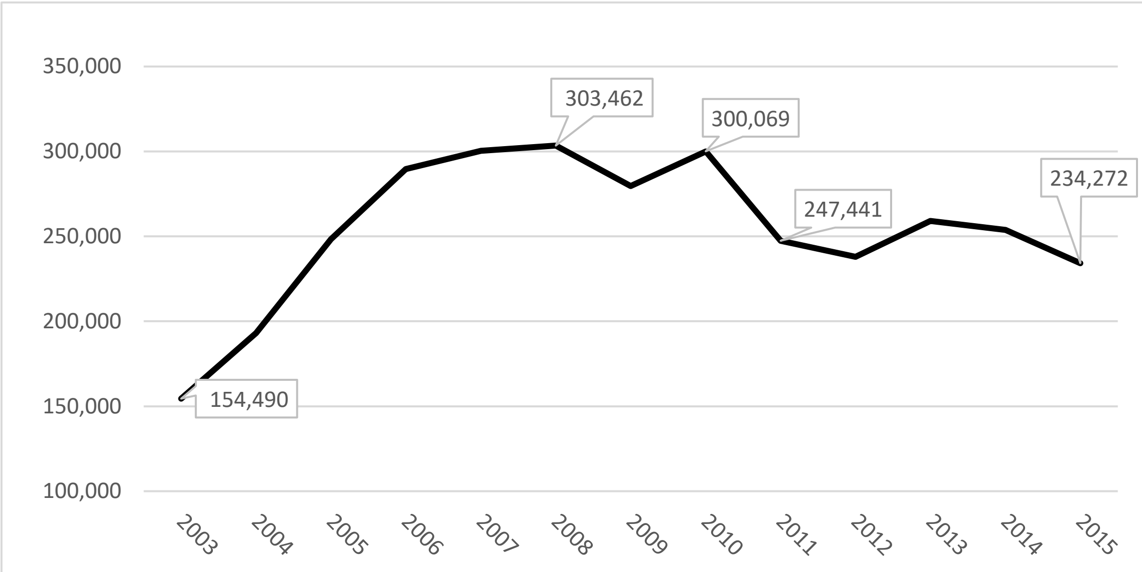
Figure 10: Colorado Payday Loan Volume



Source: Data for each year from State of Colorado (2003-2015)

Figure 11 shows that the policy change only mildly affected the number of annual borrowers. This suggests that borrowers are keeping payday loans among their credit options, but the impact of reduced new sales is unknown. In addition, the number of loans outstanding at year-end has gone up incrementally since the policy change was implemented (Beales & Goel, 2015). In short, payday loan borrowers remain, yet they re-borrow less often. A very likely scenario is that the supply of payday loans (or "deferred deposits") has fallen dramatically, while consumers continue to hold outstanding debt. We know that lenders cannot charge interest on outstanding loans, which offers the borrowers an incentive to remain indebted.

Figure 11: Colorado Number of Payday Loan Borrowers



Source: Data for each year from State of Colorado (2003-2015)

Interestingly, the decline in the payday loan market led to a rise in traditional supervised loans – consumer loans insured by the Federal Deposit Insurance Corporation with an annual percentage rate above 12% and below the 36% limit (Supervised Lenders, Colorado Attorney General, n.d.; Comparison Charts 2006-2015, Colorado Attorney General, n.d.). We cannot conclude that these two events are causally related. However, it is likely that some payday loan users turned to other forms of borrowing in the absence of payday loans.

5.4. Washington

5.4.1. Background

Washington State has undergone various phases of policy changes related to their payday loan industry. They first enacted legislation and regulated “cheque cashing sellers” in 1991, through house bill 1487, but our analysis begins in the early 2000s when payday lending had grown to a billion-dollar-a-year industry (Department of

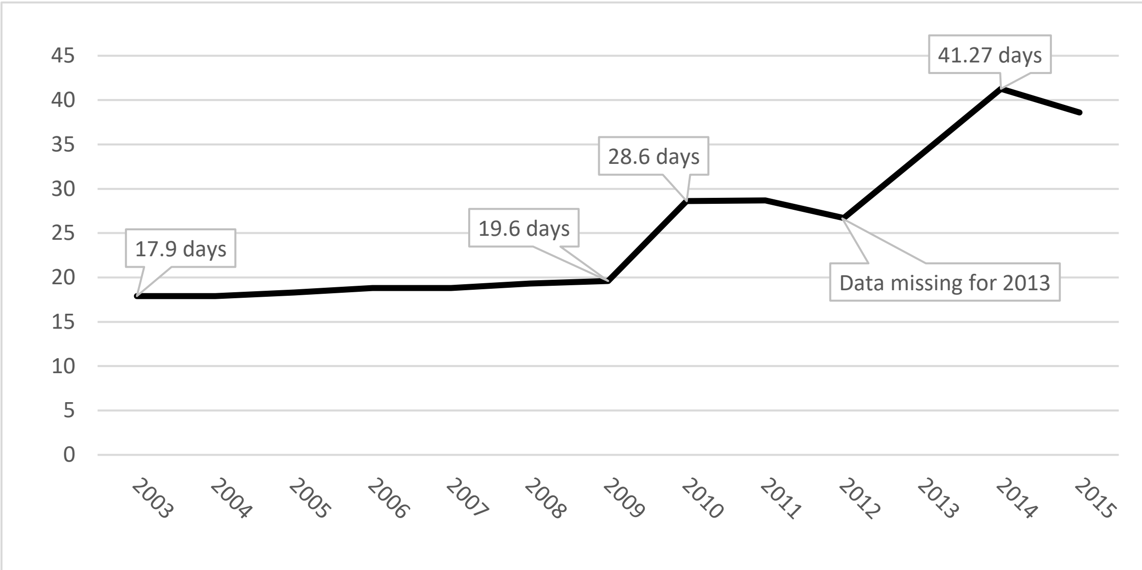
Financial Insitutions, 2004, p. 1). Washington State began with the most restrictive approach of all the cases examined in this study. The maximum fee charge was set at 15% for a loan principal of $500 or less and 10% for loans above $500, with a limitation on the total size of the loan equal to 30% of the borrower's net pay to a maximum of $700, and a loan period not exceeding 31 days (House Bill 1340, 2003). Washington also has some of the most comprehensive collecting and reporting of industry data, which they use to observe the impact of several major policy changes over the years.

5.4.2. Policy Responses

Voluntary Instalment Plan

In 2003, the government passed legislation to introduce an option for borrowers to enter an instalment plan "after four successive loans and prior to default upon the last loan" (House Bill 1340, 2003, Sec. 33). The policy mirrored Colorado's "mandatory offer of a voluntary payment plan" (See section: 5.3.1), and the results were equally unflattering; the average loan term only extended by 1.7 days from 2003 to 2009 (Figure 12). The best outcome of the new bill is that the State senate enhanced the authority of the regulator and increased information disclosure requirements (House Bill 1340, 2003).

Figure 12: Washington Average Term a Loan was Held

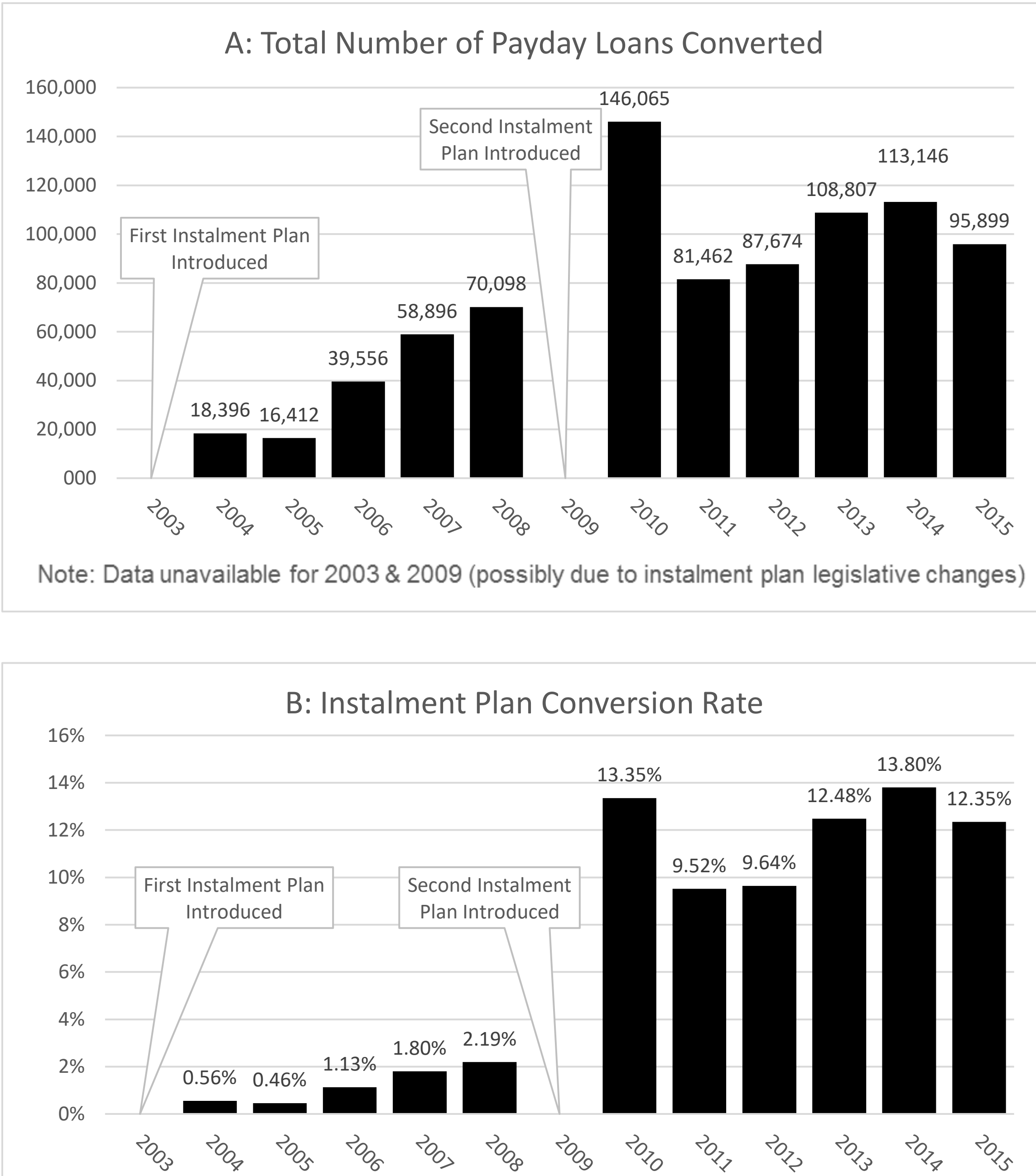


Source: Data for each year from Washington State (2003-2015)

From Figure 13A, we can observe that the instalment plan grew substantially from 2004 to 2008; however, it captured only 2.19% of borrowers (see Figure 13B). The new policy did not have a significant impact on overall borrowing nor did it make a meaningful impact on high frequency borrowing. In 2008, the average borrower was still taking out payday loans repeatedly (approximately 7.5 loans per user) for short periods (under 19 days per loan).

Source: Data for each year from Washington State (2003-2015)

Figure 13: Washington Payday Loans Converted into Instalment Plans



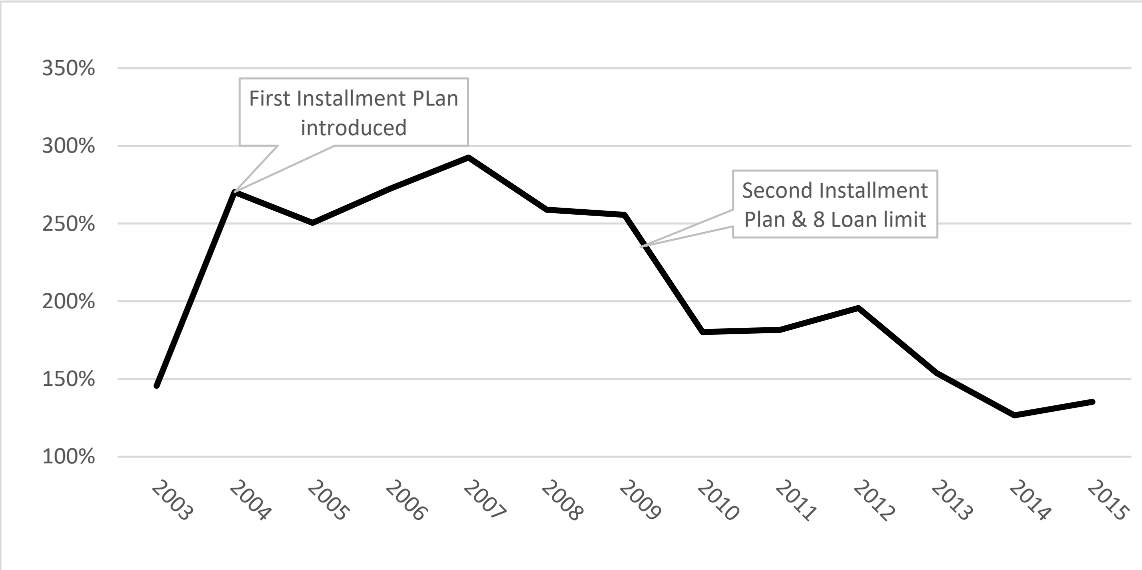
The harms of repeat borrowing were compounded by the fact that the number of borrowers had doubled from around 194 thousand people in 2003 to over 415 thousand in 2008 (Washington State Department of Financial Institutions, 2008, p.6). As the industry grew, frequent borrowing remained a critical component of combating harm to consumers. For instance, by 2009, “two-thirds of all loans went to borrowers who took out nine or more loans” (Kiel, 2013), which meant that a significant contingent of borrowers were very frequent borrowers.

Limit on Number of Loans & New Instalment Plan

To combat the high number of very frequent borrowers, Washington State decided to restrict the number of loans per borrower per year to no more than eight. They also allowed payday loan consumers to enter into an instalment/repayment plan at any time prior to default. This is a departure from the previous plan, which offered instalment plans exclusively to frequent borrowers (Washington State Department of Financial Institutions, 2010, p. 1). In order to enforce the eight-loan limit, they contracted a third-party company to collect transactional data from licensed lenders; so now the statewide data is held securely in an external database (Veritec Solutions, n.d.).

The new policy changes had a much more significant impact on the industry and to consumer borrowing. A year into the new policy the average loan term jumped from 19.6 days to 28.6 days and continued to climb in subsequent years (see Figure 11). Borrowers could now enter an 80- or 120-day loan term, which significantly lowered the cost of borrowing. Figure 14 shows the dip in the average annual percentage rate for loans after the 2009 policy changes. The average fees remained between $50 and $60 per loan, but now the fees could be paid back in increments over an extended period. As well, with more people eligible for an instalment plan, the conversion rate jumped significantly (Figure 13B).

Figure 14: Washington Payday Loan Annual Percentage Rate (APR)

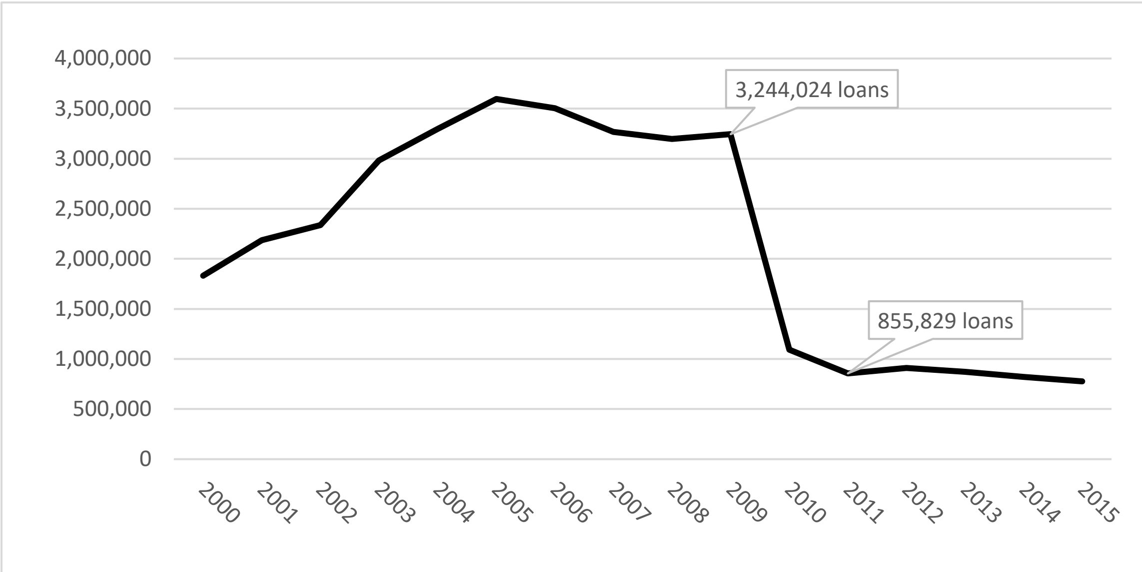


Source: Data for each year from Washington State (2003-2015)

5.4.3. Washington Case Summary

Washington chose to modify their instalment plan to make it accessible to more borrowers and put a hard cap on the number of loans one can borrow. As we have seen, these actions reduce the frequency and cost of borrowing. Since multiple policy actions were taken simultaneously, we cannot determine the individual impact of each change. Nevertheless, we know that, before the policy implementation, a large majority of loans went to high-frequency borrowers (nine or more loans), so the cap forced these consumers to limit their harmful borrowing behaviour. Unfortunately, the instalment conversion rate has never gone above 13.8% (see Figure 13B), which means that most consumers are opting not to enter an instalment plan. On the supply side, a major consequence of the new legislation is a sharp reduction in the number of loans offered by payday loan companies (see Figure 15).

Figure 15: Washington Payday Loan Industry Loan Volume (# of Loans)



Source: Data for each year from Washington State (2003-2015)

5.5. Case Analysis Summary

Colorado and Washington experienced the proliferation of payday lending much earlier than British Columbia. At the height of the industry, 6 to 7% of their respective populations had taken out a loan versus only 4.28% of British Columbians[8]. Their fee caps were much lower, but they still experienced significant growth. They have also taken drastic steps to reduce repeat borrowing, which has led to a decline in the volume of payday loans.

[8] The percentage of Coloradans and Washingtonians that took out a payday loan was determined by considering the ratio of payday loan borrowers against the state population.

Table 2: Multi-jurisdictional Industry Data illustrates the severe drop in the number of borrowers, loans taken out, and licensed lenders that occurred after policy changes were introduced to Washington and Colorado.

Table 2: Multi-jurisdictional Industry Data

	# of Loans Taken Out		# of Borrowers		# of Licensed Lenders	
	2006	**2015**	**2006**	**2015**	**2006**	**2015**
Colorado	1,801,134	448,792	289,720	234,272	661	242
Washington	3,503,721	776,824	444,494	214,099	742	139
British Columbia	N/A	736,585	N/A	158,962	N/A	226

Source: Data for Colorado from State of Colorado (2006 & 2015), Data for Washington from Washington State (2006 & 2015), & Data for British Columbia from Consumer Protection BC (2006 & 2015)

However, from Table 3, we can see that the trade-off has been drastic improvements in the cost of borrowing, through lower APRs and less frequent borrowing. Comparatively, British Columbia has a very high APR, number of loans per borrower, and average loan amount.

Table 3: Multi-jurisdictional Borrowing Data

	APR		Average # of Loans per Borrower		Average Loan Amount	
	2006	**2015**	**2006**	**2015**	**2006**	**2015**
Colorado	329%	114%	6.22	1.92	$351	$395
Washington	273%	135%	7.88	3.63	$380	$387
British Columbia	N/A	**565%**	N/A	**4.64**	N/A	**$463**

Source: Data for Colorado from State of Colorado (2006 & 2015), Data for Washington from Washington State (2006 & 2015), & Data for British Columbia from Consumer Protection BC (2006 & 2015)

Notably, states set their own usury law and therefore have great flexibility when developing legislation and regulating payday loans. In contrast, Canadian provinces develop payday loan regulation within the parameters established in Section 347.1 of the federal criminal code. They cannot implement payday loan legislation that infringes on federal rules. For instance, an instalment plan like the one in Colorado contravenes the Canadian Criminal Code maximum loan term of 62 days.

Even with these constraints, more action needs to be taken to reduce high-cost, repeat borrowing in British Columbia. Colorado's mandatory instalment plan is the most effective policy response when it comes to lowering the APR and reducing the frequency of borrowing, and similar actions can be taken in British Columbia that adhere to the criminal code.

Chapter 6. Analysis

6.1.1. Principal Objective

The overarching policy objective is to remove payday loans as a viable form of consumer credit and transition borrowers towards better borrowing behaviour. Despite the arguments propagated by industry proponents, payday loans do not offer any benefits to the consumer, and the existence of a regulated market perpetuates a very harmful form of borrowing. All the same, given the size of the market, the high demand for short-term credit, and the lack of affordable alternatives, this study acknowledges that banning payday loans outright is not advisable at this time.

The intent is to turn people away from payday loans by reducing their dependency and indebtedness to the service. As we have discussed, there is risk associated with a sudden loss of credit access for people who depend on payday loans to meet their ongoing financial concerns. As a result of these challenges, the subsequent objectives will look at ways to reduce the harms of payday loan borrowing, but only go part of the way towards resolving the problem.

6.1.2. Assumptions

An overarching assumption in my analysis is that policy actions are targeted at repeat borrowers who rely on payday loans to meet their basic needs. I acknowledge that payday loan borrowers are a heterogeneous group and policy actions will impact borrowers differently. We know that consumers can vary in terms of their motivations, attitude, demographic and frequency of use. The diversity of consumer characteristics influences behavioural responses to policy change. For example, an infrequent borrower who turns to payday loans because the product is convenient and discrete will respond differently to a reduction in supply of payday loans than someone who relies recurrently on the product out of necessity (e.g. income constrained and lacking credit alternatives). However, since there are scant data on payday loan use, it is difficult to determine how each consumer type will respond to a specific policy action.

Another assumption is that payday lenders facing more stringent regulation will become increasingly selective with their loan offerings. They will prioritize lending to individuals that offer the greatest return on investment and the most appealing customer is someone requesting a large-sum loan with a demonstrated ability to repay (i.e. proof of income that covers loan repayment). We can then assume that borrowers who are worse off in terms of indebtedness, poor credit history, and constrained income will be the lowest priority for lenders and the first to have their payday loan requests rejected. Therefore, an occasional borrower will be less affected by restricted payday lending than a habitual borrower who has developed a dependency.

There is a great deal of ambiguity in terms of consumer impacts to policy change. Nevertheless, commonalities exist between borrowers: the majority are frequent rather than occasional users, they have perceived or real limitations in their ability to access mainstream credit substitutes, and they have a relatively poor financial standing. These unifying characteristics allow us to assume that policy responses will impact a large contingent of borrowers in the same manner. As well, the analysis disregards the impact on occasional borrowers since the product does not present substantial harm to them.

Finally, I interviewed industry advocates for my research, but chose to exclude their views from my analysis. The assumption is that payday loan proponents do not look out for the best interests of borrowers and, therefore, they are not considered key stakeholders. In short, they would oppose any significant restriction on their operations or charges, which creates an inherent contradiction with the primary objective of this report: payday loans are a problematic form of borrowing that needs to be eliminated. Nonetheless, portions of the background section include the views of industry and serve to frame the discourse on payday loans in Canada.

6.2. Criteria for Evaluation

In order to analyze various policy responses, they are assessed based on a number of societal and administrative objectives. The table below describes each objective, along with a subset of criteria and measure used in the evaluation process.

Table 4: Policy Criteria and Measures

Criteria	Definition	Measure	Score
Effectiveness			
Dependency	Extent to which the policy results in a reduction in the number of loans taken out by customers (intensity of use)	# of loans taken out per borrower	None = 0 Low = 1 Medium = 2 High = 3
Cost	Extent to which the policy change results in a reduction in the spending cost to borrowers	Loan size and fee rate	None = 0 Low = 1 Medium = 2 High = 3
Reach	Does the policy or program benefit a large number of borrowers?	# of people reached	Low = 1 Medium = 2 High = 3

Criteria	Definition	Measure	Score
Development			
Access to Credit	Extent to which the policy expands affordable credit options for payday loan users	# of credit alternatives (available or perceived)	None = 0 Low = 1 Medium = 2 High = 3
	Does the option contract the payday loan industry?	Yes/No	None = 0 Low = 1 Medium = 2 High = 3
Feasibility			
Stakeholder Acceptance	Expressions of support or opposition to the policy option	Level of support/opposition	None = 0 Low = 1 Medium = 2 High = 3
Administrative Complexity	Extent to which the policy option results in additional administrative process	# of administrative processes	None = 0 High = 1 Medium = 2 Low = 3

6.2.1. Effectiveness

As discussed in previous sections, the main issue with payday loans is their cost and design, which can lead borrowers into a cycle of debt. In order for a policy response to be effective in addressing these problems it must reduce spending costs to borrowers and their frequency of borrowing, and achieve these objectives for as large a number of affected individuals as possible. Regrettably, due to a lack of evidence, we cannot consider the consequences of diverting payday loan borrowers to other costly alternatives. To account for this gap in the analysis, I consider the impact on access to credit in the following section.

6.2.2. Development

A significant factor in improving the financial standing of payday loan borrowers is converting them to more affordable alternatives. The capacity for British Columbians to overcome payday loan dependency is achieved by improving access to credit. Therefore, it is important to consider the ability of individuals to make informed decisions regarding a range of credit options. An option ranks well on the development measure if it improves access to better sources of credit. Throughout the report I have argued that the existence of a healthy payday loan industry perpetuates poor borrowing and inhibits consumers from considering other financial options. Therefore, if the policy action helps contract the payday loan industry (i.e. removing payday loans as a viable alternative for new and existing consumers) it scores well. Finally, if an option does not lead to greater credit access, and simultaneously preserves the market for payday loans, it will rank poorly.

6.2.3. Stakeholder Acceptance

Policy options are evaluated based on the likelihood of acceptance by each stakeholder group. The relevant stakeholders for this study are regional and federal government representatives, consumer advocacy groups, and financial institutions (i.e. organizations offering community-based financing or credit unions). Expert interviews, literature, and case study analysis help infer one's willingness to accept a policy action. Specifically, interviewees were asked to comment on a set of policies, with their answers either skewing in favour of, or against, each specific policy action.

6.2.4. Administrative Complexity

Administrative complexity is measured by considering the number of resources expended, and processes undertaken to implement the policy option in question (i.e. the fewer administrative steps, the less complex the policy). These include:

- Enacting legislation and developing new regulatory devices
- Creating administrative authorities or changing regulatory operations
- Implementing pilot programs
- Additional government coordination
- Evaluations and reviews
- Increased communication and stakeholder engagement (including public hearings and consultations)

Policy options that require a great deal of these processes are considered complex and given a low rating (1), while options that require very few or none of these changes are considered simple and given a high rating (3). The administrative complexity criterion is given half the weight of other criteria since it is the least important consideration.

6.2.5. Excluded Criteria

Several criteria had to be omitted from my analysis. I was unable to measure how policy responses affect specific socioeconomic groups, even though options vary in terms of equity. No data are available to measure how specific policy choices will affect different groups. To address this challenge, I have focused on improving the development of borrowers as a whole. My assumption is that reducing the cost of borrowing and improving the capacity of borrowers to make better decisions will benefit all British Columbians. As mentioned in Section 6.1.2, I assume that all policy options will target repeat-consumers and view them as a homogeneous group. Finally, I excluded costs to government from my analysis since none of the options required substantial expenses in terms of staff or budgetary resources. Where resources are expended, administrative complexity captures these changes.

Chapter 7. Policy Options

7.1. Option 1: Promote Credit Alternatives

The first option is to incentivize mainstream financial institutions and community organizations to develop new credit products, or expand existing services, as a means to offer affordable short-term credit products to payday loan users. The Alberta government has introduced a similar policy response: “[t]he Minister shall, in consultation with provincial financial institutions and community advocacy groups, promote the development, implementation and use of short-term lending options as an alternative to payday loans” (An Act to End Predatory Lending, 2016). In addition to promoting credit alternatives and working with a network of organizations, Option 1 attempts to stimulate risk and innovation by creating a fund and distributing cost-recoverable disbursements to those willing to pursue loan offerings.

Causeway and Momentum/First Calgary Financial were able to pilot community-based financing alternatives through an initial capital investment and ongoing partnership with mainstream financial institutions, whereas VanCity was able to pilot their program without external funding. Both initiatives have expanded and moved towards standardized credit products that are much more affordable than payday loans. Causeway’s product is still in its infancy, yet the program is popular and funding has increased (personal communication, February 19th, 2017). Given the range of lending methods and outcomes, the BC government will collaborate with lenders to ensure they receive the appropriate level of support (i.e. cost-recovery funding for small organizations with limited access to capital or assistance with the strategic direction for larger financial institutions). Credit unions are receptive to change and have already explicitly acknowledged their role in promoting and developing alternatives to fringe financial institutions (Canadian Credit Union Association, 2015).

7.1.1. Effectiveness

The loan term of existing piloted programs is much longer than payday loans and involves instalment repayment plans (see section 4.2). Overall, these products are much more affordable and aimed at reducing loan dependency. All three lenders interviewed had mentioned successfully working with clients to curb high-cost borrowing and break the payday loan dependency (personal communications, February 7th, 2017; January 17th, 2017; January 16th, 2017). Since these alternatives are much cheaper, incorporate financial planning/education, and work to help customers overcome indebtedness, the users are empowered with the skills needed to make better financial decisions.

In terms of reach, the program is unlikely to compete meaningfully with payday loans in the short term. Even the most ambitious example – Vancity's Fair and Fast Loan – does not have nearly the same reach as payday loan products. Payday loans are fast, convenient, and familiar, with over 200 licensed branches and 125,172 unique customers in BC, whereas credit alternatives require screening customers for their ability to pay back the loan, work intimately with the client to improve their finances, and exist in only a few communities. It would be ambitious to assume that a series of piloted credit products would become a viable alternative overnight.

Alternative short-term credit may one day become a realistic replacement for payday loans. However, until several pilot projects are successful and expanded, these programs are unlikely to divert a large number of borrowers from payday loans. As a result, this option is extremely effective at reducing the spending cost to borrowers and weaning them off their payday loan dependency, but ranks poorly in terms of reach.

7.1.2. Development

Through mainstream and community credit alternatives, users are offered the opportunity to interact with responsible lenders in a positive way (including deposit-taking institutions). Not only do borrowers gain access to a more affordable credit alternative, but they also gain access to a wealth of new financial services if they remain loyal and responsible customers. More importantly, borrowers have the potential to improve their credit score through consistent repayment. As a result, this option is extremely effective at improving access to credit.

7.1.3. Stakeholder Acceptance

All of the experts interviewed responded at least somewhat positively to this option. The literature suggests that offering more affordable credit is a step in the right direction. This option does not impede the interests of stakeholders, and therefore, it has a high acceptance level.

7.1.4. Administrative Complexity

This option does not require new legislation nor does it necessitate the expansion of regulatory operations. However, it does require implementing a new government program, coordinating with external partners, and managing the program operations (administrative and financial). A comprehensive communications plan is needed in order to attract interest from mainstream financial institutions and community organizations across BC. Finally, a vital component of this option is the ongoing relationship building and engagement with new and existing lenders, which is a highly process-driven activity. Overall, this option is quite administratively complex.

7.2. Option 2: Instalment Plan

Option 2 involves lengthening the term of payday loans and enacting an incremental repayment mechanism. Specifically, borrowers will repay their loan in at least 42 days and no more than 62 days, with instalments scheduled for each pay period during the term of the loan. This policy option fundamentally changes the payment structure from a lump sum to an incremental repayment. In the Colorado example, the instalment plan is for 6 months or longer; however, the criminal code of Canada limits payday loans to a maximum period of 62 days. As a result, this option is based on similar legislation being developed in Alberta, but considers the outcomes of the Colorado case when evaluating each criterion.

Table 5 offers a comparison of the costs of the instalment plan against the existing payday loan product (note: this calculation does not consider the recent BC fee reduction). The fee per $100 and loan size are based on aggregate industry data from 2012 to 2015 (Industry Aggregate Data Report 2015, Consumer Protection BC, n.d.). The loan period for the status quo is based on a pay period of 14 days (i.e. bi-weekly pay).

Table 5: Cost Comparison

	Option 2 (bi-weekly pay)	**Option 2 (infrequent pay)**	**Status Quo**
Fee per $100	$21.70	$21.70	$21.70
Loan size	$446.00	$446.00	$446.00
Loan period	42 days	62 days	14 days
Total fee per loan	$96.78	$96.78	$96.78
APR	**189%**	**128%**	**660%**

7.2.1. Effectiveness

This option significantly reduces the cost of a payday loan and the frequency of borrowing. As shown in the table, stretching the repayment for a longer period reduces the APR and the burden of lump-sum repayment. Although we do not have data on the average loan term in British Columbia under existing legislation, the Colorado and

Washington cases show that, prior to the mandatory instalment plans, loans were taken out for an average of 17 to 20 days. This option would extend the term to somewhere between 42 and 62 days, which will greatly inhibit the ability of borrowers to take out loans on a frequent basis.

Relative to other short-term credit options, payday loans remain an expensive choice. Overall, this option is extremely effective at reducing repeat borrowing, but remains a costly choice compared to other credit products. Nevertheless, in relation to the existing payday loan system, it is a heavily restrictive regulatory approach that fundamentally removes the lump-sum costs associated with payday loans. Finally, since it is a sweeping measure that affects all borrowers, it has a wide reach.

7.2.2. Development

There are no significant improvements to credit access with this option. Yet instalment loans reduce the overall volume of payday loans in the market. Therefore, this option has a moderate score for the development criteria.

7.2.3. Stakeholder Acceptance

Stakeholder acceptance is mixed. Several regional government representatives are against the implementation of an instalment plan in their jurisdiction, which they feel will cause excessive detriment to the lenders, and in turn, harm the borrowers through reduced access to credit.

Representatives of consumer groups, credit unions, and some regional government experts believe the instalment plan is an appropriate approach to take and will lead to better borrowing outcomes. Some of the more ardent opponents to payday loans would like to see instalment loan interest rates reduced significantly. One consumer advocate felt that the instalment plans are just another form of subprime lending that should be regulated more tightly.

7.2.4. Administrative Complexity

Option 2 would require amendments to the BCPC act but would not require expanding regulatory operations since the changes fall within the existing responsibilities of the regulator. Public consultation has already occurred in October 2015, and the idea of an instalment plan was discussed at that time, so no additional consultation is needed (Public Safety and Solicitor General, 2016). A press release from the Ministry can inform consumers and lenders of the changes without a complex or ongoing communications strategy. Generally, this option is less complex than other alternatives.

Of course, this scheme would require a provincial registry and enforcement to ensure that an individual cannot take out loans concurrently from multiple lenders. This issue is discussed in more detail in the concluding sections, as it relates to a general issue with consumers being able to skirt regulation. For the time being, it excluded from consideration in this evaluation, but remains a concern for policy makers in general.

7.3. Option 3: Reduction in the cost of borrowing

Option 3 considers the current British Columbia reduction in the maximum fee that licensed payday lenders can charge (from $23 per $100 borrowed to $17 per $100 borrowed), as well as a reduction in the maximum allowable loan size (from 50% to 30% of net bi-weekly income, and no more than $1500).

7.3.1. Effectiveness

Reducing the fee and the amount that can be borrowed leads to a lower cost of credit to the borrower. They pay less interest and the total principal amount borrowed decreases.

Table 6 provides an example of the cost to borrow three consecutive payday loans after the fee reduction for an individual not constrained by the new lower loan limit.

Table 6: Cost Comparison (three consecutive loans)

	Reduced Fee	Status Quo
Fee per $100	$17.00	$21.70
Loan size	$446	$446
Loan period	14 days	14 days
Total fee per loan	$75.82	$96.78
APR	443%	565%
Total cost	$227.46	$290.34[9]
Cost difference	**$62.88**	

Note: calculation based on the same source data as Table 5.

Based on the table above, the savings per borrower would be $62.88, which equates to an aggregate cost savings of approximately $49 million (based on average of 782,420 loans per year from 2012-2015). If we assume that the reduction in maximum loan amount reduces the amount borrowers take out, than there will be an additional

[9] Total Cost = Total fee per loan ($96.78) X Number of Consecutive loans (3)

reduction in the cost of borrowing (modest estimate: reduction in borrowing = $146 per borrower[10]). Yet even with these reductions, the APR remains high compared to other credit products. As well, there is no data to measure the impact of incremental fee and loan amount reductions on repeat borrowing.

Option 3 does not address the lump-sum nature of the loan, which is a major contributor to payday loan dependency (see above). Thus, "[a] change in the interest rate without any additional changes to loan terms or repayment terms is likely to have a negligible effect on the wellbeing of consumers" (Cardus, 2016). Finally, the Personal Interest and Advocacy Centre (PIAC) believes that "the upper limit of borrowing should be approximately 5% of monthly income and no higher", and choosing a ball-park limit like 30%, "dooms these borrowers to a debt spiral from which some may never recover" (Bishop & Lawford, 2016, p.28). One representative from an organization offering community-based financing stated that a key principle of loan underwriting is examining an individual's ability to repay as reflected by their income. They felt that offering up to 50% of a borrower's net monthly income was an arbitrary calculation that ran counter to basic principles of underwriting (community banking representative, personal communication, January 16, 2017). Therefore, we cannot conclude that there will be a substantial impact on repeat borrowing at the current maximum loan amount. Much like Option 2, this option applies to all payday loan borrowers, and therefore, has a wide reach.

7.3.2. Development

This option offers no significant improvements to credit access. The impact of this policy on industry volume of loan sales is difficult to measure. Previous research

[10] Estimate based on current average loan amount ($446) less the new maximum ($300)

indicates that restricting the amount payday lenders can charge will force them to consolidate and seek more cost-efficient operation. Some have argued that the industry has already reached maturity and experienced corporatization (see section: 2.4.1). However, the limit in British Columbia is above the speculative minimum fee needed to provide payday loans. Therefore, we can speculate that this option will not unduly burden payday lenders to the point of significant industry contraction (i.e. reduction in supply).

7.3.3. Stakeholder Acceptance

Consumer protection and advocacy groups had mixed opinions. Some felt it was a good way to reduce the harms for borrowers, while others thought it was only a minor step in the right direction. Either way, there were no major reservations. Generally, industry opponents were in favour of this option on the basis that any positive change is helpful, but felt more needed to occur for the cycle of payday loan borrowing to end.

Some regional government representatives were concerned about the unforeseen consequences of lowering the fee cap to levels where the payday lender could no longer operate. Similar views were expressed regarding any policy action that drastically affected the payday lenders' operating margins. The basis for their apprehension was a fear of unknown lenders capturing consumer demand (i.e. unlicensed lenders, loan sharks, etc.).

7.3.4. Administrative Complexity

This policy option is the least administratively complex. The British Columbia government has already set the fee cap; hence a single amendment to the Business Practices and Consumer Protection Act would be required to reduce it further. This option does not require any changes to administrative processes and the new fees could be communicated through existing channels (Ministry press release, Consumer Protection BC's webpage, etc.).

Additionally, it would be helpful for the British Columbia government to adopt an incremental rate approach, where the fee and loan limit are adjusted after observing the impact to industry. This method was mentioned in an expert interview as a critical action to appropriately determine the fee cap and maximum loan amount in the absence of cost data (personal communication, February 7th, 2017). For example, if the current fee reduction and the addition of a maximum loan limit of 30% does not drastically impact the industry, both rates can be reduced until the market responds. In this way, the regulator can incrementally ramp up their regulatory constraints. This approach would help the government overcome the limitations of scarce data.

7.4. Option 4: Financial Literacy Fund & Information Disclosure

Option 4 focuses on education. It directs Consumer Protection BC to levy a fee on licensed lenders and pool the funds for financial literacy education programs and other initiatives. According to an impact evaluation of a similar fund managed by TD Canada Trust, “there is a large unmet demand for community financial literacy funding” and the grants they distributed helped reach over 70,000 Canadians (Prosper Canada, 2015, p.6). The objective of BC’s payday lending financial literacy education fund is to offer grants to existing community organizations, counselling services, and consumer advocacy groups in order to reach as many borrowers as possible. Manitoba charges $500 per licensed location and uses this money to “provide borrowers and potential borrowers with information to help them make sound financial decisions” (Government of Alberta, 2017, p. 39). Based on the 226 licensed lenders in British Columbia, the fund can generate over $100,000 annually.

The option also mandates a new method of displaying cost to consumers. All lenders must adopt the adding-up approach as the new cost disclosure method (See section 4.2). They are also prohibited from advertising the fees in the dollars-per-$100-borrowed format. The adding-up approach and annual percentage rate are the only means of displaying the cost to consumers.

7.4.1. Effectiveness

Regrettably, Manitoba does not track the impact of its financial literacy fund on borrowing behaviour, which makes it difficult to gauge the effectiveness of the various fund activities. Even without this information, we know that financial literacy positively impacts borrowing. As an example, respondents from an FCAC survey were asked to rate themselves on a set of attributes, and those who rated higher in financial confidence were less likely to borrow and more successful at staying within their budget (FCAC, 2015). The attributes included personal financial knowledge, keeping track of money, making ends meet, shopping around for the best financial product and staying informed about financial issues. If similar impact surveys are conducted for option 4, education activities could be evaluated on their effectives at reducing payday loan dependency. However, as it stands right now, we can only observe a moderate impact on loan use and no impact on the cost of borrowing. The impact on reach is also difficult to measure. We know that a majority of payday loan borrowers would benefit from a better understanding of associated costs and the means to overcome existing cognitive biases. Conversely, there is a contingent of borrowers that turn to payday loans with full knowledge of the total costs. These individuals would not benefit from education-related initiatives. Given these considerations, this option ranks medium on the reach criteria.

7.4.2. Development

Education can expand the consumer's understanding of the credit market. Of those surveyed, "the majority of respondents were not aware of the relative costs of all short-term credit options and may be using payday loans more often as a result" (FCAC, 2016, Section 4.2). The same respondents believed that a payday loan is cheaper than an outstanding balance or cash advance on a credit card, which suggests that there is a fundamental misunderstanding of the cost to borrow. Empirical evidence shows that the APR and dollar-cost-per-$100-borrowed methods of displaying cost are a poor way of informing consumers, which also have a measurable negative impact on borrowing behaviour. Option 4 does not decrease the cost to borrowers, but it does increase the consumer’s understanding of payday loan fees. And, with better information, borrowers can make better decisions.

More transparent cost disclosure, acting jointly with improved financial literacy, lessens cognitive limitations and leads to greater access to credit. Of course, without improvement to the tangible number of credit substitutes, the positive effects are moderate. Another major concern is compliance. It is difficult to know whether the lender is undermining the cost disclosure requirements by verbally stating the cost-per-$100 borrowed or by avoiding an upfront discussion of the true cost of the loan. Finally, these actions focus on consumers and demand for payday loans, but without direct supply-side intervention, we cannot conclude that there will be any effect on the market size. Overall, this option has a medium development score.

7.4.3. Stakeholder Acceptance

Regional government representatives, again, had mixed views on the acceptability of this option. Some argued that the issue is not necessarily financial literacy, but simply a matter of circumstance that forces people to turn to payday loans. Others felt that financial literacy initiatives are a positive step towards improving consumer protection and wellbeing.

Both consumer advocacy groups and organizations offering payday loan alternatives (credit unions, community-based financing institutions, etc.) felt that financial literacy and better cost-disclosure were positive steps in the right direction. The Financial Consumer Agency of Canada was strongly in favour of financial literacy education and better information for consumers (personal communication, January 11, 2017).

7.4.4. Administrative Complexity

Legislation must be amended to include the financial literacy funding and to explicitly outline the new disclosure rules. A new administrative authority must be created to manage the fund, and Consumer Protection BC’s operations will need to be expanded to account for new compliance measure around information disclosure. Annual reporting on grant disbursement, and infrequent program evaluations are required to ensure effective use of the fund. All of these processes make this option the most administratively complex.

7.5. Summary

The matrix below provides a summary of the evaluation.

Table 7: Policy Evaluation

Option	Effectiveness	Development	Stakeholder Acceptance	Administrative Complexity	Total
Option 1: Promote Credit Alternatives	(3) Reduction in number of loans taken out (3) Alternatives are much more affordable (1) Few people benefit in the short-run	(3) Increase number of credit options available (0) No impact on payday loan industry size	(3) All stakeholders accept this option. Industry proponents welcome competition, and opponents believe better options are a necessity.	(1) Requires some coordination with institutions and the development and distribution of a cost-recovery fund. However, no changes to legislation or regulatory regime.	Score: **13.5 points**
Option 2: Instalment Plan	(3) Highly effective at reducing repeat borrowing due to the longer term of the loan (2) Highly effective at reducing the cost of	(0) Does not expand access to credit (perceived or real) (3) Heavy impact on payday loan industry size	(1.5) Mixed response: Mostly negative.	(2.5) Moderate to low complexity. Requires new legislation and regulatory directives, and fundamentally changes the business model	Score: **14.25 points**

Option	Effectiveness	Development	Stakeholder Acceptance	Administrative Complexity	Total
	borrowing (3) Benefits all borrowers			of lenders.	
Option 3: Reduction in maximum fee and amount borrowed	(1) Some reduction in frequency of borrowing due to lower debt obligation (2) Moderate reduction in the cost of borrowing (3) Universal Reach	(0) Does not expand access to credit (perceived or real) (0) Unlikely to impact payday loan industry size	(2) Mixed response: no strong opposition or support.	(3) Very few changes to the administrative processes. Legislative change required. No change to regulatory approach, and no additional actions needed.	Score: **9.5 points**
Option 4: Financial Literacy Fund & Information Disclosure	(2) Moderate reduction in the number of loans taken out per borrower (0) No impact on size and fee rate	(2) Some increase in access to credit from increased consideration (reduction in bounded rationality) (0) No impact	(2.5) Extremely positive response from stakeholders interviewed and in the literature. Some minor reservation	(0) High complexity: new legislation and expanded role of regulator, some processes absorbed by not-for-profit organizations	Score: **8.5 points**

Option	Effectiveness	Development	Stakeholder Acceptance	Administrative Complexity	Total
	(2) Some borrowers will not benefit from improved information or literacy	on Industry Size	about the fee levied on lenders.		

Chapter 8. Trade-offs

A major trade-off exists between policy responses that target the payday loan market directly and responses that focus more on consumer behaviour. For instance, option 2, and to a lesser extent option 3, reduces the rate charged and the frequency of borrowing as a way of protecting consumers from a high-interest debt dependency. However, an unfortunate consequence of these policy actions is that they neglect to address the behavioural issues and credit limitations that most consumers face. On the other hand, Options 1 and 4 attempt to curb payday loan dependencies by changing borrowing habits but do not fundamentally alter the payday loan product itself. While both approaches have the primary objective of reducing payday loan use, they follow distinctly different paths. Largely, Options 1 and 2 score well because they are able to address the cost and dependency associated with payday loans, while improving consumer development.

All the same, neither option will resolve the payday loan problem on its own. Option 1 is fundamentally lacking in its ability to contract the payday loan market and Option 2 does not transition borrowers towards better alternatives. Thus, the government must take a two-pronged approach towards ending repeat payday loan borrowing. They can do so by simultaneously adopting stringent regulations towards the payday loan market (i.e. Option 2 or 3) and proactive measures aimed at improving borrowing habits (i.e. Option 1 or 4). A key finding in this report is that consumers are choosing a harmful form of borrowing in spite of the real risks involved. The current system has failed in its responsibility to protect consumers from harm, so a more prescriptive approach is necessary. We have seen, time and time again, that jurisdictions with lenient regulations leave consumers vulnerable to exploitative practices. With a long-term objective to end the use of payday loans entirely, the B.C. government must use multiple policy approaches in concert, and transition users away from payday loan use.

Beyond the major societal objectives, our analysis also considers how palatable each option is to key stakeholders, and whether it can be implemented without overburdening the existing administrative system(s). After all, policy decisions are made within the context of existing institutions and processes. Based on the evaluation of each option, the options that pursue stated objectives through existing legislative and regulatory channels appear to have the greatest administrative ease (i.e. Option 2 and 3). Yet, at the same time, they garner the least support from stakeholders and score poorly on some key societal objectives. Options 1 and 4 are the least feasible given existing government constraints; however, Option 1 overcomes this drawback by scoring well on most criteria.

Chapter 9. Policy Implementation

A key component to the success of any policy response is willingness on the part of government to undertake an open and transparent regulatory process, where experts, stakeholders, and users can contribute evidence and their opinions. The BC government is relatively opaque when it comes to regulating payday lenders. For example, they chose to have a 30-day consultation with stakeholders in October 2016 without informing the public of the outcome, whereas Manitoba's Public Utilities Board recently released an exhaustive report on their 2016 consultation process and recommendations.

Throughout my interviews, all participants encouraged the use of knowledge and data to drive decision-making. The literature and case examples demonstrate how jurisdictions that collect and assess industry and/or consumer data are more amenable to policy change. California, Colorado, and Washington excel at collecting, analysing and reporting data from the payday loan industry, which helps their respective governments take decisive action. As it stands, there is an excess of misinformation regarding the impact of payday loans and policy changes. For this reason, I would add the caveat that the government of British Columbia must collect more data irrespective of the policy actions pursued, in order to succeed at protecting consumers from harmful lending practices.

Specifically, they must implement a transaction database in a manner similar to Washington, where borrowing activities are tracked to ensure lenders comply with regulation (Washington State Department of Financial Institutions, 2009). Currently, British Columbia does not have a means of tracking users who take out multiple simultaneous loans from various lenders, although it is illegal to offer borrowers concurrent loans. Without the database, there is no way of monitoring and enforcing this type of borrowing behaviour. This is just one example of the type of gaps that exist in regulatory enforcement when transaction data is missing.

Chapter 10. Conclusion

We know that conventional payday lending relies on repeat borrowing and that forming a dependency has negative personal outcomes. Yet the absence of available short-term credit or the means to make informed financial decisions is equally harmful to borrowers. Given all these conditions, the appropriate policy approach must reduce costs of borrowing to consumers to a reasonable level, improve the capacity for repeat payday loan users to find cheaper alternatives, and do so in a manner that neither causes negative consequences to the wellbeing of borrowers, nor conflicts with the interests of key stakeholders. Based on these competing factors, the most appropriate policy response is to **promote credit alternatives and enact a mandatory instalment repayment plan.** These actions will help move the government towards the long-term objective of eliminating payday loans.

The administrative complexity associated with the promotion and development of credit alternatives is acknowledged as a necessary cost to ensure the primary policy objectives are met. In terms of other obstacles, it is understood that there are challenges in attaining a wide reach with credit alternatives. Organizations pursuing community-based financing have identified the main hindrance to the widespread development of payday loan substitutes as a hesitancy to take risks and innovate.

The reach of this option depends heavily on the capacity and motivation of local organizations and lending institutions to pilot products. My interviews revealed a willingness on the part of credit unions and community organizations to take on the challenge, and recent developments in alternative short-term financing support these findings. In addition, British Columbia has the long-term capacity to offer a viable substitute if mainstream financial institutions and community organizations are willing to take on the task. There are over 1200 deposit-taking branches, including a network of

479 credit union branches across the province (i.e. Vancity, Coast Capital Savings, First West Credit Union, etc.) (Canadian Bankers Association, 2006). Organizations such as Vancity in Vancouver, Momentum in Calgary, Causeway in Ottawa, Desjardin in Quebec, and many others in the United States have already begun to enter the market. Given the success of several pilot programs and the appetite for credit alternatives, it will be easier for successive products to develop, especially if cost-recoverable funding is introduced.

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