

Our File: JS-2733
April 23, 2008

Nova Scotia Utility and Review Board
1601 Lower Water Street
Suite 300, Summit Place
Halifax, NS B3J 3S3

ATTENTION: Ms. Mora G. Stevens
AGA Officer/Clerk of the Board

Dear Sirs:

Re: Payday Loans – Manitoba Decision – PD-07-001

Further to the Nova Scotia Utility and Review Board (the "Board")'s letter dated April 10, 2008, please accept the following submissions on behalf of the Canadian Payday Loan Association ("CPLA") with respect to the April 4, 2008 decision of the Manitoba Public Utilities Board setting maximum rates for payday loans ("Manitoba Decision"), as it relates to the proceedings in Nova Scotia.

Introduction

The CPLA respectfully submits that the Board give little or no weight to the Manitoba Decision during its deliberations in the current proceeding. Section 18T(4)(d) of the *Consumer Protection Act* is a permissive provision, not a mandatory one. Manitoba is simply the first of many jurisdictions to render its initial decision, and, importantly, the time periods for reconsideration and/or appeal of the decision have not yet lapsed. Furthermore, many of the "main premises" underlying the Manitoba Decision remain problematic in certain key respects.

Based on an initial review of the Manitoba Decision, the Manitoba Board appears to have taken a fundamentally different philosophical approach to the provincial regulation of the payday loan industry than the CPLA suggests. As stated in Mr. Stringer's Opening Statement, the CPLA believes that the Nova Scotia hearing is not about whether payday loan lenders deserve to exist, but rather should be "focused on determining regulatory parameters that best protect consumers from excessive fees while ensuring that all Nova Scotians have access to payday loan services at fair rates in a competitive and viable marketplace." (Ex. PD-31, p. 2)

In contrast, the Manitoba Board adopted a clear opinion as to the questionable legitimacy of the industry. While this tone permeates the entire Manitoba Decision¹, it is stated perhaps most explicitly in the fourth paragraph of the Executive Summary (p. 4):

“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”.”

With respect, the CPLA submits that the Manitoba Board has failed to fully appreciate what the respective federal and provincial governments have sought to achieve in putting regulatory mechanisms for the payday loan industry in place. Furthermore, the Manitoba Board’s view that payday loans “should be avoided” appears to have unduly influenced many of its underlying conclusions, as discussed in more detail below.

Specific Concerns with the Manitoba Decision

In failing to take the CPLA’s expert evidence into account (as presented in both Manitoba and Nova Scotia), the Manitoba Decision sets the maximum cost of borrowing at a level that will certainly cause responsible small and medium-sized payday lenders to leave the industry. The Manitoba Decision expressly acknowledges this point at p. 233, but fails to consider that this could harm consumers by limiting access to credit. The CPLA firmly believes that regulation which allows for adequate competition amongst large, medium, and small payday loan operators in both urban and rural areas is in the best interests of consumers.

In contrast, the Manitoba Board explicitly adopted an approach which assumes that all payday lenders will likely set charges equal to the maximums established by regulation. At p. 227, the Manitoba Decision states (emphasis added):

“The Board establishes these maximums on the following major premises: ...

(b) The “maximums” will become the tariff for many (if not most) payday lenders; **it is unlikely any (or at least many) payday lenders from within the industry’s current rolls will set charges lower than the maximums established herein** (with payday lending made “legal” by regulation), and it is possible that some other lenders (finance companies being the most likely) may enter the market, which requires licensing (see below).”

¹ At p. 235 of the Manitoba Decision, the Manitoba Board “concludes that, in the common parlance, payday lenders could be considered *loan sharks*.” (emphasis in the original). Further, at p. 247, the Manitoba Board states it “**has no difficulty** in associating the term “exploitation” with charges beyond the maximum levels established herein.” (emphasis added). Notably, in neither case does the Manitoba Board make any attempt to distinguish as between payday lenders who operate in accordance with Codes of Conduct (such as CPLA members) and the egregious practices sometimes exhibited by other (non-CPLA member) lenders.

The CPLA fundamentally disagrees with this approach to regulation of the payday loan industry, as stated throughout its evidence and submissions in both the Nova Scotia and Manitoba proceedings. The Province of Nova Scotia, as represented by Service Nova Scotia and Municipal Relations in the Hearing, also seems to disagree with this approach. In fact, it stated on p. 1 of its written submission that the Board should: "set a maximum cost of borrowing that accommodates existing payday lenders, except for any that are exceptionally higher than the norm." The overall viability of the industry is, therefore, seen as worthy of protection.

The approach adopted (for the moment) in Manitoba fails to recognize the significant differences in cost structures as among payday lenders. In the Manitoba Decision's summary of the evidence, it notes Dr. Gould's recommendation that, in establishing a maximum cost of credit, the Manitoba Board should acknowledge that the industry is "comprised of many different companies, with many different cost structures, and different rates of returns, (that being) ... completely at odds with regulating a public utility that is essentially a monopoly." (p. 179-180)

Furthermore, the Manitoba Decision notes CPLA's position that "a payday loan company's cost structure will be influenced by a variety of factors... location... hours of operation (with) ... an impact on increasing operating costs... different way(s) of doing business (and)... each company may have a different rate of return based on a particular risk in capital structure." (p. 180). For example, small, lower volume payday lenders in rural areas of the Province face distinct cost pressures as compared to lenders in urban areas. Yet the Manitoba Board entirely fails to take these factors into account in establishing its maximum tariff.

Another "major premise" on which the Manitoba Decision explicitly relied in setting maximums is as follows, (p. 229):

"(m) American payday lenders operate in states where the maximum charges are lower than the maximum charge per \$100 loan established herein, and this suggests that industry viability will not be challenged or made impossible with the maximums set herein."

The Manitoba Board heard no formal evidence regarding the regulation of payday lenders in the many varied jurisdictions in the United States. No evidence was presented on the differences between the countries in such areas as taxation rates, wage rates, health benefits provided to employees, or with respect to the legality and pervasiveness of rollovers. The main reference in the Manitoba Decision to the Manitoba Board's understanding of American payday lenders is found at p. 56, in the section "Jurisdictional Scan":

"The Board understands that there presently are 28 American states that both allow and regulate payday lending, the latter through the establishment of rate caps. Another 6 states allow payday lending and have no stated interest rate ceiling. The other states either specifically bar payday lending or accomplish the same objective by rate caps set too low to allow a payday lender to operate (as indicated previously, the operating mode of payday lenders results in high operating costs per \$100 loan).

At the hearing, Dr. Robinson claimed that the average rate ceiling for a state with a rate ceiling was between \$15 and \$16 per hundred, with the range being \$12 to \$20 per hundred. Some states have sliding scales.”²

In its summary of the evidence, the Manitoba Decision succinctly summarizes the CPLA’s position with respect to the adequacy of the American information at p. 189:

“CPLA suggested that “what ... limited evidence the Board’s received (on the approaches of various states in the United States) does disclose is that there is a patchwork, a different and widely-divergent regulatory approaches”, and suggested that “the Board has virtually no information regarding the social and market factors to which the various U.S. state governments responded to in adopting their different regimes, and extensive expert evidence would be required to enable the Board to properly consider the context within which each state set its maximum rates”, concluding “the Board does not have any evidentiary basis to support the conclusion that the approach taken in the more restrictive US jurisdictions would be just and reasonable or even workable for Manitobans”.

There is currently no basis for the Manitoba Board’s conclusion that payday lenders in Manitoba will be able to offer payday loans within the maximums established in the April 4, 2008 decision. In fact, the weight of the evidence suggests that, at a minimum, the vast majority of payday lenders could not offer payday loans if the maximum cost of borrowing as set by the Manitoba Decision were imposed in Nova Scotia.

Furthermore, the Manitoba Decision completely fails to consider the impact of the specific tiered structure of the maximum cost of credit that it adopted. This crucial flaw in the reasoning further undermines any attempts to draw facile comparisons to the costs charged by American payday lenders operating in environments without such restrictions. The Manitoba Decision adopted a three-tiered approach, and, moreover, placed an effective cap on the size of the loan based on the percentage of the borrower’s net pay. Under the heading “Premises Supporting the Board’s Decision”, the Manitoba Board states at p. 226:

“...and the terms attached to the maximums are expected to reduce the average advance as a percentage of borrowers’ net pay, and should discourage payday lending between \$1,000 and \$1,500. Advances in excess of 30% of a borrower’s next net pay make it unlikely that the borrower’s situation can be improved by the loan, and are to be discouraged. And, for loan advances in excess of \$1,000, the charges and principal repayment requirement where due within no more than one month) are such that repayment problems can be expected, and are best avoided by discouraging such loans.”

² Dr. Robinson, the Coalition’s expert witness, did not provide any detail on regulation in the United States. As the Manitoba Decision states at p. 188: “CPLA also noted that while Dr. Robinson had “referred to regulatory caps in place in U.S. jurisdictions”, he had “acknowledged his lack of expertise in this area” and that there were numerous relevant differences between Canada and the United States”.

With respect, the Manitoba Decision simply overlooks (or fails to acknowledge) that this approach may result in consumers taking out multiple loans from a variety of payday lenders for amounts in excess of \$1000, or 30% of their next pay.³ There is also no evidence that there is any simple correlation between the rate of default and the size of the loan in relation to income. As both Mr. Slee and Mr. Reykdal discussed during cross-examination at the Nova Scotia Hearing (Transcript, p. 643-645 and p. 869-870, respectively), individual payday lenders determine the appropriate maximums to lend based on credit rating or specific lending criteria developed relying on experience, not an arbitrary cut-off figure that may simply harm consumers by denying them access to credit, as is proposed in the Manitoba Decision

Moreover (and perhaps even more problematic), is the Manitoba Board's failure to consider the effect of such caps in setting the overall maximum cost of borrowing. Consider that another of the Manitoba Decision's "major premises" states (p.229):

(i) "Economies of scale exist in most (if not all) industries, and with lower maximum charges and the closure of some higher-cost payday lenders, the remaining lenders may experience higher volumes, reducing the cost of operations per loan."

In adopting a tiered rate that effectively caps the average size of a borrower's loan, the Manitoba Decision will lead to *lower* volumes per payday loan outlet, and thus a higher cost of operations per loan, based on the Manitoba Board's very own logic. Nowhere in the Manitoba Decision does the Manitoba Board appear to take this fact into account in adopting the maximum cost of borrowing, or in its comparisons to the costs charged by American payday lenders.⁴ Similarly, the Manitoba Decision fails to take added regulatory costs facing lenders in Manitoba into account in adopting its maximums.

The CPLA also notes that the "Board Findings" and "Board Recommendations" sections of the Manitoba Decision contain no reference to the Pollara survey presented by Michael Marzolini on behalf of the CPLA. This is despite the fact that the maximums established were based on the "major premise" that:

"(a) There is a significant population in need of short-term small loans. This population is often characterized by an absence of savings, static after-tax household income, poor or no ongoing credit relationship with a bank or credit union, and limited or exhausted access to other family

³ In the Manitoba Board's extensive review of the evidence presented, the only witnesses to raise the problem of payday loans representing too high a percentage of net pay appeared to be Scott Hannah, of credit counselling services (p. 97-98) and the Coalition (p. 154). Mr. Hannah cited concerns regarding "50% or more" as the source of potential problems, and supported the CPLA's \$23/\$100 recommendation (p. 97-98). The Coalition did not adopt a recommendation on this point in the hearing, suggesting this required "further study" (p. 154). Thus, the Board's decision as to the appropriateness of the 30% cap is completely without foundation.

⁴ The CPLA did draw the Manitoba Board's attention to this point. As noted in the Manitoba Decision at p. 192: "CPLA opined that "under a tiered structure that reduces the amount that may be charged as the amount borrowed increases, lenders will be forced to increase their charges for smaller loans in order to remain viable".

assistance for the day-to-day type of access to credit that more affluent households manage without major problems.”

The CPLA finds it odd that the Pollara survey did not merit any discussion in the Manitoba Decision, particularly since the findings appear to contradict many of the concerns regarding the use of the payday loan product underlying the Manitoba Board’s conclusions.

Finally, the CPLA would note that the Manitoba Decision fixes the maximum amount that may be charged, required or accepted in the case of default at \$20 (p. 226). However, the Manitoba Decision states at p. 36: “While the cost to the lender for a NSF deposit is in the range of \$1-\$5, payday lenders may charge the borrower up to \$100, though their average charge is considerably less than that.” The CPLA is unsure as to how the Manitoba Board derived its estimate regarding the cost to the lender for a NSF deposit. The fact that the NSF default fee for each of Canada’s five Chartered Banks is between \$35 to \$40 (see p. 7, 310-Loan Final Submission) suggests that this is simply incorrect.

Conclusion

The CPLA anticipates that the Consumer Advocate may argue that the Manitoba Decision supports its earlier position that the Board not make any orders at this time due to a lack of sufficient evidence (p. 43, Submissions of the Consumer Advocate, March 3, 2008). The CPLA disagrees. The Board has had the benefit of substantial evidence with respect to the provision of payday loans in Nova Scotia on which it can and should base its decision. As noted at p. 2 of the CPLA rebuttal submission, “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.”

The CPLA would emphasize that although the *Consumer Protection Act* delegates to the Board the authority of setting the *maximum* cost of borrowing, competitive forces will ensure that the payday loans will not simply be offered equal to the maximums set. As Board Member Cochrane and Dr. Gould discussed at the Hearing (Transcript, p. 432-433):

759. Q. ... If, however, one sets a rate as a maximum, what is to stop a larger company with a different cost base from charging at the higher cost rate? And would you, in fact, expect them to do that and simply have a higher profit?

A. I would not. I would think that there would be some competition that would have these companies operate below that maximum.

760. Q. And, in fact, some of the data that you’ve referred to shows some of the companies charging significantly lower amounts in exactly the same competitive environment?

A. I'm not sure that the data shows that but I think that that would be true, that there are companies operating below that level.

761. Q. Okay. Thank you.

As emphasized throughout its submissions in this proceeding, the CPLA believes strong competition in the industry in both pricing and service levels is in the best interests of consumers. Regulation will eliminate the considerable legal uncertainties associated with the industry and encourage new entrants into the marketplace. The implementation of greater disclosure requirements will further enhance competition. The CPLA supports the setting of a maximum cost of borrowing that provides safeguards to consumers, while allowing for continued strong competition in the industry in both pricing and service levels.

For these reasons, the CPLA submits that the Manitoba Decision be given little to no weight in relation to the Nova Scotia proceedings. The Board should make its determination based on the substantial evidentiary record before it.

Yours very truly,

McINNES COOPER



John D. Stringer

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