

NSUARB-PD-07-001

NOVA SCOTIA UTILITY AND REVIEW BOARD

IN THE MATTER OF THE CONSUMER PROTECTION ACT
IN THE MATTER OF a Hearing respecting certain aspects of the
Consumer Protection Act relating to payday loans

REBUTTAL SUBMISSION OF
CANADIAN PAYDAY LOAN ASSOCIATION

March 10, 2008

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NOVA SCOTIA UTILITY AND REVIEW BOARD

IN THE MATTER OF: **The *Consumer Protection Act*, R.S.N.S. 1989, c.92 as amended**

IN THE MATTER OF: **A Hearing respecting certain aspects of the *Consumer Protection Act* relating to payday loans**

**REBUTTAL SUBMISSION OF
CANADIAN PAYDAY LOAN ASSOCIATION ("CPLA")**

Pursuant to the schedule established by the Utility and Review Board (the "Board"), written submissions from the following parties were filed with the Board on March 3, 2008:

- Board Counsel
- Province of Nova Scotia - Service Nova Scotia and Municipal Relations ("SNSMR")
- Consumer Advocate
- The Cash Store Inc. and Assistive Financial Corp. ("Rentcash")
- 310-Loan
- Canadian Payday Loan Association ("CPLA")

The CPLA has the following specific comments with respect to these submissions, structured in accordance with the proposed list of issues identified by the Board in its letter of January 31, 2008:

- a) **Does the Board have sufficient evidence before it to determine the issues in this matter? If not, what is the nature of the evidence that the Board is lacking? If evidence is, allegedly, lacking, explain how you feel the missing information would be material to any decision the Board might make.**

The CPLA agrees with SNSMR and the other industry participants that the Board has sufficient information to make an Order in this proceeding. As noted in its written submission, the CPLA believes the Board has had the benefit of substantial evidence on which it can base its decision.

In its discussion with respect to this point, the Consumer Advocate references a 2003 Decision of the Alberta Court of Queens Bench, *WBA Management Society v.*

Alberta (Beverage Container Management Board), 2003 ABQB 551. The CPLA respectfully submits that this precedent is clearly distinguishable from the present circumstances. At paragraph 3 of that decision, the Court noted: "This approach is mandated by the **monopolistic nature** of this industry..." (emphasis added). Also, the Administrative Bylaw in that case specifically stated that depot operators should be provided with "a fair return". In contrast, in delegating the responsibility for setting maximum rates for the payday loan industry, neither the amendments to the *Consumer Protection Act* nor the regulations specifically state how the Board should exercise its discretion in setting the maximum cost of borrowing. Thus, the Board does not require the type or amount of evidence suggested by the Consumer Advocate.

On page 4 of its written submissions, the Consumer Advocate raises the issue of "the importance of setting an initial rate", and submits that: "Failing to set proper initial rates through this process – and also failing to employ the appropriate methodology – will make it more difficult to correct rates in the future." The CPLA submits that this concern is unfounded, and ignores the considerable and ongoing oversight function of the Board as established in the amendments to the *Consumer Protection Act*. Section 18T(6) of Bill No. 87 specifically states that the Board shall review its existing orders at least once every three years and, after the review, the Board shall make a new order that replaces the existing orders. Furthermore, Section 18T(7) provides the Board with opportunity at any time within the 3 year period to review any existing order and, if required, make a new order that continues, modifies or replaces the original order. The CPLA has confidence that the Board would not hesitate to modify its initial decision in setting the maximum cost of borrowing in the future, should it determine that the circumstances warrant such a change.

The CPLA notes that the Consumer Advocate's position with respect to the sufficiency of evidence stands in stark contrast to its position that the Board has a duty to set the maximum cost of borrowing under Bill No. 87. On page 16 of its written submissions, the Consumer Advocate states "No one is more concerned than us that maximum rates be set as quickly as possible; the present market is unregulated." The CPLA and other industry participants have confirmed that such regulatory certainty will provide benefits not only to payday loan operators, but also to Nova Scotia consumers, who stand to benefit from enhanced disclosure, increased competition, and protection from excessive charges that are currently not in place.

- b) **Does the Board have the jurisdiction enabling it to decline to set the maximum cost of borrowing (including the amounts set out in s. 18T(2)(a)-(c) of the *Consumer Protection Act*)? If so, what factors should it consider in determining whether to decline to set the maximum cost of borrowing in this matter?**

The CPLA agrees with the submissions of SNSMR, the Consumer Advocate, and Board counsel that the Board does not have the jurisdiction to decline to set maximum rates as required by the Legislation. In fact, having given Notice of the Hearing and having heard substantial evidence over the course of a five day hearing, the Board has a statutory duty to set the maximum cost of borrowing.

c) What methodology should the Board adopt to set the maximum cost of borrowing?

On page 2 of its submission, SNSMR submits:

“Repeat borrowers cost less administratively than first time borrowers, so should pay less for their loans. Also large dollar value loans cost less proportionally than [sic] small dollar value loans. The Department urges the Board to give consideration to a formula for setting the maximum cost of borrowing that takes these factors into account.”

Similarly, the Consumer Advocate submits that a fixed fee model would result in repeat borrowers bearing a disproportionate proportion of operating costs, and states on page 34:

“For fees to better reflect actual costs, we recommend that first time borrowers pay a set fee and that fees for repeat customers be reduced accordingly.”

As noted in its earlier written submissions on pages 6-7, the CPLA believes that these recommendations would prove more difficult for payday loan customers to fully understand, a point which both SNSMR and the Consumer Advocate concede. Furthermore, attempting to differentiate between customers based on whether they are first time or repeat borrowers would apply only with respect to that particular payday lender, and could make it comparatively more expensive for a consumer to change between payday loan operators. The CPLA would note that although it may take comparatively more time to process loans of first time borrowers, payday lenders generally have excess capacity in terms of staff time for the processing of loans. Payday lenders must pay all the costs associated with remaining open throughout the day, regardless of the number of loans processed. If it takes slightly longer to process a loan for a first-time customer, the fact is that the fixed costs of the business would need to be incurred in any event and therefore it does not actually cost more to process first time loans.

The CPLA further submits that attempting to determine the actual additional time it takes to process the loan of a first time versus a repeat customer and the time period that needs to elapse before a repeat customer is again considered a “new” customer are extremely difficult, if not impossible, processes that differ with every lender. In its submissions at page 8, 310-Loan states that “...it is our position that it is not possible to identify cost differences strictly between first time and repeat customers. Depending on the length of time between a repeat customer’s loan, they may be required to provide a new set of qualification documents (bank statement, pay sub, etc.) in order to reaffirm their creditworthiness.” The CPLA agrees and notes that there is no standard practice within the industry on these points.

On page 32, the Consumer Advocate notes that Professor Gould agreed that the borrower of a bigger loan is paying a disproportionate amount of the fixed cost than were in fact incurred in processing that particular loan. Dr. Gould’s complete response to that question was as follows (p. 376-377):

Yes, that's true and, you know, it's something that I did give some thought to, and I mentioned in my evidence that you could set up a different type of system. And I think the analogous situation with public utilities, as the Board is familiar, is that you can set a rate for -- an overall rate of return for the company and then obviously have a separate rate design hearing to make sure that the company earns that rate. I think the problem here, though -- and you could do that, but the problem is that the logical consequences of following that path is that you do end up charging the small loans more than the larger loans and I'm not sure whether -- and the first question is, could you design a system, as you do with a public utility, that generates that same amount of money? And the answer is, in theory yes, but you'd have to have the distribution of loans, payday loans, which is a little hard to come by, so you have a practical problem in doing that. Then the next thing that you'd have to consider is do you want to do that from the consumers' point of view, do you want to have the person who comes in for a hundred dollar (\$100) loan pay a lot more, a very, very high cost relative to the amount borrowed? Right now there is some cross-subsidization by having just one fee across different size loans.

The net effect of having a different maximum cost of borrowing tied to the different amounts lent means that the lender is likely to institute a different, more restrictive lending criteria for those amounts. If, for example a lender can charge up to 26% of a loan for the first \$300 and 20% for the next \$300, the lending criteria is likely to be more restrictive for that portion of the loan over \$300. Consider a case in which a borrower requires \$600 for a car repair. If the borrower qualified for a \$600 loan the maximum cost would be \$138. However in many cases, based on credit history, a borrower may only qualify for a loan up to \$300. The borrower requires \$600 for the repair and therefore is forced to go to two different lenders to obtain two small loans at the highest rate. The cost would be \$156 if the maximum amounts for the initial permitted were charged. If the maximum rate was set at \$23 per hundred and applied to the full amount, the total cost of the loan would be \$138. Accordingly, the implementation of a layered rate as in this example would actually be detrimental to consumers.

The CPLA would also note that payday lenders need to earn a certain amount of revenue to remain in operation. If the amount that can be charged is reduced as loan sizes increase, it follows that payday lenders will seek to offset this by charging more for smaller loans. While borrowers with higher incomes can qualify for larger loans, those with lower incomes may only qualify for smaller amounts. As a result, with a layered rate example as suggested by SNSMR, borrowers with lower incomes, who generally obtain smaller loans, could be required to pay more for credit than those with higher incomes. The CPLA submits that this would not be a desirable result.

As well, the general costs of operation associated with any business naturally increase over time as a result of inflationary pressures. Payday lenders are able to handle these future increases in part because the size of consumer pay cheques generally rises over time as well, and the size of loans will tend to increase. However, with a layered rate that places different restrictions on the cost of borrowing based on the size of the loan, payday lenders will not be as able to offset increases in cost that accrue over time due to inflation.

It is for these practical reasons, and those set out in the CPLA's written submissions, that the CPLA recommends the Board adopt a straight forward maximum cost of borrowing per \$100 of payday loans as the appropriate fee structure. This is consistent with the recommendations of the Board's consultant, David Martin.

The CPLA would re-emphasize that the Board in this proceeding is merely setting a maximum rate for the cost of borrowing under which payday loan operators would be competing for market share. As such, payday loan operators would be at liberty to offer variable fee structures as deemed appropriate within the market cap established by the Board.

d) What type of expenses comprise regulatory costs and to what extent should the Board consider them in its deliberations?

In its discussion of regulatory costs at page 29 of its submission, the Consumer Advocate submits:

"The foregoing is not to say these costs do not generally fall within what is described above as being a portion of "base costs" or the like. Such are. However, these costs must be taken into consideration within the base costs of the industry as a whole, and not be a factor in the current process."

The CPLA finds it odd that the Consumer Advocate is advocating a methodology that refers to operating costs in determining the appropriate maximum cost of borrowing, and yet disagrees that these should be taken into consideration by the Board in the process. The CPLA understands that none of the industry participants in the Hearing are seeking costs *per se* in referring to the broad costs associated with regulation and compliance with the regulations. Merely, these industry participants, including the CLPA, simply wish that the Board consider the extent of these costs to payday loan operators as costs in addition to the general operating costs otherwise identified within the industry.

e) Prior to default, at what amount should the Board set the maximum cost of borrowing?

At page 24 its submissions, the Consumer Advocate states: "During the hearing, the CPLA withdrew its support of one the options [sic], an earlier recommendation of a set fee of \$20 per \$100 loan." The CPLA would note that it did not "withdraw" its support for this option during the hearing. The CPLA's position with respect to the recommended maximum cost of borrowing is consistent with the position set out in the pre-filed evidence, as well as in other jurisdictions in Canada such as Manitoba.

On page 25 of its submissions, the Consumer Advocate submits that "looking only at fees charged provides no insight on either the costs incurred by the lender in providing the loan or the rate of return reaped by the lender from the loan." As mentioned in the CPLA's written submission at page 14-15, David Martin explained in cross examination how pricing information in general allowed him to draw conclusions regarding the costs of offering payday loans.

On page 26 of its submissions, the Consumer Advocate states that "fairly modest increases in the amount charged can create a dramatic increase in the rate of return. Furthermore, the Consumer Advocate submitted that the evidence of Mr. Slee on this point was "neither challenged nor rebutted by any of the other intervenors". The CPLA would note that in response to questions by Mr. Cameron, Mr. Slee clarified that the information referenced in Exhibit PD-22 on this point was "most likely indicative of our structure as a direct lender"(p.642):

A. Mr. Cameron, if I could just go back to the previous question, the only thing I would like to throw in there is that the change in our return on investment from, say, twenty dollars (\$20) to twenty-three dollars (\$23) is most likely indicative of our structure as a direct lender. So our costs are not nearly as variable as bricks and mortar location may experience. So I don't stand here suggesting that these numbers represent how bricks and mortar ---

Q. And I don't suggest you do. They just simply demonstrate to us what it would do for your particular operation. That's correct?

A. Yeah.

Also, with respect to concerns regarding current rates of return within the industry, the CPLA notes that Dr. Gould stated in his report at page 18 that "in summary, there is no indication that the large payday loan companies are making excessive profits", a conclusion which was not challenged by the Consumer Advocate in cross examination.

On page 27 of its submissions, the Consumer Advocate submits: "From the Consumer's perspective, perhaps the most serious methodological concern involves weighted versus unweighted averages." Dr. Gould explained the rationale for choosing unweighted over weighted at page 405 of the Transcript:

Q. Okay. I guess I'm just trying to understand that your -- the reason you chose unweighted over weighted is because weighted shows the large companies.

A. It gives a result that's very indicative of the very large companies as opposed to the whole industry.

Q. Okay. And your concern with the fact that there would be reflecting the large companies is what?

A. That it's no [sic] indicative of the whole market. In other words, we want to deal with not just large companies, but with medium-size and small companies as well.

Finally, on page 26 of its submissions, the Consumer Advocate notes its preference for the methodological approach utilized by Dr. Gould. The CPLA would reemphasize that this method differs from "traditional" public utility ratemaking which would require specific and detailed cost information for an applicant seeking rate

approval. The purpose of collecting such information would be to provide directional and indicative support that the maximum cost of borrowing established by the Board is just and reasonable. The CPLA does not believe this would require the level of detailed information the Consumer Advocate's written submissions appear to suggest.

- f) **Upon default, at what amount should the Board set any fee, charge or penalty in respect of the default?**

No further comment.

- g) **Should the Board set any "component" of the maximum cost of borrowing, as contemplated under s. 18T(3) of the *Consumer Protection Act*?**

No further comment.

- h) **Is there a contradiction in the *Consumer Protection Act* between s. 18N(h) which prohibits rollovers [defined in s. 18A(c)] and s. 18T(2)(b), which purports to allow extensions or renewals? If so, can it be reconciled?**

The CPLA concurs with the analysis of Board counsel, Rentcash, SNSMR, and the Consumer Advocate that the seeming contradiction in *Consumer Protection Act* can be reconciled under Section 18T(2)(b) if the Board sets only the maximum annual effective interest rate that payday lenders may charge if the borrower and lender agree to extend or renew the loan.

On this point, however, the CPLA recommends that the Board should establish a maximum "rate" for extensions or renewals that is below the maximum cost of borrowing established for an initial loan, but still provides payday lenders with an incentive to agree to the extension or renewal rather than consider the loan in default. Otherwise, if a consumer is unable to repay their loan on the due date and approaches the lender for an extension, there would be no real rationale or incentive for payday lenders to agree to the extension. The Board should set a maximum rate that will create such an incentive for payday lenders to agree with the borrower to extend the loan if requested by the borrower. While it has no specific recommendation as to the maximum cost the Board should establish on this point, the CPLA submits that it remains important that the maximum rate for extensions or renewals be set below the maximum cost of borrowing for the initial loan. Norman Bishop commented on this point during cross-examination by Board member Cochrane during the hearing (p. 155):

A. (Bishop) And we're not opposed to that. I believe you're charged with setting maximum fee caps, maximum default fees and maximum amounts for extension of loans, and so we've made a recommendation -- or comments on what the extension should be. When we first created the code the Association didn't want to get into the business of regulating fees of the various members out there, so -- and wanted to be effective with the issue of rollovers which were customarily giving -- extending the loan for the full fee every time it came up for renewal. We recognize that it would be reasonable to have provisions where a willing borrower and

lender want to extend the loan, and we assume that the Board would set a lower fee for that. So, at the time the code was put in place it was to be effective trying to get good business practices in place, but now that regulation is coming it would be reasonable to set a fee for an extension and we assume it would be a lower fee than the initial fee for the maximum rate cap.

- i) **Should a payday borrower requesting an extension or renewal be charged the same as a first-time borrower?**

No further comment.

- j) **In addition to that required under s. 181 of the *Consumer Protection Act*, should the Board require any other disclosure by payday lenders to borrowers? If so, what specific disclosure requirements should be directed, and at what time should such disclosure occur?**

No further comment.

- k) **Should the Board direct payday lenders to file data in advance of the next review? If so, what type of data should be filed and at what frequency?**

On page 38 of its submissions, the Consumer Advocate recommends the Board "require operators to file annual reports providing data on operating costs and other information that the Board may consider to be relevant."

On page 4 of its submissions, SNSMR submits that the Board could request "that payday lenders file information on their actual loan charges and fees semi-annually or annually. Such information could be collected by the Department in its role of issuing permits to payday lenders and the information submitted to the Board at appropriate intervals for its review."

Rentcash submits at page 9 of its submissions that the Board "make a recommendation to the Minister that regulations be passed to allow for the collection and compilation of information, including the rates which licensed payday lenders are charging and maintain confidentiality over such information."

The CPLA respectfully submits that the Board does not require the passing of any regulations in order to authorize its request for payday lenders to file data in advance of the next review. When the Board's decision in this matter on methodology is known, the specific type information required for the Board in future reviews will be clearly identified. The CPLA maintains that a collaborative approach with industry is preferable in determining the specific data required to be filed to minimize the cost and complexity in preparing and submitting the information. As noted at page 18 of its written submissions, the CPLA believes such a collaborative approach is crucial to minimize the complexity and costs to industry associated with the gathering and reporting of information deemed to be relevant to the Board in its setting of the maximum cost of borrowing. The Board may wish to consider the possible retention of a

consultant with a commercial/economic background which could work with industry participants to collect the required data on the Board's behalf on a confidential basis and provide a periodic overview in a reporting format.

- l) Under s. 18T(7) of the *Consumer Protection Act*, what factors should the Board consider in determining whether to schedule a review to occur in less than three years?**

On page 39 of its submissions, the Consumer Advocate suggests that "anyone who otherwise may be an intervenor in the process, be that person a consumer or industry representative, can trigger a review by the Board, by demonstrating, at least on a *prima facie* basis, changes to the industry having occurred requiring the Board's attention." The CPLA does not necessarily disagree with this recommendation. However, the identity of the parties who can request a review should be left to the future discretion of the Board.

- m) Does the current state of the market in Nova Scotia provide sufficient protection for payday consumers? If not, what steps, within the jurisdiction of the Board, may be taken to improve consumer protection?**

No further comment.

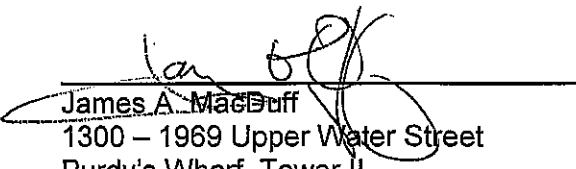
- n) Should the Board make any recommendations to the Minister pursuant to s. 18T(10) of the *Consumer Protection Act*?**

No further comment.

All of which is respectfully submitted this 10th day of March, 2008.



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