

**Payday Loan Hearings (PD-07-001) before  
the Nova Scotia Utility and Review Board**

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**RESPONSE REGARDING MANITOBA DECISION**

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April 23, 2008



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In response to the Board's letter dated April 10, 2008, 310-LOAN welcomes the opportunity to comment on the Manitoba Public Utility Board (PUB) order 39/08 regarding the Maximum Charges for Payday Loans.

### **Summary of the Manitoba Decision**

The Manitoba PUB order places the following restrictions on the charges that may be applied to payday loans in that Province:

- Payday loans are classified into three categories:
  - (a) Loans to borrowers collecting employment insurance or social assistance
  - (b) Loans in excess of 30% of the borrower's expected net pay
  - (c) Loans that do not fall into category (a) or (b)
  
- The maximum cost of credit for these categories is as follows:
  - (a) 6% of the loan amount
  - (b) 6% of the loan amount
  - (c) 17% of the first \$500, 15% from \$501 to \$1000, 6% from \$1,001 to \$1,500
  
- The maximum cost of credit for an extension, renewal or replacement loan is 5% of the loan amount and can only be charged once per extension, renewal or replacement.
  
- The maximum to be charged on default is \$20.
  
- The maximum allowable interest on overdue loans is 2.5% per month, not to be compounded.
  
- Where loans are distributed via debit or credit cards, if the borrower does not have the option to receive their loan in cash, all fees associated with the card are to be included in the cost of credit calculation and the total cost must not exceed the prescribed limits described above.

## Overview of the Manitoba PUB Approach

In their order, the PUB was very forthcoming about their approach to this decision and their philosophy behind it. They defined their focus as:

*“assisting and protecting those consumers now relying on payday loans to meet short-term credit needs, yet unable to access that short-term credit from a lower-cost source.”<sup>1</sup>*

They defined payday loans as “injurious”<sup>2</sup> and suggested that borrowers make every effort to avoid them:

*“Prospective payday borrowers should realize that payday loans are so expensive that they should be avoided, to be considered only in the absence of access to credit from mainstream lenders, family or ‘doing without’.”<sup>3</sup>*

They acknowledged that their order would eliminate a number of lenders from the market, but were silent on the exact number of lenders. They also recognized that a reduction in competition may inflict “hardship” on some borrowers, but provided no measure of that hardship:

*“The Board anticipates that the maximum charges established by this Order will result in some, if not many, payday lenders exiting Manitoba, and acknowledges that such a result will bring transitory hardship to some payday loan borrowers who will either have to establish an alternative source of credit or do without.”<sup>4</sup>*

Finally, the PUB recognized that their order would influence the risk profile accepted by payday lenders and considered this a positive outcome:

*“Credit criteria set so “loose” as to result in bad debt ratios higher than 5% are not in the public interest,”<sup>5</sup>*

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<sup>1</sup> Manitoba Public Utility Board Order 39/08 at p. 224.

<sup>2</sup> Ibid., at p. 9.

<sup>3</sup> Ibid., at p. 4.

<sup>4</sup> Ibid., at p. 10.

<sup>5</sup> Ibid., at p. 228.

## Supporting Assumptions

To support their order, the PUB made a number of assumptions which, in their view, justify the order's interventionist nature.

(1) Banks and Credit Unions will provide a substitute product for payday loan borrowers

*“It is hoped that many current payday borrowers, considering the evidence of the cost of loans associated with payday loans, and with a greater effort by banks and credit unions to serve less affluent populations seeking small loans, will be able to develop a credit relationship with banks and credit unions.”<sup>6</sup>*

(2) The cost to those consumers who will no longer qualify for a payday loan under the tighter credit restrictions that will result from the PUB order is justified

(3) There are few, if any, justifications for using a payday loan

## Testing these Assumptions

### ***Banks and Credit Unions will provide a substitute product for payday loan borrowers***

The PUB seems to contradict its own commentary in regards to the role of Banks and Credit Unions in providing immediate access to short-term, small-sum credit to payday loan borrowers. While they mention repeatedly their desire for these institutions to provide a product that is competitive with a payday loan, they also talk at great length about how the product and the borrowers who use it do not align with the objectives of those institutions:

*“Banks and credit unions, by errors of commission and omission, have contributed to the growth and success of the payday loan industry. Rather than being ‘part of the solution’, mainstream lenders have been part of the problem...When supplying credit to their borrowers, banks and credit unions apparently treat the longer-term interests of credit-impaired consumers and borrowers as quite secondary...While profiting from their operations in Manitoba, the banks in particular have not well served the less affluent, have withdrawn from poorer neighbourhoods and shown little interest in developing loan products to compete with the high-cost, short-term credit offerings of the payday lenders...The banks and the credit unions should ‘do better’.”<sup>7</sup>*

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<sup>6</sup> Manitoba Public Utility Board Order 39/08 at p. 245.

<sup>7</sup> Ibid., at p. 242.

***The cost to those consumers who will no longer qualify for a payday loan under the tighter credit restrictions that will result from the PUB order is justified***

As 310-LOAN explained in its final submission to the Nova Scotia Utility and Review Board, one of the justifications for divergent prices in the payday loan market is the lenders' credit risk profile. Lenders who accept higher risk customers must charge higher rates in order to earn a reasonable return. In their commentary, the PUB made it clear that they understand this principle and that they understand their order will force lenders who remain in the market to tighten their risk profile and turn away borrowers who they otherwise would have served:

*“Dr. Clinton held that some payday lenders had less onerous credit criteria than others; the Board questions whether there is a point where a reasonable credit criteria would suggest that no loan should be made.”<sup>8</sup>*

While the PUB has issued an order that dictates, to an extent, how much risk payday lenders can accept, they are silent on the financial impact this will have on borrowers who will no longer qualify for a payday loan, implying that the impact is insignificant and/or acceptable.

In order to justify their exclusion of some borrowers from the payday loan market, the PUB selectively sampled research from jurisdictions where payday loans are not permitted. Their review of the available research is flawed and incomplete.

In their order, the PUB cited two studies that looked at U.S. States after a payday loan ban. What is striking about the PUB's comments is that they made reference to flaws in one of the studies, but omitted one of the most glaring deficiencies in the other.

One of the studies referenced by the PUB was *Payday Holiday: How Households Fare after Payday Credit Bans* by Donald P. Morgan and Michael R. Strain of the Federal Reserve Bank of New York. In their study, Morgan and Strain find:

*“Payday loans are widely condemned as a “predatory debt trap.” We test that claim by researching how households in Georgia and North Carolina have fared since those states banned payday loans in May 2004 and December 2005. Compared with households in states where payday lending is permitted, households in Georgia have bounced more checks, complained more to the Federal Trade Commission about lenders and debt collectors, and filed for Chapter 7 bankruptcy protection at a higher rate. North Carolina households have fared about the same. This negative correlation—reduced payday credit supply, increased credit problems—contradicts the debt trap critique of payday lending, but is consistent with the hypothesis that payday credit is preferable to substitutes such as the bounced-check “protection” sold by credit unions and banks or loans from pawnshops.”*

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<sup>8</sup> Manitoba Public Utility Board Order 39/08 at p. 244.

Following their mention of this study, the PUB added:

*However, a paper published by the Centre for Responsible Lending contested Morgan and Strain's work, suggesting flaws in the research.”<sup>9</sup>*

The study that the PUB relied on to justify the exclusion of some payday loan borrowers from the Manitoba market was *North Carolina Consumers After Payday Lending: Attitudes and Experiences with Credit Options* from the Center for Community Capital. According to the PUB:

*“The report advises: ‘Researchers concluded that the absence of storefront payday lending has had no significant impact on the availability of credit for households in North Carolina. The vast majority of households surveyed reported being unaffected by the end of payday lending. Households reported using an array of options to manage financial shortfalls, and few are impacted by the absence of any single option – in this case, payday lending. More than twice as many former payday borrowers reported that the absence of payday lending has had a positive rather than negative effect on their household. The ban on payday lending has made no difference to most, and helped more households than it has harmed.’”<sup>10</sup>*

What the PUB omitted from their commentary about the Center for Community Capital study was that of the 400 residents who participated, only 23 were former payday loan users. In a survey where 94% of the participants have never used a payday loan, it should come as no revelation that this group would not be affected by a ban on the product. It also goes without saying that 23 respondents cannot be considered a representative sample for evaluating the attitudes of former payday loan users in a State with a population of almost 9 million.

Finally, for reasons known only to them, the PUB chose to omit the findings of Policis who prepared *Illegal Lending in the UK* in 2006 on behalf of the Department for Business Enterprise and Regulatory Reform. This study was referenced in our opening statement to the Nova Scotia Utility and Review Board and its key findings were:

- UK borrowers who used licensed lenders for short-term, small sum advances paid an average of £26 for a £100 loan while those who used illegal lenders, presumably because they didn't have access to licensed lenders, paid £200 for a £100 loan.
- The incidence of illegal lending in Germany is two and a half times higher than in the UK and that in France is three times higher than in the UK. The lower incidence in the UK appears to be explained by higher risk borrowers in the UK having more legal credit options than is the case in either France or Germany.

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<sup>9</sup> Manitoba Public Utility Board Order 39/08 at p. 61.

<sup>10</sup> Ibid.

- In the UK, the supply vacuum – and thus the opportunities for illegal lenders – appears not only to be smaller than in neighbouring European markets but to occur in a different part of the socio-economic spectrum. In advanced credit markets which have tighter regulatory environments (France, Germany, and Japan) illegal lenders target middle income, credit-impaired borrowers, who in the UK are served by (legal) sub-prime lenders.

***There are few, if any, justifications for using a payday loan***

Throughout their commentary, the PUB makes reference to the fact that payday loan borrowers pay “100 times or more the cost of credit required (in terms of the APR) compared to borrowers from mainstream lenders.”<sup>11</sup>

By focusing so heavily on the typical payday loan APR, the PUB misrepresents the product as an alternative to longer term credit and ignores more applicable comparisons.

Professor Iain Ramsay, whose work we have relied on heavily, identified this risk in his ‘Third Way’ paper:

*“...an APR of 200 per cent on a payday loan has a shock value that may deter an individual from using the product. That may indeed be one objective, but it may not be the best information for an individual who wishes to compare a payday loan with other alternatives.”<sup>12</sup>*

Recognizing that a proportion of payday loan consumers use the product because they do not have access to alternative sources of short-term credit, the product is most appropriately evaluated against the consumer’s actual alternatives.

For example, in their 2001 paper that looked at the demand for payday loans in the United States, Gregory Elliehausen and Edward C. Lawrence illustrated the financial benefit of using a payday loan to pay a utility bill on time and avoid the corresponding penalty. They also evaluated the financial benefit of using a payday loan to repair a car and the related savings over taking public transit until payday.

Most payday loan borrowers do not choose between a line of credit and a payday loan when they are faced with an unexpected financial shortfall. Their alternatives are the bank’s bounced-cheque fee, the utility company’s late fee and/or reconnect charge, the cost of taking a bus or taxi to get to work, do groceries and take the kids to soccer, etc. For these borrowers, a payday loan is very easy to justify and represents a sound financial decision.

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<sup>11</sup> Manitoba Public Utility Board Order 39/08 at p. 240.

<sup>12</sup> Ramsay, Iain. 2005. Consumer Credit Regulations as ‘the Third way’? (“Ramsay 2005”), at p. 13-14.

## **Conclusion**

The PUB's order will reduce the number of lenders in the Manitoba market and limit the number of people who will qualify for a payday loan. Because the rates stipulated by the PUB are drastically lower than the cost of issuing those loans for many lenders, the magnitude of the aforementioned reductions is likely to be severe.

With their order, the PUB set out to reduce the financial impact of payday loan use on Manitoba borrowers. They acknowledged that their order will force some borrowers to "do without," but were satisfied that those who do obtain payday loans in the future will enjoy a dramatically lower rate.

The PUB has erred in its failure to accurately account for the impact its order will have on those who will no longer have access to the product. Barring a dramatic change in economic conditions that affords every Manitoban abundant savings and a good credit rating, the number of people who find themselves in need of short-term, small-sum credit will not change in the near future. While those who still qualify for a payday loan will save 20% to 50% on their future loan, those who cannot access the product will see their costs rise, some quite dramatically.

As the Policis study illustrates, some newly excluded borrowers may pay up to ten times the amount that they currently pay in order to borrow \$100 from an illegal source of credit. Some will temporarily relinquish their personal assets in order to obtain a pawn loan and others will do without. Of the borrowers who do without, those who knew how to weigh the difference between the cost of a payday loan and the cost of bouncing a cheque will be worse off.

The net benefit to Manitoba customers is difficult to measure. Some borrowers will enjoy much cheaper payday loans and others will be forced to deal with less pleasant and far more expensive sources of credit. While well intended, it is our position that the Manitoba PUB order has needlessly abandoned an entire class of borrowers and in doing so contradicted its consumer protection objective.