

***At What Cost?
Access to Consumer Credit in a Post-Financial Crisis Canada***

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Executive Summary

Access to consumer credit is influenced by many factors, such as amount and security of the consumer's income, and credit card company and financial institution practices. Access is also driven by social, cultural and cognitive factors, including consumer understanding of the cost of credit; perceptions regarding ability to repay; cognitive influences regarding immediate consumption and delayed payment; understanding of the benefits and risks of debt to economic security; and the conflicts of interest inherent in the business of lending. Overall, bank and credit union credit has tightened since the global financial crisis. However, the study found that for many Canadians, the issue is less whether there is access to credit, but rather, "access to credit at what high cost and on what terms and conditions".

Much of the reported need for credit in the past two years has been the need to bridge income loss from job loss, reduced hours of employment and small business failures. Many individuals that could not access personal loans from their bank or credit union turned to alternate, more expensive, forms of credit, such as merchandise finance company loans, increasing credit card debt, skipping monthly payments on loans, and payday loans. Consolidation loans have been increasingly viewed as a debt management strategy, yet there are problems associated with consolidation. One issue identified was the growth in home equity lines of credit, originally intended to bridge financing for emergencies or a significant purchase, but now being used more akin to account withdrawing, portending future issues in respect to debt load and longer term economic security.

Consumers face the direct costs of high interest rate charges and loan and broker fees. There is evidence to suggest that costs increase when consumer borrowers do not understand how interest rates and terms work, and thus consumer debtors may be paying considerably more for their credit than they need to. The lack of financial literacy is a major concern in that many consumer debtors do not fully appreciate the costs of carrying expensive credit, identified as particularly an issue among younger adults and recent immigrants to Canada. Yet to date, financial literacy training does not align with consumer debtors' particular needs for financing based on income and a range of other factors. There are also significant indirect costs to the consumer of access only to expensive credit, such as foregone basic necessities because of excessive debt load, health outcomes and costs associated with the stress of over-indebtedness, and the costs to society, borne by creditors

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or the general tax base, when consumers default on loans or file for insolvency or bankruptcy.

Analysis of the causes of insolvency for a cohort of 4,000 consumer insolvency cases from 2008 to 2010 indicates that "access to credit" forms an extremely small percentage of declared reasons for filing bankruptcy or proposals under the *BIA*. Related causes are much higher. For bankruptcies, insufficient income accounted for 30.5% of insolvency, unemployment for 18.8%, and over-indebtedness for 12.4%. For proposals, insufficient income accounted for 40.7% of insolvency, unemployment for 15.8%, and over-indebtedness for 13.8%. Seeking relief under Canadian insolvency law is reported by bankrupts as less associated with access to credit and more an outcome of consumer debtors' inability to meet the payment demands of expensive credit they previously accessed.

Credit card debt is a significant issue for consumer debtors. The average credit card debt was \$21,620 and the median debt was \$13,979. The data show that 90% of all debtors filing for insolvency relief had credit card debt. Equally, however, mortgage debt, personal loans and finance company debt are significant factors in filing, evidence of credit behaviour that catches consumer debtors in a repeated pattern of refinancing expensive debt and re-incurring it, which can expedite financial distress.

Considerably more research and policy development is required to make consumer access to credit more understandable, affordable and accessible on a fair and reasonable basis. While financial literacy is an important goal, there is also an urgent need for the federal government to complement its current work in financial literacy with a much more comprehensive program regarding consumer credit.

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I. Introduction

The issues involving consumer debt and consumer access to credit are complex. There has been a steady rise in household debt levels over the last 20 years, and the ratio of Canadian household debt to disposable income reached 148 percent in 2010.² The 2009 *Canadian Financial Capability Survey* reported that 31% of Canadians were struggling to meet their bills and payments.³ One question is whether access to credit is the issue, or whether it is the type and cost of credit that is problematic.

Access to consumer credit is driven by external factors, such as amount and security of consumers' income, and credit card company and financial institution practices. Yet access is also driven by social, cultural and cognitive factors, including consumer understanding of the cost of credit; perceptions regarding ability to repay; understanding of the benefits and risks of debt to economic security; and the conflicts of interest inherent in the business of lending.

This paper discusses the results of a study that explored the extent to which Canadian banks and credit unions have altered their lending practices *vis à vis* consumer debtors in the past several years. It discusses the issues associated with access to consumer credit and its relationship to consumer insolvency. Overall, the research found that lower cost credit has tightened considerably since the global financial crisis, such as personal lines of credit, bank and credit union loans and in some regions, mortgages. Such tightening is more of a business decision on the part of traditional banks and credit unions to curb growing default rates than it is a more systemic restructuring of how consumers access credit.

The study found that, for many Canadians, the issue is less whether there is access to credit, but rather, "access to credit at what high cost and on what terms and conditions". Much of the reported need for credit in the past two years has been the need to bridge income loss from job loss, reduced hours of employment and small business failures that were the direct or indirect result of reduced economic activity in Canada in the wake of the financial crisis. Many individuals that could not access personal loans from their bank or credit union turned to alternate, more expensive, forms of credit, such as merchandise finance company loans, increasing credit card debt, skipping monthly payments on loans, and payday loans. Consolidation loans have been increasingly viewed as a debt management strategy, yet there are problems associated with consolidation. One issue identified is the growth in home equity lines of credit, originally intended to bridge financing for emergencies or a significant

² Statistics Canada. CANSIM table 378-0012.

³ Task Force on Financial Literacy (TFFL); www.financialliteracyincanada.com, at 12, the background study finding also that of those Canadians who were planning to purchase a home, 48 percent had saved less than five percent of the cost of the home. Fifty-two percent of Canadians who were planning to purchase a home were not expecting to incur any costs other than the down payment; 70% of Canadians were confident that their retirement income would provide the standard of living they hoped for, although only 40% had a good idea of how much money they needed to save in order to maintain their desired standard of living in retirement; and financial advisors are the most likely source (at 54 percent) among Canadians seeking advice on financial matters. See also S. McKay, "Understanding financial capability in Canada: Analysis of the CFCS", (2010), research paper prepared for the Task Force on Financial Literacy; www.financialliteracyincanada.com.

purchase, but now being used more akin to account withdrawing, portending future issues in respect to debt load and longer term economic security.

The title of this paper, "At What Cost", refers to a number of aspects of access to credit. It refers to the direct costs, such as interest rate charges and loan and broker fees. It refers to costs that increase when consumer borrowers do not understand how interest rates and terms work, and thus are paying more for their credit than they may need to. It also refers to the indirect costs to the consumer of access to expensive credit, such as foregone basic necessities because of excessive debt load, health outcomes and costs associated with the stress of over-indebtedness, and the costs to society, borne by creditors or the general tax base, when consumers default on loans or file for insolvency or bankruptcy.

Considerably more research and policy development is required to make consumer access to credit more understandable, affordable and accessible on a fair and reasonable basis. While financial literacy is one important piece of the puzzle, it is not the only piece, and there is an urgent need for the federal government to complement its current work in financial literacy with a much more comprehensive program regarding consumer credit.

The paper is organized as follows. Part II briefly discusses the methodology of the study. Part III sets a context for consumer access to credit, analyzing the overall situation and examining some of the research on this issue. Part IV offers some high level data from a sample cohort of 4,000 consumer insolvency files. Part V examines a series of issues relating to consumer access to credit and consumer debt, including mortgage debt held later in life, home equity lines of credit, the link between employment, income and capacity to manage debt, implications of credit card debt for access to credit, rising default rates on personal loans, problems associated with payday lending and financial literacy. The paper offers preliminary suggestions and identifies areas in need of future research.

II. Methodology

The methodology for this study was multifaceted, involving a literature search, data analysis and surveys of both professionals and consumers. In all instances, the appropriate ethics approvals were sought and received, and consent protocols followed.

There is extensive literature regarding access to consumer credit, much of it generated by the United States (US) and located in finance and economics literature, with a growing literature in law. There has been little comparable work in Canada. An under-explored question is the relationship between consumer insolvency and banking practices, including traditional domestic banks, foreign banks operating in Canada, credit unions and finance companies.

The study undertook analysis of a database provided by the Office of the Superintendent of Bankruptcy (OSB) of 4,000 recent consumer insolvency filings, specifically, 3,118 bankruptcies and 882 consumer proposals, primarily Division II consumer proposals, but with a representative cohort of Division I consumer proposals. There were 846 Division II debtors in the cohort and 36 Division I, which the OSB advises was proportionate to the filings by consumer debtors by type of proposal in that time period. "Division" refers to the section of the *Bankruptcy and Insolvency Act* under which the debtor files. The data were drawn from a randomized sample of filings across Canada for the period of August 1, 2008 to July 31, 2010. The data were drawn primarily from the Form 79, Statement of Affairs (Non-Business Bankruptcy/Proposal); and Form 65, Monthly Income and Expense Statement of the Bankrupt/Debtor and the Family Unit and Information (or Amended Information) Concerning the Financial Situation of the Individual Bankrupt, for bankruptcies, division 1 and division II proposals.

The study examined particular features of the entire cohort, such as income, assets and liabilities; and then focused specifically on the files that identified lack of access to credit or over-indebtedness as the declared principal cause of insolvency. The data produced some interesting results, as discussed in Part IV below. However, results may be premature in terms of understanding the full effect of the financial crisis, given the time lag between changing economic circumstances and the decision to file insolvency proceedings. Further follow up with data over the next two years would be helpful to policy development.

The research also included a qualitative survey of twenty credit counsellors across Canada, their services covering most geographical parts of the country. Most Canadian credit counselling services are charitable not-for-profit agencies, and in 2009-2010, they served more than 250,000 Canadians representing nearly \$1.248 billion of unsecured consumer debt.⁴ However, the credit industry has a very powerful influence over these services as it provides the bulk of funding support, participates on boards of directors of such agencies, and has former credit managers that now work as credit counsellors. There is also some normative debate as to the extent of such agencies offering counselling services as opposed to acting as debt collection services.⁵ The credit counsellors interviewed for this study did offer some helpful observations about access to credit.

The credit counsellors were asked five questions; specifically: whether they had seen a rise in default rates on mortgages, personal loans or small business loans (sole proprietors) since October 2008 in the communities they serve and to what degree; whether there were any factors in their local community or region that have made access to credit for consumers particularly difficult since the financial crisis; what, in their view, should be changed in respect of access to consumer credit; and were there any other issues they wished to discuss regarding access to consumer credit, based on their experience as credit counsellors?

Surveys were also conducted of bank managers and credit union managers, with questions similar to those asked of creditor counsellors, but focusing on lending patterns at their institution. Here, there was considerable resistance to speaking with us, even though the consent forms, the proposed questions, and explanation of the study were sent in advance. Overall, 35 managers agreed to be interviewed; another 82 refused to participate, primarily because they could not receive permission from their head office, and another 95 simply did not respond to letters, e-mails or telephone calls or advised that they were too busy. Managers that we did successfully interview were drawn from Vancouver, Victoria, Burnaby, Saskatoon, Edmonton, Calgary, Winnipeg, Toronto, Hamilton, Montréal, Québec City, Halifax, and Charlottetown, and so their views do offer a good cross-section of regional observations. Managers in smaller cities were particularly willing to offer their candid and helpful insights.

"On-the-street" interviews were also conducted, although these interviews are of questionable research value and produced at best only anecdotal information. It took a canvass of almost 1,000 people to acquire 238 interviews in Vancouver, Calgary, Toronto and Montréal. Individuals were also given the opportunity to take away the questions and consent forms and respond at a later time, but only three surveys were completed in this manner. The age range of respondents was approximately 33% under age 30; 58% aged 31 to 60; and 9% over aged 60. Different locations made a difference in the response rate, in terms of types of neighbourhoods and regions of the country. In particular, consumer debtors entering or exiting payday loan outlets were reluctant to participate in the survey. Interviewees were

⁴ Adriana Molina, "Financial Literacy and the Canadian Credit Counselling Services Industry", 2010, Research paper prepared for the Task Force on Financial Literacy, <http://www.financialliteracyincanada.com/documents/research-reports.html> at 7. All dollars referred to in this paper are Canadian dollars, unless otherwise noted.

⁵ See for example, E. Uribe and A. Tait, "Credit Counselling: A Way Forward", Public Interest Advocacy Group, March 2007.

asked five questions, after being informed of the scope and objectives of the study and giving the appropriate consent. They were asked whether they have had trouble gaining access to credit in the past two years, such as credit cards, a home mortgage or a personal loan. They were asked whether or not they had used pay-day loans, and if so, what their experience was. They were asked about missed loan or credit card payments in the past two years, and if so, the reason. They were asked what percentage of credit card debt they held in relation to their total annual income; and they were asked for any other views they might have regarding access to credit.

The data from the on-the-street interviews were not particularly helpful as the sample was too small and too random. Thus, it is not discussed in the paper. For purposes of completeness, however, it is summarized here in very cursory fashion, because it does resonate with the observations and data below. Overall, only 11% reported access to credit problems, a number of people suggesting that access was perhaps too easy. However, 27% expressed concern about high interest rates for the debt they did have. 9% had accessed payday loans, and generally did not have a good experience, offering comments such as "once they get their hooks into you, it is hard to get away". 34% reported they had missed credit card payments in the past two years, and in the vast majority of cases, it was due to forgetting or not really paying attention to timing of payments; the remainder reported using credit card finance to bridge job loss for basic necessities. In response to questions regarding the amount of credit card debt as a percentage of annual average income, 12% reported no credit card outstanding balance; 18% reported it was 10% or less; 24% reported that it was 11% to 20% of total income; 9% said it was 21% to 30%; 10% more than 40%; and 27% had no idea of what it might be. Responses we did hear repeatedly included that there should be stricter confidentiality policies for banks handing out customer information; that banks should stop pushing people to get more credit cards; that credit to students and individuals without steady employment just sets them up for future failure; that the debt culture now is that younger adults do not understand debt until they have a huge amount of debt; and finally, that bank profits are too high and some of those profits should be directed towards lower loan and credit card interest rates.

What is evident from all of these initiatives to collect data is that there is truly a paucity of information on consumer access to credit in Canada and the relationship between the various forms of credit and financial distress. Considerably more resources, as well as more fulsome access to credit information, are essential prerequisites to more meaningful data analysis.

One objective of the study had been to make policy recommendations in respect of federal banking practices regarding consumer debtors. While this paper does contain some suggestions, the multifaceted methodology revealed that there is still too much opaqueness in the information to offer comprehensive recommendations at this early stage of research. The study does establish that consumer lending practices have shifted considerably in recent years and that they are currently in a state of flux. The multiple options available to consumer borrowers and the lack of transparency around terms and true costs means that considerably more research is needed before government can truly coordinate its policy and practices with respect to financial literacy and insolvency with banking and other credit practices.

III. Context

We know that there is linkage between quantum of consumer debt and insolvency. Studies over the past several years have documented the degree to which consumers are in debt when they file for bankruptcy or seek to negotiate a proposal with their creditors. The link with consumer access to credit is less clear, yet appears intuitively to be the case. Individuals often access credit because they expect their incomes to grow, allowing them to service a greater level of debt. They also access credit to smooth liquidity shocks such as medical

support bills or job loss.⁶ Households in many countries, including Canada, experienced substantial increases in access to credit in the late 1990s; the greatest gains occurred, according to one US study, for low-income households and minority groups.⁷ One reason for the increase was that credit was extended to higher risk borrowers, but a higher interest rate was charged to compensate for any increase of risk to the lender.⁸

Currently, most of the research on consumer access to credit comes from the US, and within that literature, there is no consensus on whether access to consumer credit is beneficial or harmful to consumer debtors.⁹ While, generally, access to credit for businesses of all sizes is viewed as stimulating economic growth, there is normative disagreement about both the individual and overall effects of greater access to consumer credit.¹⁰ There is also a contested literature in respect of liberalized access to credit and the incidence of consumer insolvency in the US.¹¹

Buckland, Montgomerie and others have observed that economic growth in the 1990s was "consumer debt-led growth", referring to debt-financed consumer spending as a principal instrument to stimulate macroeconomic growth, where consumer debtors were encouraged to continue to spend to keep the economy moving, increasing their debt loads at a time when wage levels were stagnant.¹² With the onset of the global financial crisis, consumer debtors were not able to sustain payments on the amount of debt they held.

According to the Certified General Accountants Association of Canada, household debt in Canada, which includes mortgages and credit card debt, was at an all-time high of \$1.41 trillion in December 2009.¹³ Statscan reports that the ratio of household credit market debt to personal disposable income was 146.8% in December 2010.¹⁴ The per capita amount of

⁶ Berrak Btiyükkarabaca and Neven Valev, "The role of household and business credit in banking crises", (2010) 34 *Journal of Banking and Finance* 1247 at 1248; O. E. Ergungor, "Bank Branch Presence and Access to Credit in Low to Moderate-Income Neighborhoods", (2010) 42 *Journal of Money, Credit and Banking* 1321 at 1322.

⁷ J. Fisher and A. Lyons, "Information and Credit Access: Using Bankruptcy as a Signal", (2010) 42 *Applied Economics* 3175-3193.

⁸ *Ibid.* at 3175; W. Edelberg, "Risk-based pricing of interest rates in consumer loans", (2006) 53 *Journal of Monetary Economics* 2283-2298.

⁹ Jonathan Zinman, "Restricting Consumer Credit Access: Household Survey Evidence on Effects around the Oregon Rate Cap", (2009) 34 *Journal of Banking and Finance*, no. 3, 546-556.

¹⁰ *Ibid.* at 1.

¹¹ Elizabeth Warren and A. Warren Tyagi, *The Two Income Trap: Why Middle-Class Mothers & Fathers Are Going Broke*, (2003: Basic Books, New York) who have empirical data offering a direct link. In contrast, Igor Livshits and James MacGee and Michele Tertilt, "Accounting for the Rise in Consumer Bankruptcies", Bank of Canada Working Paper, 2005, http://www.bankofcanada.ca/wp-content/uploads/2010/08/bankruptcy_rise.pdf, find that an increase in income shocks and expense uncertainty cannot quantitatively account for the rise in US bankruptcies; rather, they find that a combination of a decrease in the credit market transactions cost together with a decline in "stigma" accounts for the rise in consumer bankruptcy in the US. See also Bruno Biais and Thomas Mariotti, "Credit, Wages and Bankruptcy Laws" (2009) 7 *Journal of the European Economic Association* no. 5, 939-973.

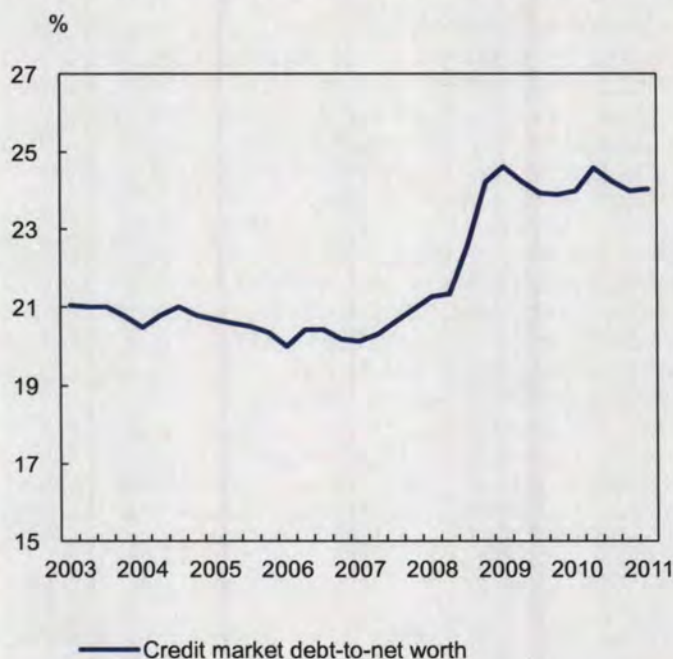
¹² Jerry Buckland, "Affordable Credit Options for Vulnerable Consumers: Identifying Alternatives to High-cost Credit in Australia, Belgium, Canada, France, Germany, the UK, & the US", Research Report for the Canadian Consumer Measures Committee, November 2, 2010 at 8, citing Montgomerie, 2007 at 170.

¹³ Dilip Soman, "The Trouble with Consumer Credit: Literacy Considerations and Policy Implications", (2010), Research paper prepared for the Task Force on Financial Literacy; www.financialliteracyincanada.com, at 5.

¹⁴ Statscan, March 2011 Indicators, <http://www.statcan.gc.ca/daily-quotidien/110314/t110314a2-eng.htm>.

household debt was \$44,500 in December 2010.¹⁵ Statscan offers the following graph to illustrate the pattern of household credit market debt to net worth over the past seven years:

Graph 1 Household credit market debt to net worth, 2003 to 2010



One study suggests that Canada's household credit to GDP (total claims of deposit money banks on households as a ratio to GDP), is 89.18, compared with 40.78 in the US and 35.71 in Japan.¹⁶ Even a decade ago, Canada had the highest rate of consumer credit to GDP for 19 countries.¹⁷

At the same time, there is evidence that young adults, recent immigrants, Aboriginal Canadians, and low-income and low net-worth households in Canada are struggling to make ends meet.¹⁸ In many cases, consumer debtors fail in their efforts to meet a heavy debt load and they become insolvent. In Canada, the total number of consumer bankruptcies has grown in the past 40 years from 6,271 bankruptcies in 1973 to more than 89,000 in 2010. In 1980, the insolvency rate for all ages was 1.1 per thousand Canadians; by 2004, that rate had quadrupled to 4.0 per thousand Canadians.¹⁹

¹⁵ *Ibid.*

¹⁶ Büyükkarabaca and Valev, *supra*, note 6, at 1249, data from 1999 to 2007, comparing 37 countries.

¹⁷ Ronald Mann, "Global Credit Card Use and Debt: Policy Issues and Regulatory Responses", The University of Texas School of Law, Law and Economics Working Paper, April 2005, <http://ssrn.com/index.html> ("Global Credit Card Use") at 41-2, citing Morgan Stanley study.

¹⁸ TFLL, *supra*, note 3 at 14.

¹⁹ OSB Statistics, (after taxes) [http://strategis.ic.gc.ca/epic/internet/inbsf-osb.nsf/vwajj/StatsBooklet2006-EN.pdf/\\$FILE/StatsBooklet2006-EN.pdf](http://strategis.ic.gc.ca/epic/internet/inbsf-osb.nsf/vwajj/StatsBooklet2006-EN.pdf/$FILE/StatsBooklet2006-EN.pdf). Comparing the Canadian rate of bankruptcy to other countries in 2004, the United Kingdom rate was 1.1 per thousand population; Australia was 1.8 per thousand; and the United States is 7.0 per thousand population, *ibid.* Hence, while Canada fares better than its neighbour to the south, its rates of individual bankruptcy are much higher than the U.K. and Australia.

For the 12 month period ending March 31, 2011, there were 132,757 consumer insolvency filings, of which 89,332 were bankruptcies and 43,425 were proposals.²⁰ For the first time, proposals are a third of all filings, suggesting that debtors have some resources to make a proposal to their creditors and that the insolvency may reflect temporary financial distress that can be addressed on a going-forward basis if some relief from debt is immediately available. As of March 31, 2011, total consumer insolvency filings were down 11.5% from the same time last year,²¹ perhaps reflecting some easing of the worst effects of the 2008-2009 downturn. One question is whether changes to consumer lending practices have altered the profile of consumer debtors that access the bankruptcy and insolvency system either through bankruptcy or proposals under the *Bankruptcy and Insolvency Act (BIA)*.

There is a growing psychological and social cognitive literature in respect of consumer credit. Generally, the conclusion has been that while access to consumer credit can be welfare-improving, psychological bias in household finance is such that many consumers over-borrow relative to an unbiased benchmark, because of "present-based" preferences,²² over optimism regarding capacity to repay,²³ and an underestimation of the costs of borrowing.²⁴

Fadel observes that there are powerful psychological and cognitive biases that affect an individual's financial and economic decisions; for example, the so-named "hyperbolic discounting" effect, which is the tendency for people to have a stronger preference for more immediate payoffs rather than later payoffs, which may result in consequences that range from not recognizing the cost-cumulative impact of "affordable luxuries", such as habitual \$5 cups of coffee, to taking on unaffordable mortgage and car payments with even more expensive credit-card debt.²⁵ "Hyperbolic discounting" offers an explanation as to why individuals acquire substantial credit card debt at high interest rates; studies have illustrated how the rewards provided by buying something today with credit tend to outweigh the discounted displeasure of future bill statements and repayment of loans.²⁶

The ways in which consumers are accessing credit and making credit decisions has also shifted considerably in the past two decades. The life-cycle hypothesis (LCH) of consumption assumes that individuals will earn more income as they progress through their working years and experience a decline in income at retirement; they will thus borrow when they are young, save during middle age, and spend less during retirement.²⁷ Yet consumers are frequently

²⁰ OSB Quarterly Statistics, March 2011, <http://www.ic.gc.ca/eic/site/bsf-osb.nsf/eng/br02622.html>.

²¹ For the 12 month period ending March 31, 2010 there were 112,227 consumer bankruptcies and 37,797 proposals. *Ibid.*

²² D. Laibson, "Golden Eggs and Hyperbolic Discounting", (1997) 112 Quarterly Journal of Economics 443 at 459-469.

²³ L. Ausubel, "The Failure of Competition in the Credit Market", (1991) 81 American Economic Review 50 at 55-64; Paige Marta Skiba and Jeremy Tobacman, "Payday Loans, Uncertainty and Discounting: Explaining Patterns of Borrowing, Repayment, and Default", (2008) Vanderbilt Law and Economics Research Paper No 08-33.

²⁴ V. Stango and J. Zinman, "Exponential Growth Bias and Household Finance", (2009) 64 Journal of Finance 2807.

²⁵ Charles Fadel, "Financial Literacy and 21st Century Skills", (2011) Research paper prepared for the Task Force on Financial Literacy, <http://www.financialliteracyincanada.com/documents/research-reports.html>, at 7.

²⁶ Soman, *supra*, note 13 at 15, citing C.J. Harris. and David Laibson, "Hyperbolic Discounting and Consumption," (2002), in Mathias Dewatripont, Lars Peter Hansen, and Stephen Turnovsky, eds., 258-98, *Advances in Economics and Econometrics: Theory and Applications*, Eighth World Congress, Vol. 1.

²⁷ Soman, *ibid.* at 11. See also Albert Ando and Franco Modigliani, "The 'Life Cycle' Hypothesis of Saving: Aggregate Implications and Tests," (1963) 53 *American Economic Review*, 55-84; Franco Modigliani and Richard Brumberg, "Utility Analysis and the Consumption Function: An Interpretation

subject to cognitive and psychological biases that allow them go into more debt than they initially bargained for.²⁸ Soman reports that individuals often fall prey to psychological biases that colour their evaluation of various credit options; and individuals frequently lack the computation skills necessary to accurately estimate the effect of debt on their future financial well-being.²⁹ Psychologically, individuals who are in debt report low levels of happiness and well-being.³⁰ Yet, because individuals have high levels of credit card debt but low levels of liquid assets, they are unable to smooth out their consumption over their lifetime as predicted by the LCH.³¹

There is also a growing literature, albeit not uncontested, that access to credit should be a human right.³² Access to credit is important for low-income individuals and can prevent unnecessary liquidation of illiquid investments, such as cashing in all or part of an RRSP.³³ Some empirical research suggests that social networks determine, to some extent, the sources of credit, including from "pure conformity" where practice or fad dictates behaviour; "instrumental conformity", where uniformity of products can create access; and "informational conformity", the signalling that occurs when one person communicates the benefits of one form of credit, and then lack of, or limited, information propels consumers towards conformity.³⁴ It would be interesting to investigate whether such social networks are influencing the rise in use of on-line personal loans and payday loans.

There is considerable literature suggesting that access to expensive credit, such as payday loans, high interest loans and credit card interest charges, exacerbates financial distress and insolvency or bankruptcy filings.³⁵ However, other studies have concluded that expensive credit can smooth negative expenditure shocks, such as housing costs or auto repairs; and allow short-term management of liquidity to alleviate financial distress.³⁶

of Cross-Section Data," in *Post-Keynesian Economics*, Kenneth K. Kurihara, ed., (New Brunswick, NJ: Rutgers University Press, 1954) at 388-436.

²⁸ Richard Thaler and Cass R. Sunstein, *Nudge: Improving Decisions about Health, Wealth, and Happiness* (New Haven, CT: Yale University Press, 2008).

²⁹ Soman, *supra*, note 13 at 3.

³⁰ *Ibid.* at 6, citing Sarah Brown, Karl Taylor, and Stephen W. Price, "Debt and Distress: Evaluating the Psychological Cost of Credit", (2005) 26 *Journal of Economic Psychology* 642-63.

³¹ Soman, *supra*, note 13 at 15.

³² Marek Hudon, "Should Access to Credit be a Right?" *Journal of Business Ethics* 84 (2009): 17-28.

³³ Ergungor, *supra*, note 6 at 1321.

³⁴ Bruce Wydick, Harmony Karp and Sarah Hilliker, "Social Networks, Neighborhood Effects, and Credit Access", Working Paper (2009);

<http://production.ucms.rug.nl/feb/onderzoek/onderzoekscentra/cibif/conferences/microfinance/program/Wydick.pdf>, examining 465 households in Guatemala, and suggesting that they are particularly influential in developing countries; at 2.

³⁵ Dennis Campbell, Asis Martinez-Jerez & Peter Tufano, "Bouncing Out of the Banking System: An Empirical Analysis of Involuntary Bank Account Closures", (2008) May Federal Reserve Bank of Chicago Proceedings 462; Paige Marta Skiba & Jeremy Tobacman, "Do Payday Loans Cause Bankruptcy", (2010) Vanderbilt Law and Economics Research Paper No 11-13; Brian T Meltzer, "The Real Costs of Credit Access: Evidence from the Payday Lending Market" (2011) 126 *Quarterly Journal of Economics* 517.

³⁶ Adair Morse, "Payday Lenders, Heros or Villains?" (2009) *Journal of Financial Economics*. [In Press], Working Paper University of Chicago; B. Wilson, D. Findlay, J. Meehan, C. Welford and K. Schurter, "An Experimental Analysis of the Demand for Payday Loans", (2008) Working Paper, George Mason University; D. Morgan and M. Strain, "Payday Holiday: How Households Fare after Payday Credit Bans", (2008) Federal Reserve Bank of New York Staff Report No. 309 (2008); David Evans and Joshua D. Wright, "The Effect of the Consumer Financial Protection Agency Act of 2009 on Consumer Credit." George Mason University Law and Economics Research Paper Series 09-50, http://www.law.gmu.edu/assets/files/publications/working_papers/0950EffectoftheCFPA.pdf.

A 2009 study commissioned by the Bank of Canada on US consumer access to credit found a relationship between aggregate consumer spending and credit availability in the United States.³⁷ The study noted that, as a result of the financial crisis, banks started to restrict access to credit for consumers and businesses, which in turn restrained aggregate demand and economic activity. Consumer spending suffered as households were not able to gain access to credit in order to finance their expenditures.³⁸ "Credit availability" is measured as the willingness of lenders to provide funds at market interest rates, capturing movements in credit availability related to non-interest fees, maturity of credit extended, maximum credit size, loan covenants, credit score requirements, and collateralization requirements.³⁹ Credit availability is an important determinant of consumer spending.⁴⁰ The study found that consumer spending falls in response to a reduction in credit availability, and that large changes in credit availability are particularly important for consumers' spending decisions; and these periods tend to be associated with periods of high economic uncertainty. It suggests that it may not only be the level of credit availability that matters for consumer spending, but also the uncertainty surrounding the availability of credit.⁴¹ The study concludes that to the extent that policy may influence the credit constraints facing households, central banks may be able to undertake credit easing policies geared towards affecting credit supply and successfully affect the path of consumer spending.⁴²

One US study found that there is a positive relationship between bank branch presence in low-income neighbourhoods and access to mortgage financing, in part because of the relationship lending underlying local banks granting home mortgages, and in part because of US legislation that requires banks with branches in low to moderate income communities to serve the communities' needs.⁴³ Banks that can interact with the borrower on both sides of the balance sheet, i.e. lending and having a record of their deposit, chequing and savings history, can learn about a borrower's quality of financial management over time, such as paying utilities and rent, rather than assessing mortgage applications based on a single fixed snapshot that is a more traditional measure of credit quality.⁴⁴ Moreover, the study found that such relationships can be more amenable to delivery of services targeted to working class people, such as financial literacy, working with community groups to organize pre- and post-lending education and counselling; "second-chance" chequing accounts; and lower-cost alternatives to payday loans.⁴⁵

This literature resonates when examining recent insolvency filings in Canada, and may explain some of the levels of debt when consumers file.

IV. The Profile of Consumer Debtors Accessing the Bankruptcy and Insolvency System

Using data collected by the OSB, the study examined causes of insolvency through access to a cohort of 4,000 consumer insolvency filings from August 31, 2008 to July 31, 2010, of which 3,118 were consumer bankruptcies and 882 were consumer proposals. The data overall

³⁷ Kimberly Beaton, *Credit Constraints and Consumer Spending*, Bank of Canada Working Paper 2009-25, September 2009.

³⁸ *Ibid.* at 3.

³⁹ *Ibid.* at 8. See also P. Bacchetta and S. Gerlach, "Consumption and Credit Constraints: International Evidence", (1997) 40 *Journal of Monetary Economics* 207-238.

⁴⁰ Beaton, *ibid.* at 17.

⁴¹ *Ibid.* at 21.

⁴² *Ibid.* at 17.

⁴³ Ergungor, *supra*, note 6 at 1322-1323, citing the *Community reinvestment Act of 1977*.

⁴⁴ *Ibid.*

⁴⁵ *Ibid.* at 1324.

were analyzed, with particular attention to files where access to credit or related factors were declared to be the principal cause of insolvency.

1. Causes of Insolvency

What is evident from Tables 1 and 2 below is that "access to credit" forms an extremely small percentage of declared reasons for filing bankruptcy or proposals under the *BIA*, with only 12 debtors citing this cause as the principal cause. Related causes, such as over-indebtedness and insufficient income, are much higher. For bankruptcies, insufficient income accounted for 30.5% of insolvency, unemployment for 18.8%, over-indebtedness for 12.4%, health for 12.0%, marriage breakdown for 11.5%, business failure for 7.7%, and debt to the Canada Revenue Agency for 2.4%. Access to credit, problems due to the financial crisis, student loans and miscellaneous each accounted for less than 2%.

For proposals, insufficient income accounted for 40.7% of insolvency, unemployment for 15.8%, over-indebtedness for 13.8%, marriage breakdown for 9.3%, health for 8.3%, business failure for 4.8%, debt to the Canada Revenue Agency for 2.4% and insolvency due to the financial crisis for 2.2%. Access to credit, student loans and miscellaneous each accounted for less than 2%.

Table 1 Principal Causes of Insolvency, Bankruptcy Files, 3118 sample cohort, 2008-2010

Cause	Number	Percentage
Insufficient Income	951	30.5%
Over-indebtedness	388	12.4%
Access to Credit	8	0.3%
Problems due to Financial Crisis	50	1.6%
Business Failure	239	7.7%
Marriage Breakdown	358	11.5%
Health	374	12.0%
Debt to CRA	74	2.4%
Loss of employment	587	18.8%
Student Loans	36	1.2%
Miscellaneous	53	1.7%
TOTAL	3118	100.0%

Table 2 Principal Causes of Insolvency, Proposal Files, 882 sample cohort, 2008-2010

Cause	Number	Percentage
Insufficient Income	359	40.7%
Over indebtedness	122	13.8%
Access to Credit	4	0.5%

Cause	Number	Percentage
Problems due to Financial Crisis	19	2.2%
Business Failure	42	4.8%
Marriage Breakdown	82	9.3%
Health	73	8.3%
Debt to CRA	21	2.4%
Loss of employment	139	15.8%
Student Loans	8	0.9%
Miscellaneous	13	1.5%
TOTAL	882	100.0%

2. Assets and Liabilities

For the data set of 4,000 files, the median assets were \$7,275, whereas the median debt was \$46,930, remarkably close to the per capita debt figure reported for all Canadians.⁴⁶ Table 3 and the graphs that follow illustrate that both the average debt and the median debt are many times the assets of debtors at the time of filing. For bankrupts, average assets were \$50,177, but the median of assets was only \$6,105, compared with average debts of \$104,307 and a median debt of \$44,942. Thus, bankrupts had seven times more debt than assets.

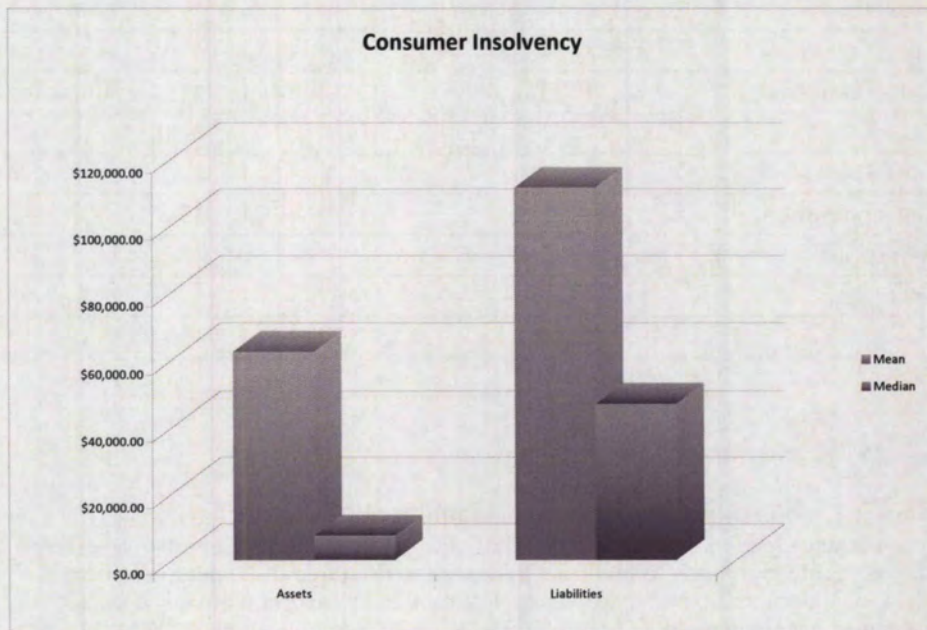
For debtors filing proposals, the average assets were \$104,561 and the median was \$18,353; whereas the average debt was \$135,257 and the median debt \$58,801. Hence for proposals, there was a group of insolvent consumer debtors with high assets and high debts, which skewed the average upward, and the median figure becomes more meaningful for understanding the asset/debt ratio for the entire cohort. The figures illustrate that there are several times more assets to try to protect through a proposal than assets held by debtors who filed for bankruptcy. However, even with greater assets, the median of liabilities owed at the time of filing were three times the assets of debtors.

Table 3 Mean and Median Assets and Liabilities for 4,000 Consumer Insolvency Filings, 2008-2010

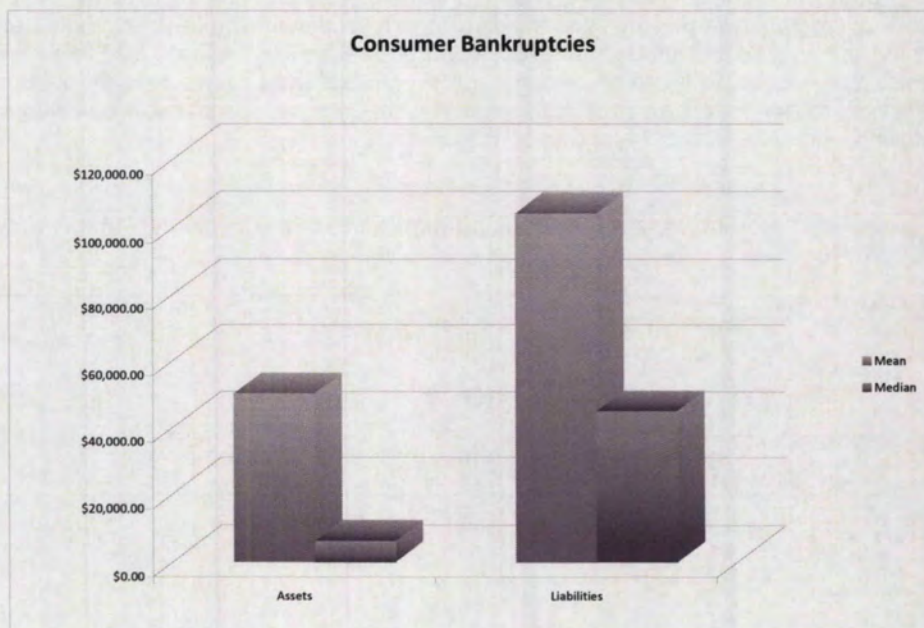
	Assets - Mean	Assets - Median	Liabilities - Mean	Liabilities - Median
Entire Cohort	\$62,247.48	\$7,275.00	\$111,218.50	\$46,930.00
Bankruptcies	\$50,176.54	\$6,104.50	\$104,306.59	\$44,942.00
Proposals	\$104,560.78	\$18,353.00	\$135,257.44	\$58,801.00

⁴⁶ See Statscan figures reported at note 13.

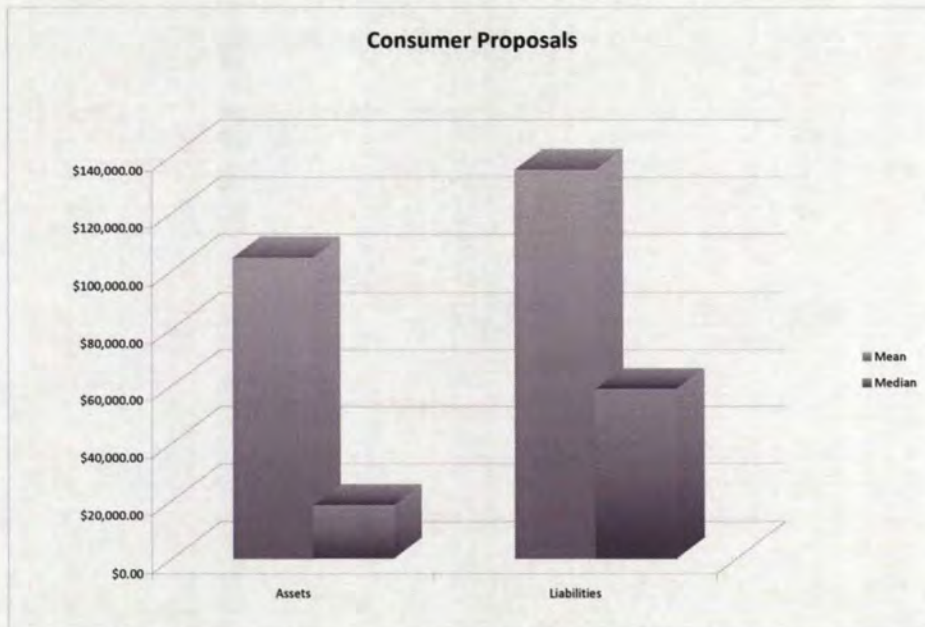
Graph 2 Consumer insolvency files, mean and median assets and liabilities, 4,000 files



Graph 3 Mean and median assets and liabilities, Bankruptcies, 3118 files



Graph 4 Mean and median assets and liabilities, Proposals, 882 files



3. Type of Debt

The full data set also generated information on the sources of debt, with mortgage debt, credit card debt and personal loans comprising the largest source of financial pressure. The type of debt that insolvent consumer debtors have is significant, given the above observations regarding the direct and indirect costs of expensive debt. For all files in the cohort, the amount of credit card debt was significant, a median of \$10,800 for credit cards from bank and trust companies and a further almost \$6,000 from other credit cards.⁴⁷ For the bankruptcy files, the median was \$10,396 for credit cards from bank and trust companies and a further \$5,700 from other credit cards. For all proposals, the amount of credit card debt was significant, a median of \$11,700 for credit cards from bank and trust companies and at further almost \$6,700 from other credit cards.

Overall, the median debt for bankrupts was \$44,492 and the median debt for debtors making proposals was \$63,663. Mortgages are the largest debt that consumer debtors hold, which is not particularly surprising, but only 1097 (27%) of the 4,000 filers had houses, condominium apartments, co-operative housing or other forms of ownership in their housing accommodation ("homes"), of which 90% of these debtors had mortgages. Of that group, only 24% of bankrupts owned a home and of those bankrupts, 87% had a mortgage; so the figures below in Table 4 represent 652 debtors with mortgages. For proposal debtors, 39% had homes, of which 98% had mortgages, thus the mean and median mortgage figures below represent 336 proposal debtors. What is also significant is the amount of personal bank loans and finance companies loans that consumers hold in addition to credit card debt, as illustrated in Table 4.

⁴⁷ The OSB form collects these different types by these categories.

Table 4 Mean and Median Debt by Type, 4,000 Insolvency Filings

All Insolvencies

	Mortgages	Bank Loans	Finance Company Loans	Bank/Trust Credit Cards	Other Credit Cards
Mean	\$182,253.15	\$24,633.81	\$14,754.60	\$17,120.81	\$9,992.92
Median	\$157,000.00	\$13,846.19	\$8,842.00	\$10,800.00	\$6,000.00
Number	988	2403	1650	3105	2471

Bankruptcies

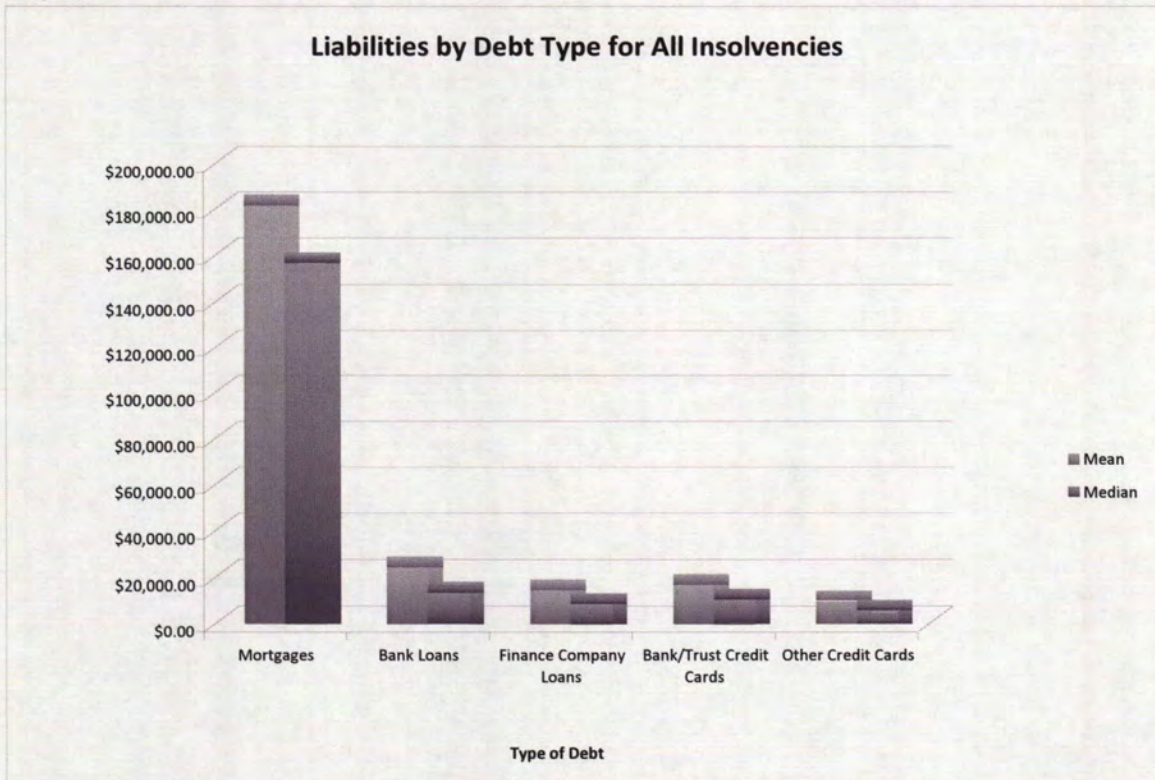
	Mortgages	Bank Loans	Finance Company Loans	Bank/Trust Credit Cards	Other Credit Cards
Mean	\$167,550.80	\$25,881.31	\$15,866.47	\$16,581.88	\$9,717.84
Median	\$141,000.00	\$13,392.50	\$9,000.00	\$10,396.00	\$5,699.63
Number	652	1844	1264	2394	1880

Proposals

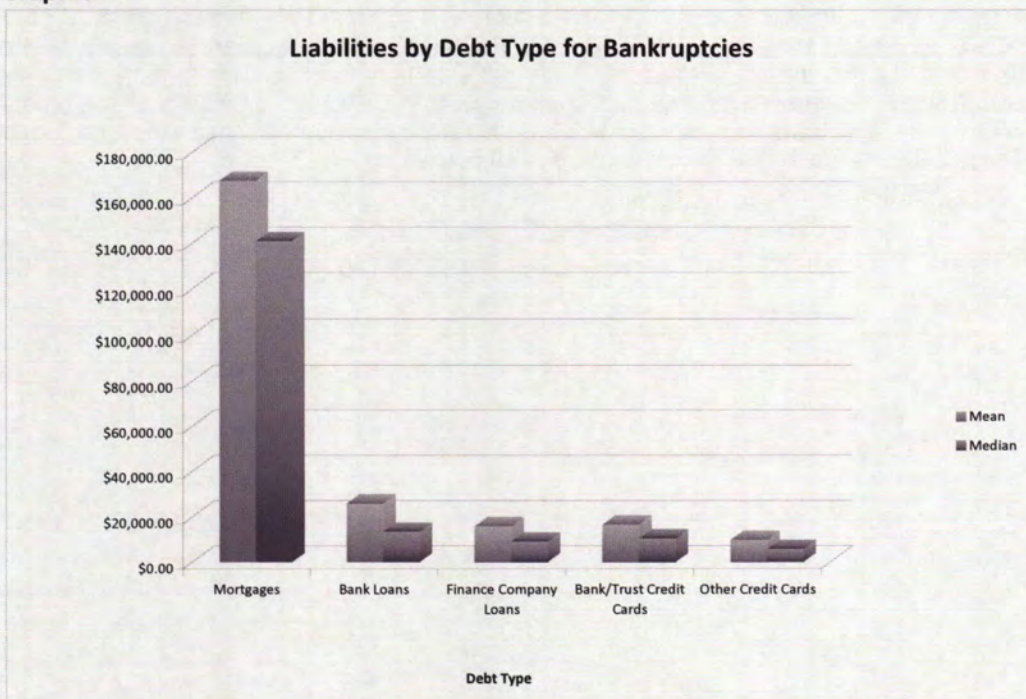
	Mortgages	Bank Loans	Finance Company Loans	Bank/Trust Credit Cards	Other Credit Cards
Mean	\$210,782.71	\$20,518.62	\$11,113.67	\$18,935.42	\$10,867.95
Median	\$187,500.00	\$15,000.00	\$8,580.50	\$11,700.00	\$6,700.00
Number	336	559	386	711	591

These figures are illustrated in Graphs 5 to 7 below.

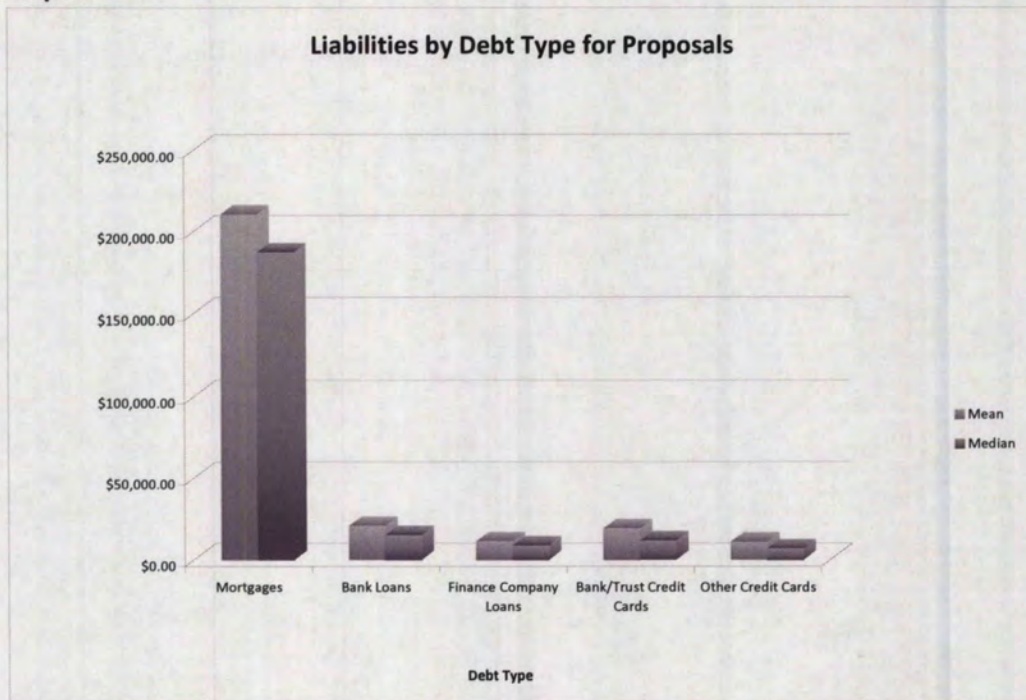
Graph 5



Graph 6

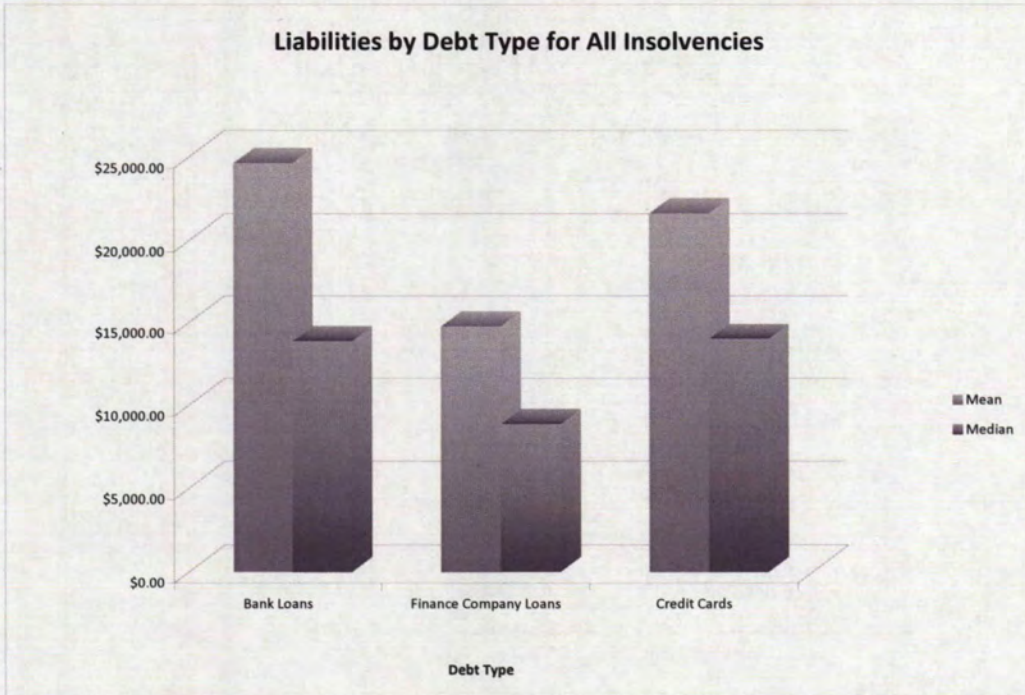


Graph 7

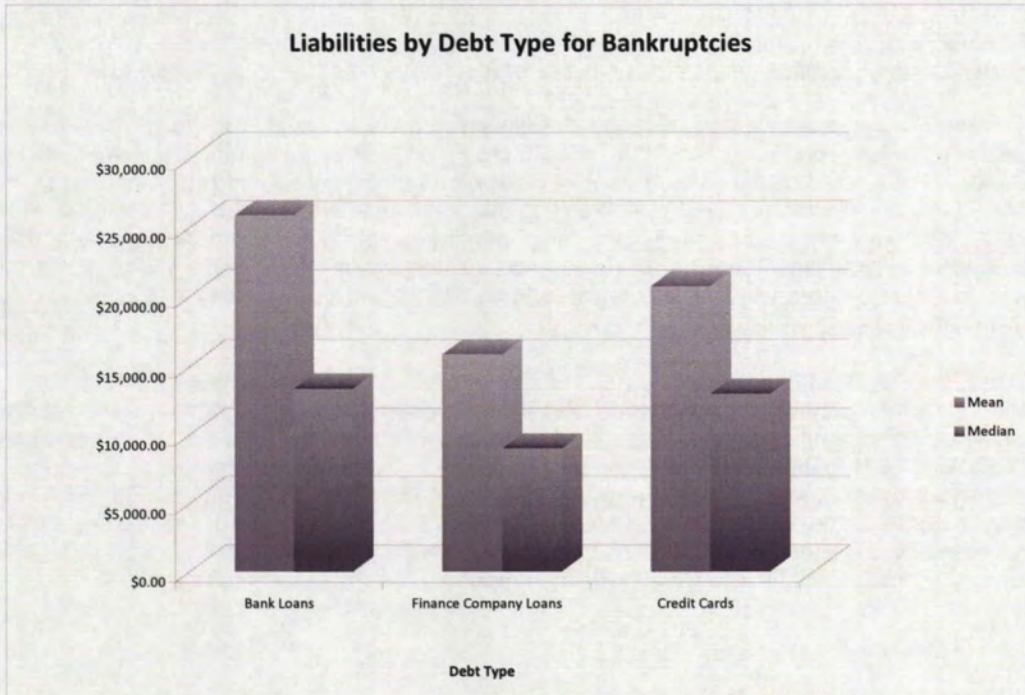


Removing mortgages from the graphs and combining the two categories of credit card debt, the amount of non-mortgage debt carried by insolvent debtors becomes clearer. For all files in the 4,000 cohort, the average credit card debt is \$21,620 and the median debt is \$13,979. 90% of all debtors filing had credit card debt. For bankruptcies, the average credit card debt was \$20,739 and the median was \$13,021. 90% of bankrupts had credit card debt. For proposals, the average credit card debt was considerably lower, \$7,969, with the median amount of credit card debt being \$3,924. 91% of proposal debtors had credit card debt. These amounts are illustrated by Graphs 8 to 10 below.

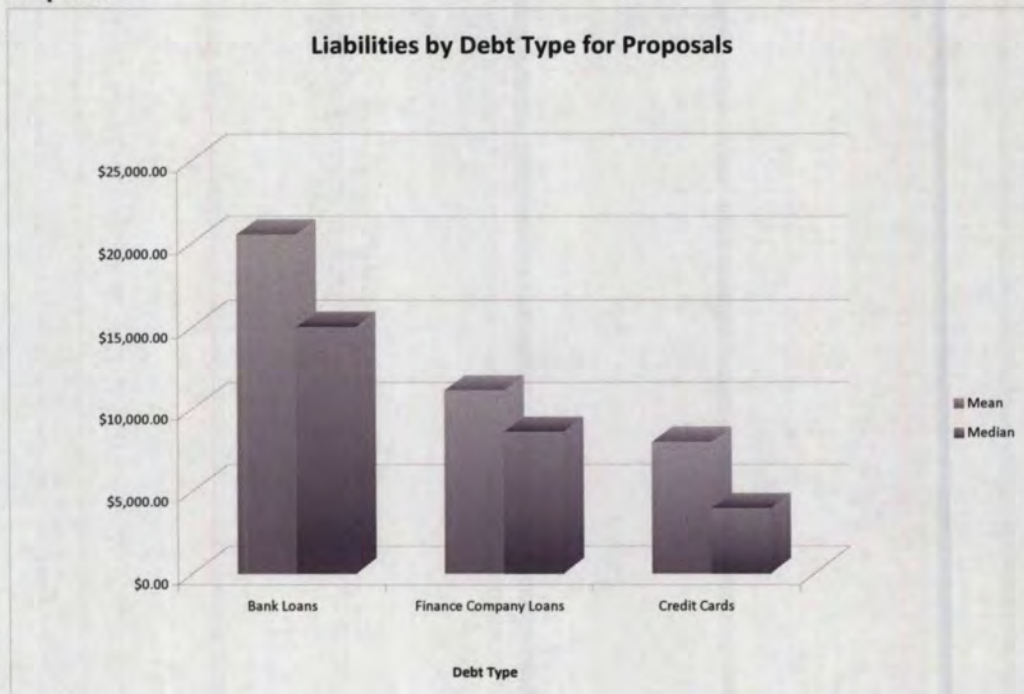
Graph 8



Graph 9



Graph 10



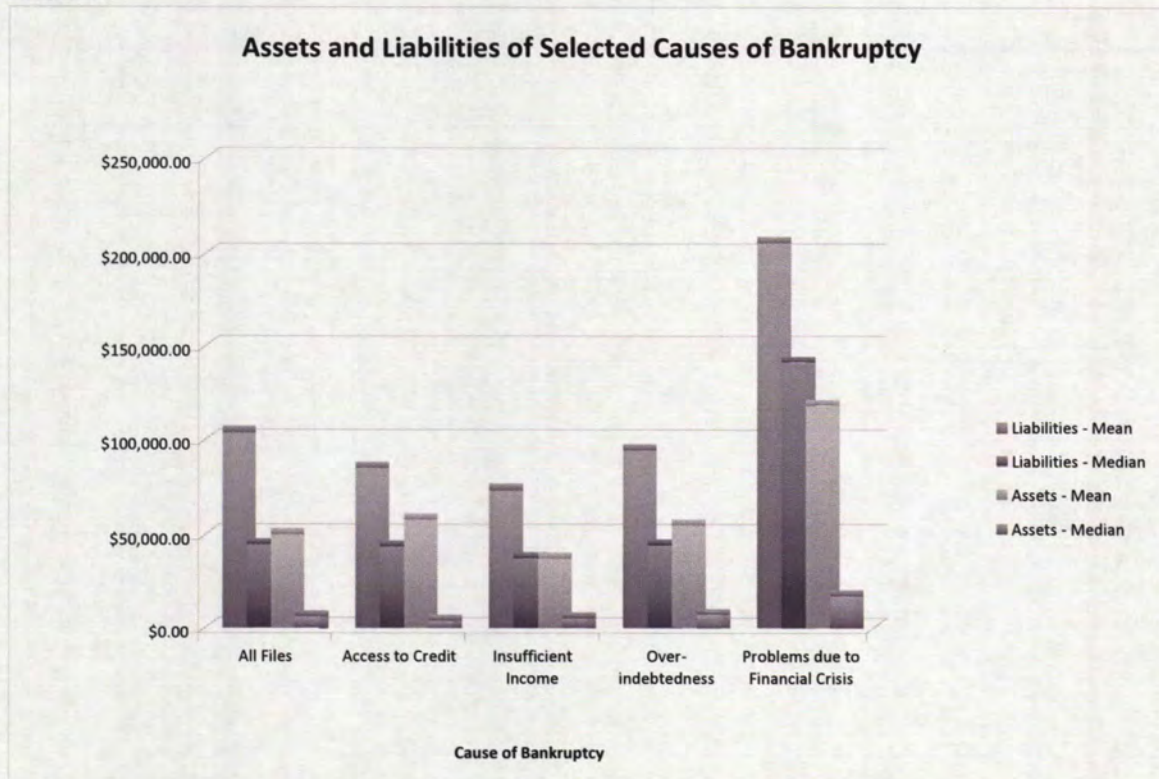
4. Assets and Liabilities for Selected Causes of Insolvency

The study also examined assets and liabilities in cases in which the principal cause of insolvency was reported as lack of access to credit, as well as examining what appeared to be the most related causes, insufficient income, over-indebtedness and problems due to the financial crisis. In terms of debtors reporting that the cause was lack of access to credit (a very small number), they had one third fewer median assets but a comparable level of debt compared with all files in the bankruptcy cohort. Where insufficient income was cited as the principal cause, there were slightly lower median assets and considerably less debt than for all bankruptcies.

Where the financial crisis was cited as the primary cause, the median assets at the time of filing for bankruptcy were almost three times the overall median at \$17,401, and the median liabilities were significant, \$141,502. In this group were some debtors with very significant debt; and if the debtors with liabilities of greater than \$500,000 are removed, the median drops to \$124,903, still significantly higher than for all files. The amount of debt in this group may support some of the observations by credit professionals, discussed below, that a number of consumer debtors were living far beyond their means, and it was an economic shock associated with the financial crisis that tipped the balance into insolvency.

Table 5 Assets and Liabilities, Bankruptcies, selected causes of insolvency

	Liabilities – Mean	Liabilities – Median	Assets - Mean	Assets – Median
All Files	\$104,307	\$44,942	\$50,177	\$6,105
Access to Credit	\$84,961	\$43,907	\$58,068	\$3,827
Insufficient Income	\$73,800	\$37,682	\$37,651	\$5,301
Over-indebtedness	\$94,617	\$44,780	\$55,115	\$7,150
Problems due to Financial Crisis	\$206,004	\$141,502	\$118,525	\$17,401

Graph 11

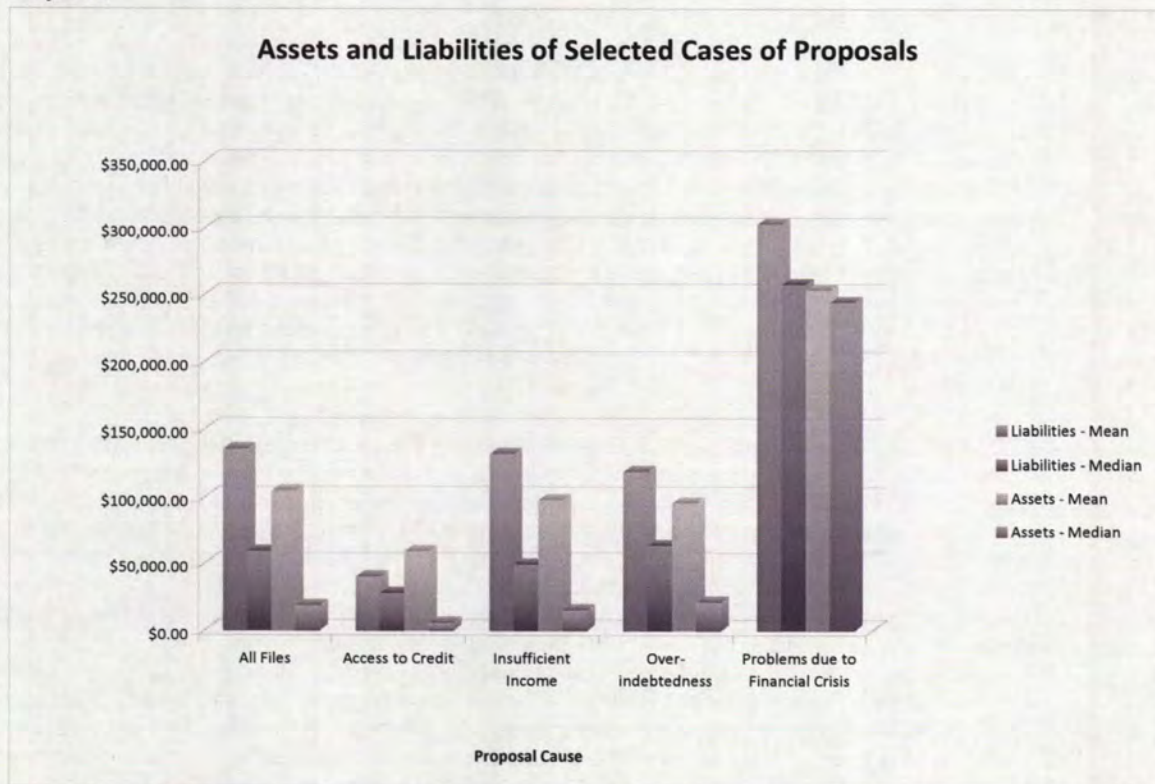
Turning to the data in the cohort of 882 proposal files, only 4 debtors reported that access to credit was a primary cause of insolvency, and this very small number had considerably fewer assets and about half the debt. For the almost 14% that cited over-indebtedness as the cause, asset levels were higher than the overall median and the amount of debt was

considerable higher, with a median of \$63,663. For the 41% of proposal debtors that reported that insufficient income was the primary cause of insolvency, median assets were \$15,201 and median debt was \$49,242, both lower than the overall figures. Finally, for the 19 debtors (2.2%) that reported that insolvency was due to the financial crisis, their assets and debts were much higher than any other category, with median assets of \$244,500 and median debt of \$257,745.

Table 6 Assets and Liabilities, Proposals, selected causes of insolvency

	Liabilities – Mean	Liabilities – Median	Assets - Mean	Assets – Median
All Files	\$135,653	\$59,228	\$104,920	\$18,552
Access to Credit	\$40,157	\$27,845	\$59,275	\$5,750
Insufficient Income	\$132,146	\$49,242	\$98,065	\$15,201
Over- indebtedness	\$119,216	\$63,663	\$95,930	\$21,130
Problems due to Financial Crisis	\$303,272	\$257,745	\$253,498	\$244,500

Graph 12



The data overall illustrate significant debt in relation to assets, no matter the cohort, a factor that insolvency legislation in Canada is aimed at assisting to remedy by providing mechanisms that offer consumer debtors a “fresh start”. The data provides the backdrop for the next discussion, the degree to which access to credit and the cost of credit play a role in consumer insolvency.

V. Access to Consumer Credit Before and After the Global Financial Crisis

This part discusses various ways in which access to credit appears to have been an issue before and after the financial crisis. It is based on the interviews with the 55 credit counsellors, bank managers and credit union managers (“credit professionals”), further analysis of a subset of the 4,000 consumer insolvency files, and the extant literature. Banking practices with respect to consumer and household access to credit have shifted over the years, including access to mortgages, lines of credit and loans, and the shift away from traditional deposit-taking banks to alternative forms of credit.

1. Consumer Access to Mortgage Debt

In Canada, the largest purchase most consumers make in their lifetime is a house, condominium or co-op apartment, almost always by taking one or more mortgages. Access to credit in this respect is critically important, as it allows individuals some security in their housing situation. Access to mortgage debt requires the appropriate evaluation of the

property and house/condominium covered, as well as an assessment of the capacity of the consumer borrower to carry the expected costs of the mortgage.

Considering the life-cycle hypothesis of consumption, discussed above, mortgage debt is to be acquired earlier in adults' credit history, often moving from "starter" homes to more permanent homes, and the mortgage debt retired during middle age. Bank and credit union managers observed that this pattern was the norm for many years. However, the pattern has shifted. In 2009, 34% of retired individuals aged 55 and over, whether single or in a couple, held mortgage or consumer debt. The median amount owed by these individuals was \$19,000.⁴⁸ The incidence of mortgage debt was much higher among consumers in the same age group who had not yet retired; among pre-retirees aged 55 and over, two-thirds held mortgage or consumer debt and their median debt load was \$40,000, double that of retirees.⁴⁹ What that means is that for the majority of people over age 55, resources that should otherwise be directed to savings pre-retirement, are being used instead to pay mortgages.

In the US, the sub-prime mortgage debacle revealed the problems of inappropriate granting of mortgage credit. The issues surrounding the sub-prime meltdown are many, including the economic incentive structure that allowed increased granting of access to mortgages where there was no realistic expectation they would be repaid;⁵⁰ the steering of particular classes and races of people into sub-prime mortgages when they would have qualified for regular mortgages under less onerous terms;⁵¹ and the negative externalities created when originating lenders could shed the risk of the debt immediately through securitization and derivatives. Given that the sub-prime issue was not generally an issue for Canadian consumer debtors, this article does not discuss these issues, other than to observe that defaults of sub-prime mortgages resulted in some large financial institutions facing direct or indirect exposures to complex structured products, which in turn influenced their lending patterns. However, in Canada, we face a different set of issues relating to consumer access to mortgage debt, which appears to have been exacerbated by the financial crisis.

Many Canadian mortgages are granted based on a traditional formula of 20-per-cent down payment on the mortgage, implying a loan-to-value ratio of 80 per cent. However, Soman observes that short-term low interest and long-term high interest is especially popular for interest-only loans that have various payment options and adjustable-rate mortgages, which allows for zero or even negative amortization during the introductory low-interest rates. He notes that these types of mortgages are problematic for individuals who steeply discount future events, as they are over-optimistic about more funds available in the future or they focus on short-term rewards at the expense of long-term costs.⁵² Soman suggests that these consumers underestimate the total cost of a deferred-cost mortgage and enter into contracts that lock them into a high interest rate that they are unable to pay.⁵³

The interviews with the bank managers and credit union managers across Canada were particularly helpful in identifying issues in respect of access to mortgage credit. In the several years prior to the financial crisis, there were individuals who bought their first home by 100% financing; they had good credit, so they took cash advances on their credit cards and used

⁴⁸ StatsCan, *Retiring with Debt*, April 2011, <http://www.statcan.gc.ca/daily-quotidien/110427/dq110427b-eng.htm>.

⁴⁹ *Ibid.*

⁵⁰ Where risk of the original lender was shed because the loan was immediately securitized, thus incentives at the front end were to grant the credit without proper scrutiny of ability to repay.

⁵¹ Cheryl Wade, "Subprime Mortgages and Corporate Governance on Wall Street: Monitoring Compliance with the U.S. *Fair Housing Act*", *Annual Review of Insolvency Law, 2009* (Toronto: Carswell, 2010).

⁵² Soman *supra*, note 13 at 16.

⁵³ *Ibid.*

that as a down payment and then financed the remaining 95% through one or more mortgages. In such circumstances, servicing the mortgage has often meant that everything else goes on credit cards, which can create the conditions for mortgage default.

The experience both prior to and after the financial crisis has been that, typically, mortgages are the last loans that people default on. Consumers recognize that their house/condo is an asset, so they pay that bill. However, the managers surveyed indicated that across Canada, with the exception of Saskatchewan, there has been a moderate to large increase in defaults on mortgage payments since 2008. There has also been substantial increase in consumer debtors seeking forbearance agreements or to remortgage where individuals can no longer service the monthly payments. In Alberta, there has been a significant increase in the number of defaults in mortgages; and financial institutions that previously shied away from foreclosures are starting the process as soon as two payments are missed. There has been a considerable rise in the Maritimes in default rates on mortgages since October 2008, often due to insolvency. One credit union in Halifax reported that the default rate on mortgages and personal loans in 2010 was the highest percentage in its history; yet another observed that the increase was primarily on the business loan side, rather than mortgage default, particularly where the business had been struggling prior to the financial crisis. Several major banks reported that they have tightened lending policy to adhere to government regulations in regard to home purchases, moving to shorter amortizations and higher down payments.

In Saskatchewan, the foreclosure rate has been stable since 2004, with one manager noting that housing expenses and mortgages are not usually where consumers default. The stability is attributed to the activities of the Saskatchewan Provincial Mediation Board. Financial Institutions that intend to foreclose on a mortgage must give notice to the Board, which has thirty days to inform the property owner about the foreclosure process and to endeavor to assist the owner and the financial institution to find a mutually satisfactory arrangement for payment of the arrears. If no arrangement is made, the financial institution can commence foreclosure proceedings.⁵⁴ The Board encourages parties to find a mutually acceptable arrangement for the payment of arrears, including payment of arrears, sale of the property, quit claim the property and turn it over to the lender, and other action that is within the financial means of the borrower.⁵⁵

One issue identified is the cost of access to mortgage credit through non-bank mortgage brokers. In many cases of home purchases, there are multiple brokers that can get mortgages for clients without them going through credit checks and income verification that banks would ask for; consumers can get often get whatever amount they want. However, it is not in the best interests of the consumer to purchase a home that he or she cannot sustain the payments for. A number of credit professionals suggested that there should be more responsibility on brokers to examine the consumer's credit background and a duty to know their client before putting together the mortgage deal. Rates are higher with private lenders, and brokers and consumers may go to these private lenders because they do not qualify through the bank. However, frequently the consumer debtor ends up in financial difficulty and the broker arranging the deal has long exited the picture.

One recommendation is that there should be more integrity in full and truthful disclosure of the full costs of the mortgage to the consumer and full disclosure of the credit capacity of mortgage applicants. Mortgage brokers often do not provide full disclosure, which in turn impedes the ability of lenders to make the proper decision, particularly where the consumer is dealing with the broker rather than the financial institution directly.

⁵⁴ Government of Saskatchewan, "Provincial Mediation Board," <http://www.justice.gov.sk.ca/PMB>.

⁵⁵ Government of Saskatchewan, "Information about Mortgage Foreclosure Notices," <http://www.justice.gov.sk.ca/PMB-Mortgages-Forclosures>.

One interviewee noted that government has partially addressed this issue through decreased amortization of mortgages and qualification requirements for fixed rate term, but observed that housing corporations that are primary insurers of high ratio mortgages are not sufficiently concerned about high ratio mortgages because the risk is borne by CMHC, which provides insurance. Similarly, there were several complaints that the federal government development banks and Farm Credit Canada are supposed to be complementary lenders, in some instances to provide financing where a bank or credit union declines the loan; but rather, they are becoming competition for local lenders. Interviewees viewed these changes as unfair competition because the resources of the Crown are backing the loans. New rules applicable to government-backed insured mortgages reduce the maximum amortization period to 30 years from 35 years for new government-backed insured mortgages with loan-to-value ratios of more than 80 per cent. Second, they reduce the amount one can borrow in refinancing mortgages from 90% to 85% of the home's value. Both changes came into force on March 18, 2011. The government also withdrew government insurance backing of home equity lines of credit, in force on April 18, 2011.⁵⁶

A number of credit counsellors observed that when housing prices dropped, individuals were not able to shed mortgage debt by selling the home and scaling down. One counsellor observed that there is likely to be another major rise in defaults once the Bank of Canada prime lending rate normalizes to the 5-6% range, given that a large portion of home owners are on a floating rate or on a fixed rate that will mature in 1-2 years, and they will be experiencing a much higher rate/payment in their housing costs.

Across Canada, there appears to be increasing consolidation of debt into mortgages. Consolidation loans can often create the conditions for mortgage default. Individuals are defaulting on their mortgages because they have already taken the equity out of the house or business and when their finances started to feel tight with income reduction due to job loss, reduced hours of employment or illness, there was no longer an equity cushion in their home.

Finally, it is important to note that many consumer debtors that file for bankruptcy do not have houses or apartments in which they have any equity that might serve as a financial cushion. In some cases, rents have become prohibitively high and the existence of other debts means that the consumer debtors cannot afford the rent. There are some programs that aid, such as Ontario's "rent bank", which as of 2004, provided \$4 to 5 million a year across Ontario to provide interest-free loans to single parent families for rental arrears. Such programs are incredibly important alternatives to incurring expensive debt and should be encouraged across Canada.

2. Home Equity Lines of Credit (HELOC)

Banks report having tightened their lending since October 2008, especially in regard to consolidation loans. Prior to the financial crisis, a significant consolidation and access to credit strategy was a home equity line of credit (HELOC).

A HELOC is where the lender agrees to lend a maximum amount within an agreed period, where the collateral is the consumer borrower's equity in his or her house. The lines of credit were originally conceptualized for use for major expenses, such as post-secondary education, home improvements, or medical bills, and not for day-to-day expenses. A HELOC

⁵⁶ Department of Finance Canada, News Release, 2011-003, "The Harper Government Takes Prudent Action to Support the Long-Term Stability of Canada's Housing Market" (17 January 2011), Department of Finance <http://www.fin.gc.ca/>. See also Canada, Department of Finance, *Background - Supporting the Long-Term Stability of Canada's Housing Market*, (2011), Department of Finance <http://www.fin.gc.ca/>.

differs from a conventional home equity loan in that the full amount of the loan agreed on is not advanced immediately; rather, the borrower uses a line of credit to borrow amounts up to a credit limit each year. The interest rate on an equity line is variable and may change quarterly, based on the prime rate. HELOC funds can be borrowed during the draw period, typically from 5 to 25 years.⁵⁷ A HELOC may have a minimum monthly payment requirement, frequently only the interest.⁵⁸ The full principal amount is due at the end of the draw period, either as a lump-sum payment or as per an amortization schedule.

However, HELOC were used as access to credit for purposes not originally intended. When consumers reached the limits on their credit cards, they resorted to HELOC, and in turn, ran credit card debt up again, placing their mortgages at risk of foreclosure. During the housing boom, the value of homes skyrocketed and the requirements to obtain a HELOC relaxed significantly.⁵⁹ Consumer debtors have paid off credit cards with equity in their homes during the boom and have no equity left and have more credit card debt again. Spending equity in people's homes has become, in the words of one credit counsellor "a frightening epidemic". When the value in homes decreased, consumer debtors' ability to continually spend via the HELOC declined or stopped. Now, the debt servicing ratios have been lowered and income confirmation, especially for the self-employed, is required before HELOC are granted in many cases.

The trend to use home equity lines of credit to finance day to day consumer expenses can be contrasted with studies that suggest that consumers' retirement years will be secure as they can rely on their home equity as one retirement strategy.⁶⁰ As Canada shifts from a system where pension savings were secure as consumers could not access their savings in a registered pension plan, a study commissioned for the federal Research Working Group on Retirement Income Adequacy suggested seniors can rely on their home equity as the cushion. The report noted that with the sharp decline in stock market values in the fall of 2008, Canadians found that their retirement wealth was adversely affected, especially those who had already or were about to retire. Several defined benefit plans became insolvent as they no longer had sufficient assets to cover their pension liabilities.⁶¹ The report observed that Canadians have significant savings in owner-occupied housing and that they can access their savings by downsizing their housing or taking on a reverse-mortgage during retirement years.⁶² However, the growth in HELOC could render that option meaningless, which is a problem that will manifest itself as the population continues to age.

3. *The Link between Employment, Income, and Capacity to Manage Debt*

For the most part, steady employment has been a big factor in both access to credit and capacity to manage debt. The decline in employment during the financial crisis was significant. The Bank of Canada reported 400,000 lost jobs during the height of the crisis. There were layoffs, permanent job losses, reduction of hours and failed businesses. Employment loss or reduction of income created significant problems for payment of mortgages and other ongoing payment obligations.

⁵⁷ Repayment is of the amount drawn plus interest.

⁵⁸ However, a debtor may make a repayment of any amount so long as it is greater than the minimum payment but less than the total outstanding.

⁵⁹ If a consumer had equity, and total LTV borrowed was less than 80%, the consumer qualified.

⁶⁰ Jack Mintz, *Summary Report on Retirement Income Adequacy Research*, December 18, 2009, Department of Finance, <http://www.fin.gc.ca/activty/pubs/pension/pdf/riar-narr-BD-eng.pdf>, the report is a summary of research prepared for the Research Working Group on Retirement Income Adequacy of Federal-Provincial-Territorial Ministers of Finance.

⁶¹ *Ibid.* at 5, 7.

⁶² *Ibid.* at 5, 7.

The linkage between default rates and loss of employment is very strong, in the view of almost all the credit professionals interviewed across Canada. Since the financial crisis, the number of middle-class families and individuals who are having difficulties because of employment loss and income reductions has meant that default rates have permeated into that tier. Bank and credit union managers witnessed many more working class and middle class individuals seeking to renegotiate terms and conditions of repayment based on their loss of income. A number of regions, such as the Maritimes, saw defaults due to job losses in particular sectors, along with concurrent insolvency filings. For example, in one community with a significant fishery sector, people depended heavily on the US market for lobsters and that market collapsed with the US economy collapse, in turn tightening credit availability in the local community in Canada. Credit managers reported a serious rise in loan defaults in areas with lower incomes and jobs overall.

The changes in access to credit have varied, depending on region and sector of the economy hit by recession. Initially, in 2009, Ontario was dramatically affected, and rapidly rising unemployment made it very difficult to get credit. In particular, anyone who worked in the auto industry or related industries was unlikely to get credit on economical basis, one credit professional observing that 5-7 spin-off jobs are lost for every one job lost in the auto industry. The key with high unemployment is that the consumer's debt/income ratio changes. More recently, credit counsellors are seeing a spike in consumer defaults in Alberta, where consumer debtors are suffering the effects of lost employment. There has been a dramatic decline in government jobs in a number of provinces, and according to a number of interviewees, the global financial crisis also resulted in halt of hundreds of construction jobs and manufacturing jobs related to export products to the US, again causing considerable financial hardship for consumers in those sectors to access credit.

Even if an individual is able to secure new employment relatively easily after a job loss due to economic downturn, access to credit is a problem. Since many people have not been at their new jobs for very long, they are being declined credit because it is not viewed as a stable employment history. For example, contract employment for one year is not considered by most lending institutions to be steady employment and people will not be offered credit. Yet they need the credit to get back on their feet financially.

Graph 13 below illustrates some of the connection between income and financial distress. Of the 3118 bankruptcy files, both the mean and median income of the bankrupt were \$20,000 or less.⁶³ Including the total family income of the bankrupts filing in income amounts, those figures were \$25,602 and \$23,754 respectively. For the few bankrupts that cited access to credit as the principal cause of insolvency, the median income was \$20,014.⁶⁴ For bankrupts whose primary declared cause of insolvency was insufficient income, the median income was \$19,944; and including total family income, the median was \$23,400.⁶⁵ Where over-indebtedness was the principal cause of insolvency, the bankrupts' median income was \$20,164, with the family median income of \$26,400.⁶⁶ Where the declared cause was that bankruptcy was precipitated by the financial crisis, that median income was \$19,200 for the bankrupt's income and \$29,572 for family income.

The figures suggest that low income is a major contributing factor to insolvency in all files. Across these arguably related causes, access to credit, insufficient income and over-indebtedness, bankrupts have little or no cushion for any kind of economic shock, given that individual and family incomes are so low. Interestingly, where the financial crisis was

⁶³ \$20, 233.17 and \$19,644.00 respectively for all files.

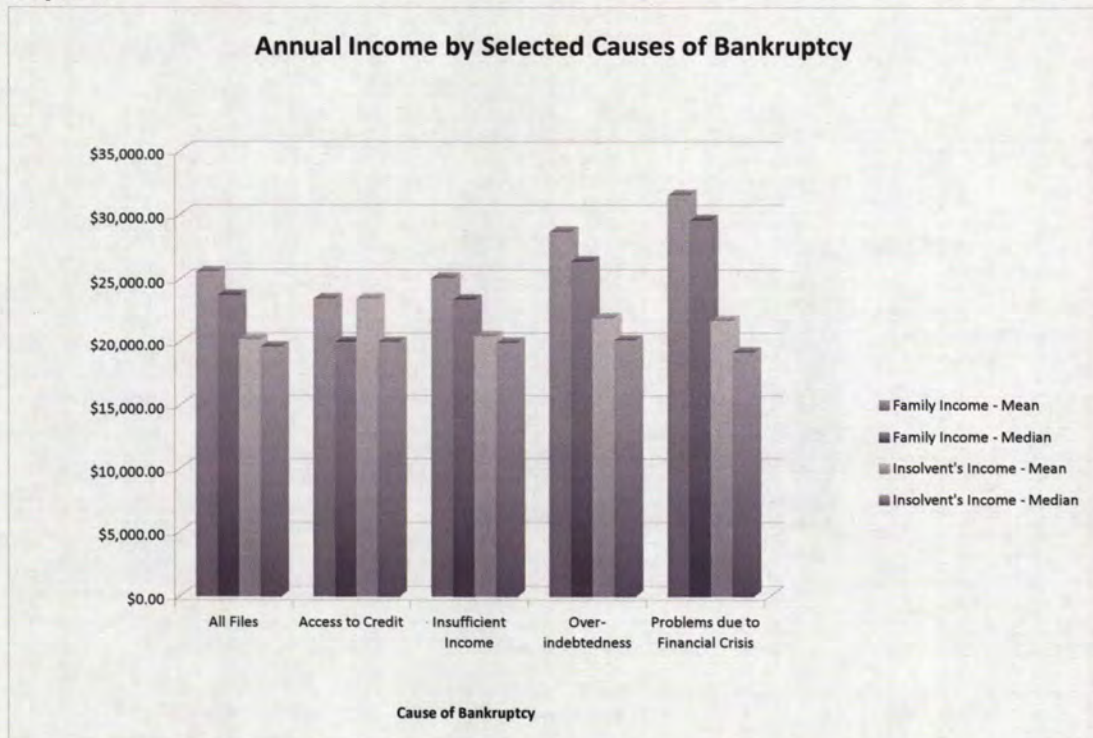
⁶⁴ The mean (average) was \$23,489.57, and the same figures were for family income, meaning that in these files, the bankrupt was the sole income earner.

⁶⁵ The mean was \$20,508 for the bankrupt's income and \$25,112 mean for total family income.

⁶⁶ The mean was \$21,951 for the bankrupt's income and \$28,691 mean for total family income.

identified as a cause, consumer debtors filing have higher income levels, as illustrated by the graph.

Graph 13

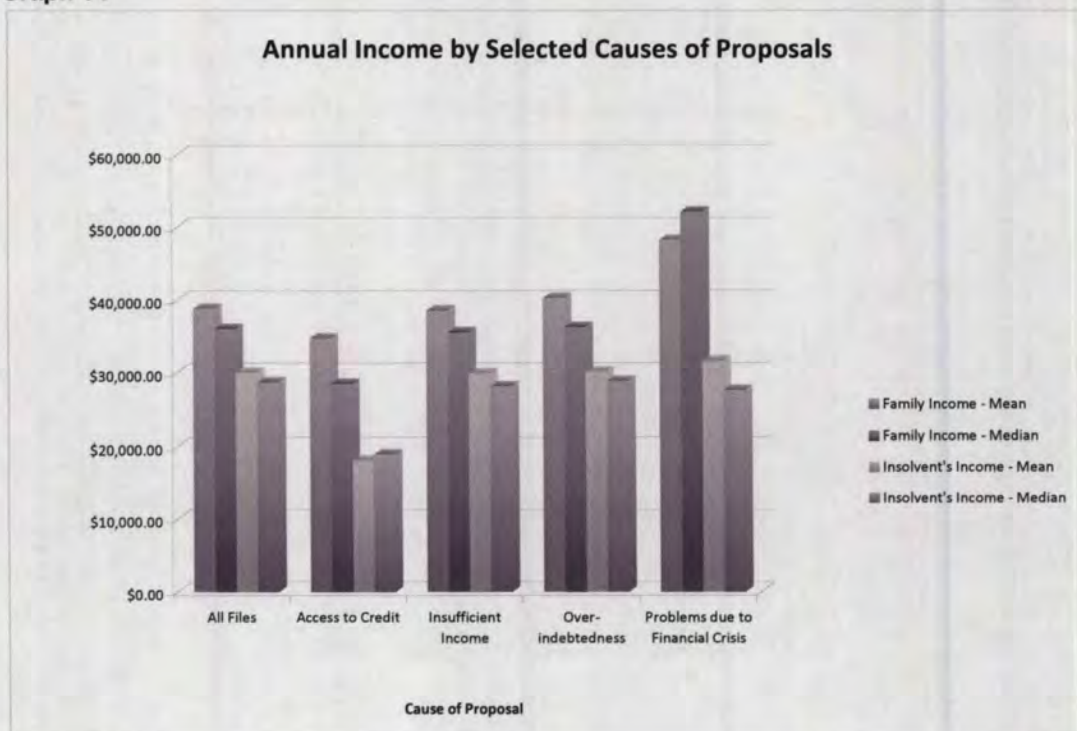


Proposals tell a slightly different story, as illustrated by Graph 11 below. There are generally higher levels of income that may be available to make a proposal viable. For the entire cohort, the median income of the insolvent debtor was \$28,668 and the median family income \$36,000.⁶⁷ For those debtors declaring access to credit a problem, the median insolvent debtor and family income are still low, \$18,948 and \$28,488 respectively.⁶⁸ For insufficient income, over-indebtedness and problems due to the financial crisis, median income levels are higher than those for bankruptcies, all between \$27,600 and \$29,000, the average income between \$30,000 and \$32,000. For insufficient income and over-indebtedness, the median family income levels were approximately \$36,000 and the average (mean) between \$38,500 and \$40,300. For proposal debtors that identified the financial crisis as a principal cause of insolvency, median family income was \$52,104, suggesting that the crisis has pushed families with higher income into insolvency.

⁶⁷ The mean (average) income of the debtor making the proposal was \$29,997 and the mean family income was \$38,803.

⁶⁸ The mean (average) income of the debtor making the proposal was \$18,124 and the mean family income was \$34,723.

Graph 14



Hence, for proposals, income levels are generally higher than bankruptcies, and thus debtors do have some availability of surplus income to be able to make a proposal to their creditors. Thus while the levels of liabilities are considerably higher, the availability of income combined with the desire to protect a higher level of assets means that consumer debtors are making proposals. The increase in the number of proposals overall in relation to bankruptcies, discussed above, may also be illustrative of this growing group of consumer debtors who had little to financially cushion themselves during the recent economic uncertainty, yet have the income to avoid bankruptcy. It is evident from the graph above that for many debtors, their income is the bulk of the family income, other than for the very few files where the financial crisis was cited as a cause.

Most of the credit professionals interviewed observed that after job losses since October 2008 and inability to replace the job with another, many individuals have opened small businesses and sole proprietorships. While they are trying to put their skills to good use, often there is not a market for their services or they are not able to manage their finances, and they are shouldering expensive debt associated with start-up costs because they cannot get lower priced bank and credit union loans. Credit professionals observed that small businesses usually must have two years of business financials before they can even apply for credit. Unfortunately, the first two years is when debtors need the funds to stay in business, hence they turn to credit card and other expensive debt to finance start up costs. These consumers usually try to personally guarantee any money borrowed from more traditional lenders; however, as these consumers are considered self employed, they do not meet the strict guidelines for employment confirmation.

Small business credibility is based on personal credit, and establishing such credibility to lenders, which has increased in difficulty because of job shortages. Since it is based on

personal credit, it increases the difficulty of the new business getting credit. Because of the prior loss of a job, the debtor has also lost his or her credit rating, again making self-employment credit more difficult to access. Where they are able to secure financing, the personal guarantees that individuals have given are being called on, resulting in default and foreclosure when the business fails, increasing bankruptcies post the financial crisis.

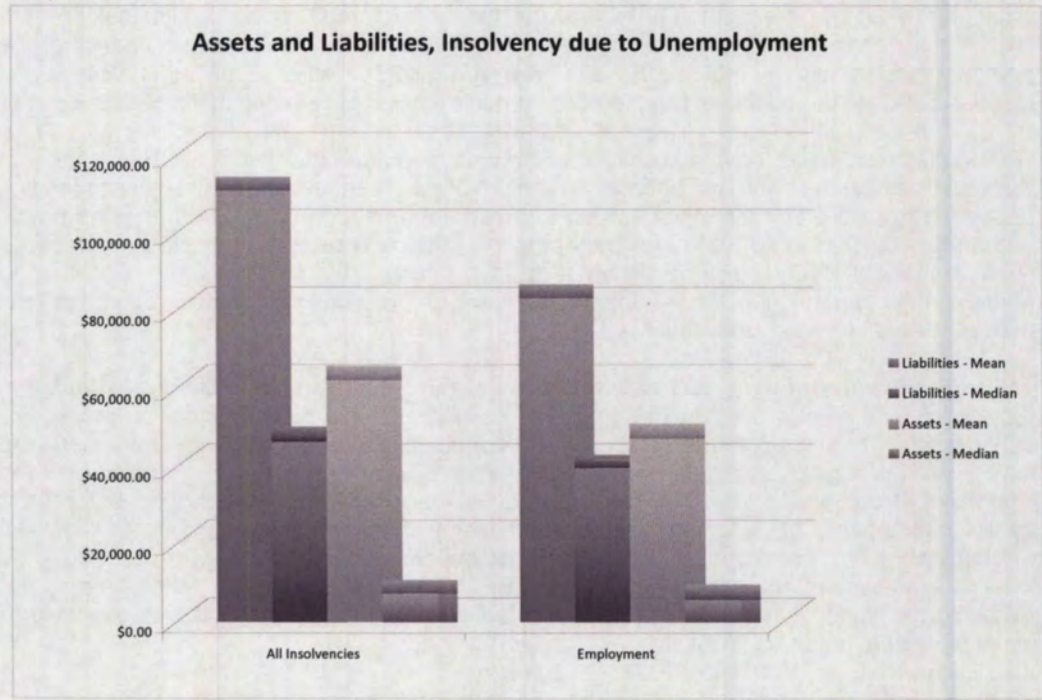
With the financial crisis, certain businesses were affected more than others. One manager in PEI observed that its bank had adopted a retail adjudication model for small business lending ten years ago, so that if the client has up to a certain amount in sales and has good credit, then the bank looks at whether they paid personal bills on time, etc. However, a number of bank managers observed that because of the crisis, they are far more attentive to fundamentals regarding business loans and less on relationships, which results in less access to credit for many individuals.

Table 7 and Graphs 15 and 16 below relate to income, assets and liabilities for debtors that reported loss of employment as their principal reason for filing a bankruptcy or proposal. For bankruptcies where loss of employment was the principal cause of insolvency, bankrupts had lower median assets and liabilities, but the loss of employment likely precipitated the insolvency. Here again, one can observe that the bankrupt is responsible for the bulk of family income and thus job loss can be particularly problematic for carrying the family's existing debt load. For proposals where the principal cause of insolvency was reported to be loss of employment, both assets and liabilities were lower than for all proposals, yet considerably higher than bankrupts had, and there was more income that was available to make payments under a proposal.

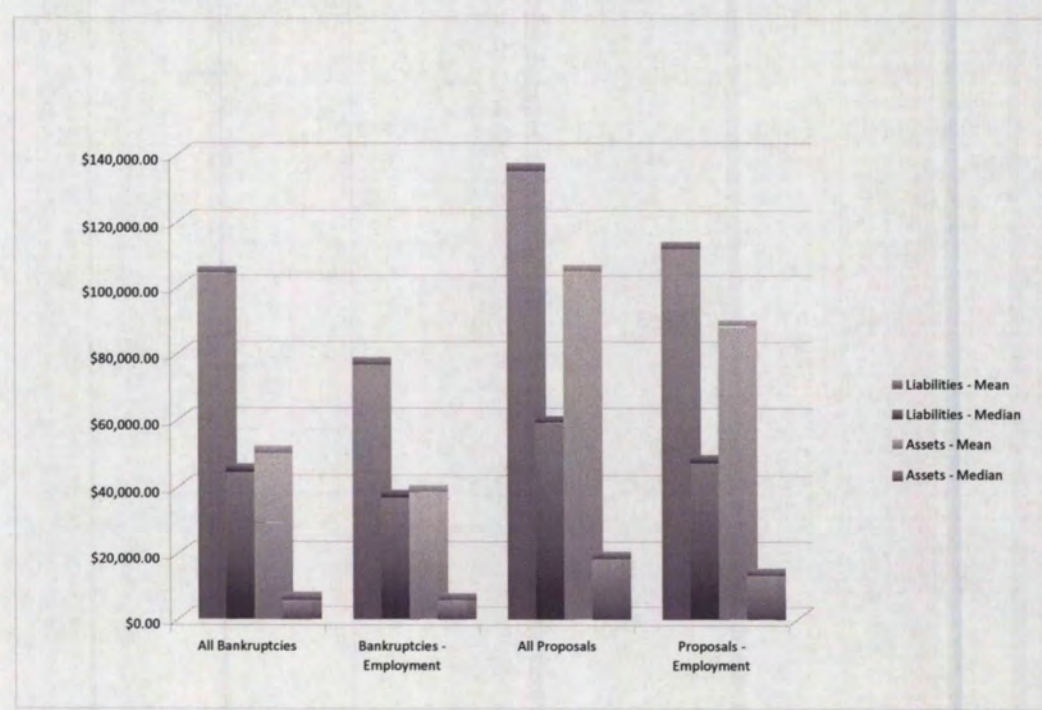
Table 7 Assets, Liabilities and Income for Consumer Debtors Filing because of Loss of Employment, 726 files

	Liabilities - Mean	Liabilities - Median	Assets - Mean	Assets - Median
All Bankruptcies	104,307	44,942	50,177	6,105
Bankruptcies - Employment	76,920	37,200	38,642	5,700
All Proposals	135,653	59,228	104,920	18,552
Proposals - Employment	112,064	47,729	88,121	13,500
	Family Income - Mean	Family Income - Median	Insolvent's Income - Mean	Insolvent's Income - Median
All Bankruptcies	25,602	23,754	20,233	19,644
Bankruptcies - Employment	22,591	21,120	16,846	18,000
All Proposals	38,803	36,000	29,997	28,668
Proposals - Employment	35,493	35,736	25,651	24,125

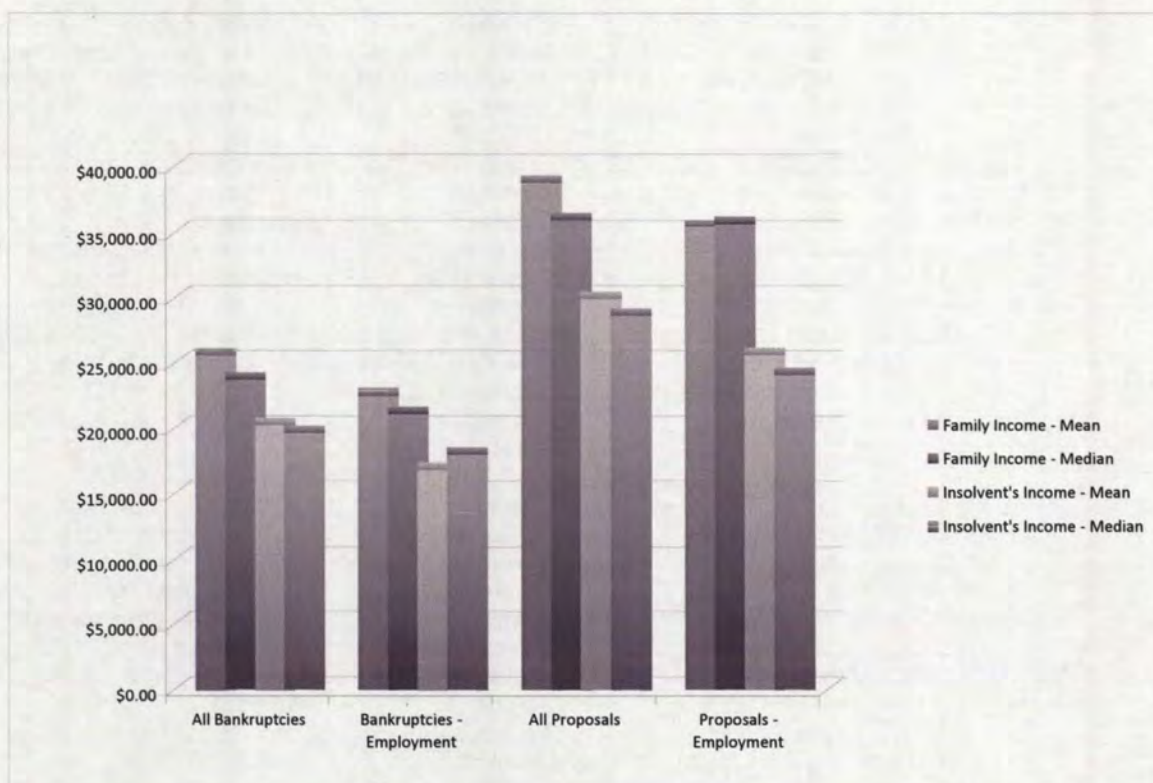
Graph 15



Graph 16 Assets and Liabilities, bankruptcies and proposals, insolvency due to unemployment



Graph 17 Annual Income, bankruptcies and proposals, Insolvency due to Unemployment



Credit counselling services are often not able to help people with small businesses, as they cannot place business debt on their programs unless the business is closed officially with Canada Revenue Agency (CRA). Credit counselling debt repayment programs are often 48 months, but one credit counsellor observed that the amount of debt has increased and people need to be on a Orderly Payment of Debt (OPD) program for 60 months most often; and their level of debt is so high that they cannot qualify for their program to payoff in 48 months.⁶⁹

4. The Link Between Credit Card Debt and Consumer Access to Credit

In Canada, there is increasing understanding of the relationship between credit card debt and insolvency, but little work has been done in understanding the prior relationship between credit cards and access to credit. Credit cards bring important efficiencies to commercial

⁶⁹ The Office of the Superintendent of Bankruptcy's website explains that OPD programs are also called a Consolidation Order. It is available in Alberta, Saskatchewan and Nova Scotia. It "is an order from the provincial Court that combines all your debts into one and determines the amount that you must pay to the Court on a periodic basis", Office of the Superintendent of Bankruptcy, "Alternatives to Bankruptcy," online: <http://www.ic.gc.ca/eic/site/bsf-osb.nsf/eng/br02049.html>. See also the Alberta program, Money Mentors, "Our Services," online: <http://www.moneymentors.ca/home/our-services/debt-management.html>.

exchange.⁷⁰ Equally, however, they can create access to very expensive credit, which consumers may not appreciate can prejudice their longer term financial viability.

Ronald Mann has undertaken considerable empirical research in the United States and other countries analyzing these linkages.⁷¹ His work examines the effect of credit card borrowing. He found that credit card spending relates to subsequent growth in consumer credit and that the growth in credit card debt related to a subsequent growth in US consumer bankruptcy filings.⁷² On the positive side, credit cards can assist with bridge financing when a family is experiencing interruption in income, in that if they have loss of employment, they are unlikely to get a conventional loan. Mann suggests that high credit card borrowing might reflect use of credit cards to meet crisis-level expenses to ease the short-term financial pressure faced by a family, and hence may be a useful short-term financing tool.⁷³ Mann has situated the rise of credit cards in the general shift from paper-based to electronic payments.⁷⁴ He observes that the plastic card, to the extent that it has facilitated entrepreneurial activity and consumer borrowing, has been an important component of a modern economy, but that there are social costs associated with credit cards, in the form of financial distress.⁷⁵ He observes that excessive credit card debt can impose substantial costs on the debtor, family members and the general welfare safety net; as well as cost consequences from the diminished productive activities of those individuals in financial distress.⁷⁶

However, there can be problems where consumers did not intend to use credit cards as a borrowing mechanism, or where they spend more than they would otherwise and acquire unanticipated debt.⁷⁷ In the effort to meet fixed debt commitments, such as mortgage and utilities payments, consumers often rely on credit cards to bridge expenses, without fully appreciating the real costs of carrying that debt. Retail stores have added to the proliferation of credit cards, and while they assist with access to credit in the short term, it is often difficult to maintain payments on multiple cards, in turn impairing the consumer's credit rating. By the time the consumer approaches a bank or credit union for assistance, the credit is already seriously impaired and difficult to fix. As one credit professional observed, early in the life of credit cards, paying the minimum payment would pay the balance off in 18 months; now, if a consumer pays a minimum payment on \$2000, it would take 36 years to pay off. The majority of credit professionals interviewed suggested that credit card interest rates and fees should be brought more in line with personal loans, including minimum payments that really do assist in reducing the debt load.

Buckland reports that sub-prime credit cards have proliferated in Canada, charging fees and interest combined into an Annual Percentage Rate (APR) that is 'substandard,' referring to an interest rate higher than what is charged by regular credit cards, often targeted at consumers with a poor or no credit history.⁷⁸ Here again, there is a segment of the population that is able to access credit card debt, but these consumer debtors are paying considerably more than the already high fees and interest charged by credit card companies to the general population.

⁷⁰ Mann, *Global Credit Card Use*, *supra*, note 17.

⁷¹ *Ibid.*

⁷² *Ibid.* at 2.

⁷³ *Ibid.* at 63. Mann's work also provides a comparative analysis of the adoption of debtor card use over credit card use. While beyond the scope of this article, he provides some significant insights into the greater use by Canadians of debit cards than credit cards and implications for economic activity.

⁷⁴ Ron Mann, *Charging Ahead, The Growth and Regulation of Payment Card Markets*, (Cambridge University Press, Cambridge, 2006) at 3.

⁷⁵ *Ibid.*

⁷⁶ *Ibid.* at 49-50.

⁷⁷ *Ibid.* at 141.

⁷⁸ Jerry Buckland, *supra*, note 12 at 6.

Consumers that routinely use credit cards have poor memory of their past expenses, underestimate these expenses, and consequently overspend believing they have more liquidity at their disposal than they do.⁷⁹ Payment by credit card results in a disassociation between consumption and payment, known as "transaction decoupling" so that payment costs and consumption benefits become uncoupled from one another, effectively anaesthetizing individuals from being exposed to the psychological pain of paying.⁸⁰ Soman has argued that unlike cash payments where the payment is made at the time of purchase, with credit card payments, the consumer does not have to pay until a month later, when the bill comes, factors that make it harder for consumers to maintain self-control and easier for them to spend using credit cards.⁸¹

There are also a number of contracting issues involved in credit card debt, including, standard form contracts that are often incomprehensible to cardholders; unilateral rights to amend terms of agreements; and financial terms such as annual percentage calculations and default provisions that are not accessible to the lay credit card holder.⁸² These difficulties are exacerbated by the fact that the cardholders may have a number of credit cards, all with varying payment terms and conditions.⁸³ Oren Bar-Gill's research suggests that credit card products are systematically designed to take advantage of common cognitive defects that limit the ability of typical consumers to accurately price the cost of credit, such as offering teaser rates where people do not study closely the longer-term interest rates or outcomes relating to missed payments.⁸⁴

Mann and Bar-Gill's observations are borne out by the experiences of the 55 credit counsellors and credit managers interviewed for this study. Some companies have increased interest rates on credit cards for no discernable reason, and are demanding higher payments, which are proving problematic for getting ahead of the monthly minimum payments. A number of bank managers suggested that creditors are monitoring their delinquency more closely, and are increasing rates on credit card debt if payments are late or missed, which does not help the consumer and just increases the profitability for the creditor's bottom line.

Numerous credit professionals suggested that credit card companies should not be able to randomly increase a consumer's credit limit. The consumer should update financial information to ensure he or she qualifies. Given both financial literacy issues and behavioural norms, automatic increases in limits encourage debt spending instead of forcing consumers to examine their budget practices. The government has responded to this concern. Effective January 1, 2010, the Credit Business Practices Regulations contain a number of changes that are intended to increase transparency and protect consumers.⁸⁵ There are new regulations applying to multiple types of lenders regarding credit cards and credit contracts: the Regulations Amending the Cost of Borrowing (Banks) Regulations,⁸⁶ Regulations

⁷⁹ Soman, *supra*, note 13 at 7, citing also an earlier paper, D. Soman, "Effects of payment mechanism on spending behaviour: The role of rehearsal and immediacy of payments", (2001) 27 *Journal of Consumer Research* 460-474.

⁸⁰ *Ibid.*

⁸¹ *Ibid.* at 18.

⁸² Mann, *supra*, note 17 at 131-132.

⁸³ *Ibid.* Mann observes that the average number of credit cards per household in the U.S. is 13 credit cards. Mann's work makes an important contribution to our understanding of the use and overuse of credit cards. He observes that many of the problems from overuse arise post contract, and hence may call for different policy considerations than those under standard contract formation.

⁸⁴ Oren Bar-Gill, "Seduction by Plastic", (2004) 98 *NW. U. Law Rev.* 1373.

⁸⁵ SOR/2009-257, (2009) *C Gaz II*, 1795. Department of Finance, News Release, 2009-089, "Government of Canada Helps Protect Canadian Credit Card Users" (30 September 2009), Department of Finance <http://www.fin.gc.ca>.

⁸⁶ Regulations Amending the Cost of Borrowing (Banks) Regulations, Canada, SOR/2009-258.

Amending the Cost of Borrowing (Authorized Foreign Banks) Regulations,⁸⁷ the Regulations Amending the Cost of Borrowing (Trust and Loan Companies) Regulations,⁸⁸ Regulations Amending the Cost of Borrowing (Retail Associations) Regulations,⁸⁹ Regulations Amending the Cost of Borrowing (Canadian Insurance Companies) Regulations,⁹⁰ and Regulations Amending the Cost of Borrowing (Foreign Insurance Companies) Regulations.⁹¹

Section 6 of each of these amended new regulations addresses increases to credit card limits; specifically, an institution may not increase the credit limit on a borrower's credit card account without first obtaining the borrower's express consent to do so. If the borrower's consent to the increase is given orally, the institution must, by the time of the next statement of account, provide confirmation of that consent to the borrower in writing, in paper or electronic form.⁹² The regulation also specifies that the use of any service related to the credit card account by the borrower, such as use of the credit card, does not constitute express consent.⁹³ The policy rationale for altering the way that credit card limits are increased is to "assist consumers to keep track of their financial situation."⁹⁴

Another suggestion, not yet adopted, was that there should be a prohibition on a bank or credit card company adversely affecting a consumer's credit score when the consumer has requested a lowering of his or her credit card limit.

Also recommended by the credit professionals was that solicitation for credit cards through the mail should not be allowed. Approval of credit is based on a scoring system and a probability of default. If a consumer is within those parameters, credit card applications are mailed via a computer system, increasing access to expensive credit, which is tempting for the consumer debtor for all the above-discussed reasons.

One issue is how to lessen the likelihood of imprudent borrowing without reducing the benefits that credit cards offer.⁹⁵ Mann recommended that "universal default provisions" should be banned; these provisions are where an accredited card issuer can unilaterally raise the rate on its card if the consumer misses a payment to another creditor. Mann's work concludes that increased disclosure is not sufficient as a remedy and these further measures are needed.

Mann also suggests a ban on marketing to minors and college students, similar to that imposed in the UK.⁹⁶ That recommendation was echoed by a number of credit professionals, who suggested that marketing of credit cards on university campuses should not be allowed. Mann suggests that another policy option would be to subordinate the US *Bankruptcy Code's* right to recover debts incurred by minors on credit cards, although he notes that such a move may create incentives to abuse such a protection.⁹⁷ Mann found that Canada and the US

⁸⁷ Canada, SOR/2009-259.

⁸⁸ Canada, SOR/2009-260.

⁸⁹ Canada, SOR/2009-261.

⁹⁰ Canada, SOR/2009-262.

⁹¹ Canada, SOR/2009-263.

⁹² *Ibid.*, section 6(2), the institution must, not later than the date of the first statement of account that is provided after the date of that consent, provide confirmation of that consent to the borrower in writing, in paper or electronic form.

⁹³ Canada, SOR/2009-257, s 6.

⁹⁴ Canada, Department of Finance, *Background - Regulatory Measures Related to Credit*, (2009), online: Department of Finance <<http://www.fin.gc.ca>>. See also: Department of Finance, News Release, 2009-048, "Minister of Finance Releases New Credit Card Regulations to Improve Protection for Consumers" (21 May 2009), Department of Finance, <http://www.fin.gc.ca>.

⁹⁵ Mann, *supra*, note 17 at 4-5.

⁹⁶ *Ibid.* at 50, citing s. 50 of the UK *Consumer Credit Act*.

⁹⁷ *Ibid.* at 6.

have the highest card based transactions per capita in the world, six times Japan for example, and a third more than the UK. Credit card debt in the US is 40% of all non-mortgage consumer credit, whereas it is only between 20% and 30% in Canada.⁹⁸

Some credit card companies increase the affinity benefits (air travel miles or points towards purchase of a vehicle or other assets) where the cardholder does not pay his or her bill on monthly basis, creating incentives to run up debt without understanding the costs of carrying that debt.⁹⁹ The UK previously had a rule that cardholders had to pay 15% of their credit card debt each month, but it was removed in 1978 and card issuers moved the minimum to 5%.¹⁰⁰ In Canada, the amount tends to range between 1.5% and 3% according to the surveyed credit professionals.

Canada's Senate Committee on Banking Trade and Commerce examined issues in respect of credit cards in 2009.¹⁰¹ It recommended that the federal government appoint an oversight board, within an existing federal organization, that would consult with participants from Canada's credit card and debit card payment systems as well as relevant federal stakeholders, including a mandate to make recommendations on any regulatory or legislative measures that it considers to be required to ensure fairness for participants in the credit card and debit card payment systems. The oversight board would monitor and publish annually information on trends in interchange, switch, merchant and other associated payment systems fees; and establish a code of conduct for payment systems participants and practices for setting fees and rates.¹⁰²

The Senate Committee was also concerned about a number of industry practices that have the effect of increasing the cost of credit. It recommended that the federal government take appropriate action to permit surcharging and/or discounting by merchants; require merchants to display, at the point of purchase, the amount of any applicable surcharge or discount; permit merchants to inform customers about relatively lower-cost payment methods; and prohibit any "honour-all-cards" rules, including those that require merchants to accept a network operator's higher-cost premium cards and those that link credit card and debit card merchant acceptance.¹⁰³ It urged the federal government take appropriate action to require the calculation of switch and interchange fees on the basis of a flat fee for debit card transactions; set the interchange fee at zero for a period of three years for all debit card transactions; and prohibit priority routing in order that cardholders are able to select, at the point of sale, their preferred payment method when using a co-badged card.¹⁰⁴

The Senate Committee further recommended that the government require card issuers to disclose, in a clear, simple and conspicuous fashion, the following information on each monthly statement: the number of months it would take to pay off the balance owing and the cost that would ensue if no further advances and/or purchases were made and if the consumer were to make only the minimum monthly payment; the monthly payment required to pay off the outstanding balance within 36 months if no further purchases and/or advances were made; and the year-to-date total of all interest costs and other fees that have been paid and/or accrued from use of the credit card. It recommended that the government should

⁹⁸ *Ibid.* at 9.

⁹⁹ *Ibid.* at 54.

¹⁰⁰ *Ibid.* at 60.

¹⁰¹ Senate, Standing Committee on Banking, Trade and Commerce, *Transparency, Balance and Choice: Canada's Credit Card and Debit Card Systems* (June 2009) (Chair: The Honourable Michael A Meighen); <http://www.parl.gc.ca/Content/SEN/Committee/402/bank/rep/rep04Jun09-e.pdf>.

¹⁰² *Ibid.* at 20, recommending also that merchants should be permitted to bargain collectively regarding payment card conditions and fees, and this form of cooperation should be exempt from the provisions of the *Competition Act*.

¹⁰³ *Ibid.* at 23.

¹⁰⁴ *Ibid.* at 32.

require card issuers to provide cardholders with information about the range of their credit card products, including all associated fees and interest rates, and with information that would direct the cardholder to the Financial Consumer Agency of Canada's online credit-card selection tool. Finally, the Senate Committee reported that government should direct the Financial Consumer Agency of Canada, and provide it with the resources necessary to take a more vigorous approach to enforcing existing and future disclosure requirements, requiring the agency to monitor and report on card issuer practices, including compliance with new and existing federal regulations in respect of disclosure requirements.¹⁰⁵

The federal government in 2009 announced new regulations to limit business practices that are not beneficial to consumers and to provide clear and timely information to Canadian consumers about credit cards. As noted above, effective January 1, 2010, the Credit Business Practices (Banks, Authorized Foreign Banks, Trust and Loan Companies, Retail Associations, Canadian Insurance Companies and Foreign Insurance Companies) Regulations include a number of changes that are intended to increase transparency and thereby protect consumers.¹⁰⁶ The Credit Business Practices Regulations are aimed at limiting business practices of financial institutions that are not beneficial to consumers and amending the existing Cost of Borrowing Regulations to improve disclosure.¹⁰⁷ The changes include requiring a minimum 21-day grace period on new credit card purchases. Providing a grace period applies to all new purchases when consumers pay in full in the current month, regardless of an outstanding balance the month before. Banks are now to allocate payments made in excess of the required minimum using a method that is beneficial to consumers, either allocating payments to the balance with the highest interest rate first, or distributing the payments based on the relative proportion of each.

The new regulations are aimed at prohibiting federally regulated financial institutions from increasing someone's credit limit unless that person explicitly agrees.¹⁰⁸ The rules will also place limits on debt collection practices, to ensure a uniform standard that would apply to the debt collection practices of all federally regulated financial institutions. Financial institutions will be prohibited from imposing a fee when the credit limit is exceeded solely because a hold was placed on available credit by the merchant.

¹⁰⁵ *Ibid.* at 39.

¹⁰⁶ SOR/2009-257, (2009) C Gaz II, 1795. Department of Finance, News Release, 2009-089, "Government of Canada Helps Protect Canadian Credit Card Users" (30 September 2009), Department of Finance <http://www.fin.gc.ca>.

¹⁰⁷ Department of Finance Canada (2009). "Backgrounder: Regulatory Measures Related to Credit", www.fin.gc.ca/n08/data/09-048_1-eng.asp. In the US, the *Credit Card Accountability, Responsibility and Disclosure Reform Act of 2009*, U.S. Congress. (2009a). *S.392 (Bill)—Credit Card Reform Act of 2009*, www.opencongress.org/bill/111-s392/text. Accessed July 1, 2010. U.S. Congress. (2009b). *Credit Card Accountability, Responsibility and Disclosure Reform Act of 2009*. Public law 111-24, Senate and House of Representatives of the United States of America, Washington, DC is aimed at protecting consumers from skyrocketing credit card debt, unfair credit card practices, and deceptive credit card offers". There are protections against arbitrary credit card rate changes and due-date gimmicks without giving cardholders advance notice; individuals can keep better track of their personal finances by requiring credit card issuers to have a cardholder's express consent, or at least give advance notice, for changes in credit limits or interest rates.

¹⁰⁸ Canada, SOR/2009-257, s 6. Specifically, section 6 of the regulations, which came into force January 1, 2010, specifies: Consent for Increases in Credit Limits 6. (1) An institution may not increase the credit limit on a borrower's credit card account without first obtaining the borrower's express consent to do so. (2) If the borrower's consent to the increase is given orally, the institution must, not later than the date of the first statement of account that is provided after the date of that consent, provide confirmation of that consent to the borrower in writing, in paper or electronic form. (3) The use of any service related to the credit card account by the borrower, including the simple use of the credit card, does not constitute express consent for the purpose of subsection (1).

The new regulations require federally regulated financial institutions to enhance disclosure requirements by requiring that for credit contracts and credit card applications, all salient information, such as fees and rates, be provided in a summary box, in order to bring the information to the consumer's attention, in turn, improving consumer understanding of the implications of only making the minimum payment, enhancing disclosure by showing consumers how long it would take to pay off the balance owing on a credit card if they only made the minimum payment every month, and providing a clear example monthly of how compound interest affects those who pay it.¹⁰⁹ The changes will also provide consumers advance notice on monthly statements, if interest rates are going to be increased in the short term. This requirement would capture situations such as rate increases following the end of low introductory rates or rate increases triggered by the consumer skipping one or more minimum payments, thus allowing consumers to act to avoid the increase.¹¹⁰ The policy rationale for altering the way that credit card limits are increased is to "assist consumers to keep track of their financial situation."¹¹¹

Credit managers report that the new provisions are having some effect on consumer debtors, in that they are starting to realize the cost of debt they are carrying. Whether that understanding will translate into different credit patterns, including reducing the load of expensive debt, is too soon to tell. Such measures do not address many of the underlying problems associated with credit card debt, such as insufficient income, job loss and lack of alternate lower cost credit as a bridging mechanism at times of income disruption. To date, there is no political will to cap the interest rates charged by credit card companies. Hence, while the cost of debt will be more transparent, credit card and similar debt will continue to be the most accessible form of expensive credit.

5. Personal Loans, Lines of Credit and Rising Default Rates

Both regional differences and community economic base are factors in access to personal loans and lines of credit. In agricultural communities, for example, the need for credit is highly dependent on the weather, to cover as economic losses suffered from flooding, etc. In communities with a high dependency on social income supports, credit has always been tight and continues to be the same. In the west, credit unions observed that it is harder to maintain business in smaller communities, as centralized farm credit is siphoning off business. In terms of what credit professionals observe regarding changes to access to consumer personal loan credit since October 2008, there was relative consistency across the country, although some regional differences. Generally, there has been a tightening of personal loans and lines of credit, and more diligence in credit assessments. PEI and Saskatchewan reported that they did not really change practices after October 2008, and credit counsellors in Saskatchewan have observed a drop in files across the province. Managers also observed that while early in the crisis, consumers at either end of the age spectrum, i.e. younger adults and elderly people, were having the most difficulties, tightened access to credit has now spread across all age cohorts.

Most banks and credit unions reported a 70 to 75% approval rate for loans prior to the financial crisis, but observe that conditions have tightened and thus the approval rates have dropped, although in some instances, they are moving back up in 2011. 80% of the bank and credit union managers that were interviewed observed that banks have started to restrict access for consumers to personal loans and lines of credit. Households have not been able

¹⁰⁹ http://www.fin.gc.ca/n08/data/09-048_1-eng.asp.

¹¹⁰ May 21, 2009, <http://www.fin.gc.ca/n08/09-048-eng.asp>.

¹¹¹ Canada, Department of Finance, *Background - Regulatory Measures Related to Credit*, (2009), online: Department of Finance <<http://www.fin.gc.ca>>. See also: Department of Finance, News Release, 2009-048, "Minister of Finance Releases New Credit Card Regulations to Improve Protection for Consumers" (21 May 2009), Department of Finance, <http://www.fin.gc.ca>.

to gain access to credit to finance their living, many observing that, in their view, consumers were previously living beyond their means because of easier access to credit prior to 2008. Both managers on the lending side and credit counsellors on the debt assistance side generally believed that access to credit had previously been too liberal, and that many consumers do not have sufficient cushion in their budget to withstand sudden economic shocks such as reduced pay or fluctuating interest rates.

If a consumer is seeking to consolidate all his or her debt with a personal loan from a bank or credit union that the consumer has an established relationship with, the consumer is more frequently being declined than prior to the financial crisis. Many institutions now will only consolidate unsecured debt that is with them, not with other institutions, which may not help the client's overall situation. Many financial institutions are streamlining their credit operations via internet online applications or a scoring system. Creditors are using credit reports from the credit bureaus to assess the credit worthiness of potential borrowers; and good credit reports can be used as leverage by consumers to obtain lower interest rates and reduce the cost of borrowing, although most lenders interviewed report that consumers infrequently do so.

In the view of many credit professionals, there is a need to go back to relationship building, using face to face interviews to have a full understanding of the consumer debtor's situation before granting credit. Many also expressed the view that creditors should more frequently discuss money management and budgeting skills and be prepared to help the consumer in that regard so that they can avoid further financial problems.

It is expected that consumer debt costs will increase in the next period, once the prime lending rate normalizes, so that loans and lines of credit will be more expensive to service. Many managers and credit counsellors observed that households are near the edge of not being able to sustain payments now, and are unlikely to handle a significant increase in their credit and interest costs. The statistics above regarding job loss seem to support this idea, in the sense that there were debtors that were barely managing to service their debts, but a change in their economic circumstances pushed them over the edge into insolvency.

Many of the consumer debtors that are in trouble financially now are still dealing with the consequences of freely available credit prior to 2008. In general, the cost of living has far exceeded the increase in personal income for the vast majority of consumers; and the majority of households have not made the appropriate adjustments to their budget. Most consumers are unaware of where is the money going, and few have a strategy to pay off their more expensive debt.

Across Canada, credit professionals raised the issue of what could be done to try to reduce consumers' reliance on credit and increase their savings. Studies on personal saving rates based on national accounts data have shown that Canadians have been saving less since 1980, when personal savings rates peaked at 20 percent. Currently, personal saving rates on a national accounts basis are 5 percent of disposable income.¹¹² While employment security is the largest contributing factor to the ability to save, credit professionals suggested that mass advertising promoting immediate consumption has no counter balancing force or message in the mass media regarding the value of savings.

The auto industry and its relating financiers are offering even more financing as part of the effort to restart the auto sector after its insolvency restructuring. Qualification for credit is set at a very low threshold of eligibility, and many consumers, particularly younger consumers, are purchasing cars worth \$30,000 or more, with loans with payment terms that have gone from 36 months to 84 months. There has already been an increase in vehicle repossession in Alberta and other provinces, creditors are no longer keeping "bad deals" on the books. Thus,

¹¹² Mintz, *supra*, note 60 at 6.

the benefits to the auto sector generated by this long-tail financing may be creating conditions for financial distress in the future.

In terms of personal loans, credit counsellors reported a large spike in defaults across Canada during 2009 and 2010, when consumer debtors could not live within their existing budget any longer. There were many credit professionals that observed that bill collectors placed considerable pressure on consumers to pay unsecured debt first and expect the consumer to not pay the essentials, like housing costs or food; then the consumer has little choice but to use credit cards to meet those needs.

Many consumer debtors have consolidated consumer debt by personal loans, secured by their home equity or assets. Consolidation loans can reduce interest costs from more expensive debt such as credit card debt and expensive consumer product loans. Yet, credit professionals observed that lenders often take little or no steps to educate the client on credit use or conditions for the consolidation approval, such as requiring all credit be cancelled to avoid the client getting into the same situation again. What happens is that the clients get right back into debt, fall behind and then default on the mortgage or other security.

Finally, there were a number of observations about computerized lending and/or "on-line loans", which on the one hand have facilitated credit and on the other may not always offer the scrutiny that a face to face lending relationship does. Managers observed that many situations do not fit neatly in the computerized model and that there should be more room for discretionary decisions based on other objective factors. In some cases, managers observed that the computer model has approved some deals they would have denied and vice versa.

6. Payday Loans

Payday loans are short-term loans, typically between \$300 and \$500, advanced against a post-dated cheque, which is payable on the borrower's next payday; loans that typically add a number of registration and other fees to the maximum rate legally available, and are often refinanced or "rolled over" to the next payday with additional fees payable, making them the most expensive source of consumer credit available¹¹³ Berry and Duncan observe that one study showed that, on average, payday lenders provide 15 repeat or rollover loans for every first time loan extended. Provincial payday lending laws and Canada's *Criminal Code* section 347.1 define payday loans as under \$1,500, setting a maximum dollar value that is aimed at ensuring the loans are captured in payday lending laws.

Payday loans are viewed as both beneficial and harmful. Consumer debtors become involved in a vicious cycle of borrowing and then re-borrow the funds from the same outlet or go to a different outlet to get the funds they need to service the first loan. The overall market figures illustrate the size of the industry, although numbers vary somewhat by source reporting. The Canadian Payday Loans Association (CPLA) estimates that there are 1,635 retail outlets providing payday loans in Canada.¹¹⁴ The government of Ontario estimated in 2009 that there were 1,350 retail outlets in Canada of which 750 are in Ontario. In a report commissioned in by the CPLA in 2004, a survey of loan providers found that loan volumes from each retail location generally ranged from less than \$1 million to \$2.5 million.¹¹⁵ A 2006 report for the Library of Parliament found the total loan volume could not be determined

¹¹³ Ruth E. Berry and Karen A. Duncan, *The Importance of Payday Loans in Canadian Consumer Insolvency*, 2007, [http://www.ic.gc.ca/eic/site/bsf-osb.nsf/vwapj/Payday_EN.pdf/\\$FILE/Payday_EN.pdf](http://www.ic.gc.ca/eic/site/bsf-osb.nsf/vwapj/Payday_EN.pdf/$FILE/Payday_EN.pdf)

¹¹⁴ Canadian Payday Loan Association, "Our Mandate" (2011) online: <<http://www.cpla-acps.ca/>>.

¹¹⁵ Ernst & Young, "The Cost of Providing Payday Loans in Canada" (2004) at 40, online: <<http://www.cpla-acps.ca/>>.

authoritatively, but estimates ranged between \$170 million and \$1 billion.¹¹⁶ The government of Ontario estimated in 2009 that the national industry loan volume is \$2 billion and that the average payday loan is \$300.¹¹⁷

Two companies dominate the market in Canada. Dollar Financial Corp. is a US company that operates retail storefront locations in Canada, the US, the United Kingdom (UK) and Poland.¹¹⁸ In Canada, they operate as "Money Mart" in nine provinces and the territories, and as "Instant Cheques" in Québec.¹¹⁹ As of June 30, 2010, they claimed the largest market share in Canada by branch, 31% of market share, reporting 465 financial services stores, including 62 franchises, and an estimated 1500 retail outlets in Canada. In fiscal 2010, their Canadian consumer loan originations were US \$792,231,000. Their Canadian company funded consumer loan revenues were US \$147,851,000.

Cash Store Financial (CSF), formerly called Rentcash Inc., operate "The Cash Store" and "Instaloan", with operations primarily in Canada, and a small business in the UK.¹²⁰ As of September 30, 2010, they had 542 retail branches in Canada, claiming to hold 35% of the market share by branch and 1550 outlets. In the 12 months prior to September 30, 2010, they had a loan volume of \$681,400,000, including UK loans; and since they only had two branches in the UK, Canadian loans represent most of this volume.¹²¹

Neither annual report discloses the number of loans provided. However if one uses the Ontario government's estimated average loan of \$300, then DFC may have given 2,640,770 loans and CSF 2,271,333 loans in the reporting year discussed above.

In the US, the rate of payday lending has rapidly expanded in recent years and the annual payday loan volume in the US now exceeds 50 billion USD.¹²² The number of payday outlets is greater than the number of McDonalds and Starbucks outlets combined.¹²³ Payday lending requires employment and a chequing account, as the amount is borrowed with the next pay cheque as security; the post-date cheque is given at the time of the loan. Studies have found that payday borrowers generally have low but steady incomes and poor credit histories.¹²⁴ Payday borrowers are using loans for emergencies, groceries and debt service.¹²⁵ In the US, at least 13 states restrict payday loan terms, imposing outright bans, prohibitions on serial payday borrowing, or with binding interest rate caps on payday loans or consumer loans in general.¹²⁶ The market rate for a 2-week payday loan in the US is 390% APR, although fees can be higher.¹²⁷ Serial borrowing under payday loans is very prevalent.¹²⁸

¹¹⁶ Andrew Kitching and Sheena Starky, "Payday Loan Companies in Canada: Determining the Public Interest" (2006) Library of Parliament PRB 05-81E, online: <<http://parl.gc.ca>>.

¹¹⁷ Ontario, Maximum Total Cost of Borrowing Advisory Board, "Capping Borrowing Costs" (2009) at 7, online: <<http://www.sse.gov.on.ca>>.

¹¹⁸ Dollar Financial Corp, "Annual Report" (2010) online: <<http://www.dfg.com>>.

¹¹⁹ Instant Cheques does not provide short term loans.

¹²⁰ Cash Store Financial, "Annual Report" (2010) online: <<http://www.csfinancial.ca>>.

¹²¹ In 2010, CSF changed their fiscal year end from June 30 to September 30. Thus, when they break down their revenue into brokerage revenue (\$171,612,000) and other revenue (\$50,165,000), it is really for a 15 month period. However, they also provide their total revenue for the 12 month period prior to September 30, 2010 (\$180,200,000).

¹²² Zinman, *supra*, note 9 at 3, citing one study that annual growth in lending is 40% annually.

¹²³ *Ibid.* at 1.

¹²⁴ *Ibid.* at 3, citing several studies.

¹²⁵ *Ibid.* at 4.

¹²⁶ *Ibid.*, citing <http://www.ncsl.org/programs/banking/paydaylend-intro.htm>.

¹²⁷ *Ibid.* at 3.

¹²⁸ M. Stegman, "Payday Lending", (2007) 21 *Journal of Economic Perspectives* 169-190. Brian Melzer, "The real costs of credit access: Evidence from the payday lending market." (2009), Working Paper, Northwestern University.

Legislation can temper the harmful effects of payday loan interest rates. One study undertook empirical research on the effects of a payday lending cap in Oregon that came into force effective 2007. The Oregon cap requires the maximum combination of fees and finance charges to be \$10 for every \$100, with a minimum loan of 31 days (max APR of 150%).¹²⁹ The number of payday lending outlets dropped by 2/3 in the first seven months after the cap came into force and within two years had dropped from 346 licensed payday loan outlets to 82.¹³⁰ The study found that restricting access to consumer credit hinders productive investment and/or consumption smoothing over the short term, but was unable to conclude that access to expensive credit improves consumer welfare.¹³¹ It found that payday interest caps dramatically reduced access to credit in the state, and that borrowers shifted into incomplete and in some cases inferior substitutes, such as chequing account overdrafts and consequent overdraft and late fees, and indirect effects such as utilities shutoffs, account closures, and loss of ability to open an account.¹³² However, the study also found that for the remaining outlets, short-term access to credit may have improved for payday borrowers because of the lower costs and longer-term payment window.¹³³ It suggested further study using proxies for consumer welfare and financial condition, such as postponed medical care, forced moves, shutoff of utilities and reactivation fees, hunger and credit score declines.¹³⁴

In 2007, Berry and Duncan argued that payday advance credit was unlike other short-term loans in that the principal was typically due in 14 days or less; and that these loans were rolled over, time and time again, incurring higher administration and interest charges and becoming a greater burden for the lender.¹³⁵ They recommended replacement of payday loans with a short-term loan or installment loan, so that the consumer debtors might find it possible to pay the debt off without having the experience of bankruptcy.¹³⁶ Berry and Duncan observed that the payday borrower who files for bankruptcy tends to be single, younger and with a higher income than bankrupts without these loans, and argued that these characteristics make the case for consumer education to provide a balance to the presence of payday loan establishments in many inner-city and suburban neighbourhoods. Buckland observes that the 2005 Survey of Financial Security found that lower-income consumers used payday loans more often than other consumers, and that among households who used payday lending at least once a month, 52.4% had household income less than \$30,000.¹³⁷ Berry and Duncan suggest that if traditional lenders provided more accessible services, and there was more objective information about payday lenders in public service advertisements, these borrowers are more likely to access other lending options, observing that payday lenders do not post reliable information about interest rates and rollover provisions in their premises or on their Internet sites, thus not allowing consumers to compare rates and services accurately.¹³⁸ Since their study, a number of provinces have enacted legislation, but only a few of the identified problems have been addressed.

The *Criminal Code* was amended in 2006 to allow for provinces to regulate payday loans. Section 347.1 specifies:

347.1 (1) The following definitions apply in subsection (2).

¹²⁹ Zinman, *supra*, note 9 at 3.

¹³⁰ *Ibid.*

¹³¹ *Ibid.* at 9, based on a sample of 1040 borrowers, of 17,940 approached.

¹³² *Ibid.* at 2. See also Campbell *et al*, *supra*, note 19.

¹³³ *Ibid.* at 8.

¹³⁴ *Ibid.* at 9. Campbell *et al*, *supra*, note 19 report 6.4 million involuntary chequing account closures in the US in 2005.

¹³⁵ Berry and Duncan, *supra*, note 113 at 16.

¹³⁶ *Ibid.*

¹³⁷ Jerry Buckland, *supra*, note 12 at 10.

¹³⁸ Berry and Duncan, *supra*, note 113.

"interest" has the same meaning as in subsection 347(2).

"payday loan" means an advancement of money in exchange for a post-dated cheque, a pre-authorized debit or a future payment of a similar nature but not for any guarantee, suretyship, overdraft protection or security on property and not through a margin loan, pawnbroking, a line of credit or a credit card.

(2) Section 347 and section 2 of the *Interest Act* do not apply to a person, other than a financial institution within the meaning of paragraphs (a) to (d) of the definition "financial institution" in section 2 of the *Bank Act*, in respect of a payday loan agreement entered into by the person to receive interest, or in respect of interest received by that person under the agreement, if

(a) the amount of money advanced under the agreement is \$1,500 or less and the term of the agreement is 62 days or less;

(b) the person is licensed or otherwise specifically authorized under the laws of a province to enter into the agreement; and

(c) the province is designated under subsection (3).¹³⁹

There are two types of payday loan statutes that have now been enacted provincially. In Alberta and Saskatchewan, the statutes are aimed at regulating the cost of credit in general. These statutes have sections that apply to fixed credit, but not payday loans specifically, and they do not require licensing of payday lenders. The second type, in force in British Columbia, Manitoba, Ontario, and Nova Scotia, apply directly to payday lenders. With the exception of British Columbia, they require lender licensing. New Brunswick's initiative to enact legislation in 2007 appears to have stalled before it was proclaimed in force.¹⁴⁰

Consumer protection provisions in both types of statutes involve many of the following features: requirements for the loan agreement; a provision that ambiguities in loan agreements are to be interpreted in favour of the borrower; increased disclosure when advertising interest rates or interest free periods; disclosure of changes to the loan agreement; restrictions on default charges; restrictions on brokerage fees; the ability of the consumer borrower to cancel loan within 48 hours and the ability to pay loan in full without penalty; eligibility for refund of fees paid in contravention of the statute; prohibition of rollovers, loans in excess of income, wage assignments, and requiring security for loans; and establishment of funds for consumer education.

i. Caps on Lending

The British Columbia *Business Practices and Consumer Protection Act* Part 6.1 sets interest limits between 23% and 30%, setting out other conditions.¹⁴¹ Alberta and Saskatchewan

¹³⁹ S. 347.1 (3), *Criminal Code*. The Governor in Council shall, by order and at the request of the lieutenant governor in council of a province, designate the province for the purposes of this section if the province has legislative measures that protect recipients of payday loans and that provide for limits on the total cost of borrowing under the agreements. (4) The Governor in Council shall, by order, revoke the designation made under subsection (3) if requested to do so by the lieutenant governor in council of the province or if the legislative measures described in that subsection are no longer in force in that province.

¹⁴⁰ In 2007, New Brunswick introduced Bill 4, *An Act Respecting Payday Loans*, which would have amended the *Cost of Credit Disclosure Act*, SNB 2002, c C-28.3. However, the Bill does not seem to have passed, since the amendments are not included in the current consolidation of the Act.

¹⁴¹ *Business Practices and Consumer Protection Act*, SBC 2004, c 2. Limits on total cost of borrowing — payday loans 112.02 (1) The Lieutenant Governor in Council may, by regulation, set the maximum amount, or establish a rate, formula, tariff or method of determining the maximum amount, that may be charged, required or accepted by a payday lender in respect of (a) the total cost of credit for a payday loan, (b) any interest, and (c) any permissible charge. (2) A payday lender must not charge, require or accept from the borrower or consumer any amount that exceeds a maximum set or determined under subsection (1). Pursuant to the *Payday Loans Regulation*, BC Reg 57/2009, Permissible charges:

have set similar limits on interest and a cap on the amount of income on which the loan can be secured.¹⁴² Section 14(3) of the regulations accompanying the Ontario *Payday Loans Act* specifies that the maximum cost per \$100 borrowed is \$21.¹⁴³ Manitoba has set the lowest cap, at 17%.¹⁴⁴

In reality, payday lenders in regulated provinces can charge more than the criminal usury limit under Canada's *Criminal Code*. Payday lenders are exempted from that federal limit, while being subject to the provincial limit. The criminal interest rate of 60% is different than the provincial maximum costs of borrowing limit as the criminal interest rate as defined in the *Criminal Code* is an annualized rate. Some provincial payday lending laws, such as Ontario, set a flat percentage regardless of the term of the loan. The federal Office of Consumer Affairs explains the difference is as follows: the maximum charge for a \$100 loan, probably due within two weeks, will be \$17-25, depending on the regulating province, the provincial

17 (1) The maximum amount that may be charged, required or accepted by a payday lender for a loan is 23% of the principal. (2) In addition to subsection (1), if the repayment amount specified in the agreement is not paid, a payday lender may charge an amount up to the following maximum amounts as default fees: (a) interest at a rate of 30% per annum on the outstanding principal; (b) a one time fee of \$20 for a dishonoured cheque or a dishonoured pre-authorized debit. (3) The maximum charges under this section include all amounts collected directly or indirectly from the borrower....Prohibited practices — maximum repayment: 23 (1) In this section, pay period means (a) the period from the date on which the payday loan is entered into until the day on which the borrower next receives his or her pay or other income, or (b) a period during the term of a payday loan from the day on which a borrower receives his or her pay or other income until the day on which the borrower next receives his or her pay or other income. (2) A payday lender who enters into a third or subsequent payday loan agreement with a borrower in a 62-day period must, (a) if the borrower is paid or otherwise receives income on a bi-weekly, semi-monthly or more frequent basis, provide in the loan agreement that repayment is to be spread over at least 3 pay periods, or (b) if the borrower is paid or otherwise receives income on a less frequent basis than that referred to in paragraph (a), provide in the loan agreement that repayment is to be spread over at least 2 pay periods. (3) A payday lender must not require a repayment under a loan agreement referred to in subsection (2) that is more than, (a) for a borrower referred to in paragraph (a) of that subsection, 35% of the sum of the principal and the cost of borrowing in relation to the loan, or (b) for a borrower referred to in paragraph (b) of that subsection, 50% of the sum of the principal and the cost of borrowing in relation to the loan. (4) This section does not apply with respect to a payday loan that is made in anticipation of income that is to be received by the borrower as a lump sum on a one-time basis during the term of the payday loan.

¹⁴² Alberta *Fair Trading Act*, RSA 2000, c F-2. *Payday Loans Regulation*, Alta Reg 157/200. Section 17(1) The maximum total cost of borrowing that may be charged, required or accepted by a payday lender is 23% of the principal amount of the loan. (2) In addition to subsection (1), if a borrower fails to repay the amount specified in the agreement, the payday lender may charge the following: (a) interest at a rate of 2.5% per month, not to be compounded; (b) a one-time fee in an amount determined by the Director for each dishonoured cheque or dishonoured pre-authorized debit. (3) The maximum charges under this section include all amounts that can be collected directly or indirectly from a borrower. Saskatchewan *Cost of Credit Disclosure Act*, 2002, SS 2002, c C-41.01; Saskatchewan *The Payday Loans Regulations* establishes the rate of 23% of the principal amount as the maximum total cost of borrowing; allows payday lenders to charge a maximum of 30% per annum on defaulted loans; allows payday lenders to charge a maximum fee of \$50 for a dishonoured cheque or pre-authorized debit that can be charged only once per payday loan agreement; restricts the size of the payday loan to 50% of borrowers' net pay or income during the term of the loan; Government of Saskatchewan, News Release "Saskatchewan Moves Toward Full Regulation of Payday Loan Industry" (8 June 2010) online: Government of Saskatchewan <<http://www.gov.sk.ca/>>. This news release indicates that the regulations have been approved, but that the province is waiting for approval from the Federal Government for an exception under the *Criminal Code*.

¹⁴³ Ontario Reg 98/09, s. 14.

¹⁴⁴ *Consumer Protection Act*, CCSM, c C200; *Payday Loans Regulations*, Man Reg 99/2007.

limit. If one were to calculate an annualized percentage for that loan, the percentage rate would exceed 60% because the term of the payday loan is so short, far shorter than a year.¹⁴⁵ Thus while the provincial caps are a first step, they do little to temper the high amounts of interest that continue to be charged to individuals using payday loans.

Interestingly, in the Newfoundland and Labrador government's decision not to enact a provincial payday lending statute, the government observed as follows:

"After significant research and careful consideration, the Provincial Government has decided not to regulate payday loan companies operating in Newfoundland and Labrador. Rather, it will uphold the maximum interest rate set out in section 347 of the *Criminal Code of Canada*, which is 60 per cent per annum, as the maximum rate to be charged by payday loan companies. "As a government, we could not in good conscience implement regulations that potentially could result in annual interest rates equating to nearly 550 per cent being charged to consumers in our province," said the Honourable Kevin O'Brien, Minister of Government Services. "By putting in place provincial regulations for payday loan companies that permit annual interest charges above 60 per cent, we would not be protecting consumers' best interests. We do not want individuals being gouged or putting themselves more in debt and having a hard time catching up because of high interest rates for these types of short-term loans. We have reviewed the terms and conditions relating to maximum interest rates outlined in the *Criminal Code of Canada*, as well as regulations of other provinces and territories for payday lenders, and have decided that payday loan companies in this province will continue to be subject to section 347 of the *Criminal Code of Canada*."¹⁴⁶

Hence the Newfoundland and Labrador government, by not adopting provincial payday provisions, has in fact taken a tougher line on payday loan interest caps than the provincial governments that have enacted legislation.

However, in addition to the important issue of caps on interest, the provincial statutes have enacted a number of important consumer protection provisions that will address a number of identified problems associated with payday loans.

ii. Cost of Credit Statutes

The Alberta *Fair Trading Act* does not require licensing of lenders.¹⁴⁷ Section 62 requires the credit grantor to disclose the information required by the statute and regulations to the borrower. Borrowers are entitled to cancel any optional continuing service with 30 days written notice.¹⁴⁸ Borrowers can pay the full balance on any non-mortgage loan without incurring any penalties.¹⁴⁹ In addition, s. 72 specifies that any duties that apply to lenders also apply to loan brokers and requires disclosure of brokerage fees. If the borrower defaults, the statute limits the charges to reasonable costs incurred by the lender for things such as legal fees.¹⁵⁰ For fixed credit, if an advertisement states the interest rate or claims

¹⁴⁵ My thanks to David Clarke, Senior Policy Advisor, Office of Consumer Affairs, for explaining how such rates work. See also, the Hansard discussion on amending criminal interest rates, Standing Committee on Industry, Science and Technology, 39th PARLIAMENT, 1st SESSION, Tuesday, December 12, 2006, <http://www.parl.gc.ca/HousePublications/Publication.aspx?DocId=2592240&Language=E&Mode=2&Parl=39&Ses=1>.

¹⁴⁶ Press Release, Newfoundland and Labrador Government, "Provincial Government Will Not Regulate Payday Loan Companies", June 16, 2010, <http://www.releases.gov.nl.ca/releases/2010/gs/0616n11.htm>.

¹⁴⁷ Alberta *Fair Trading Act*, RSA 2000, c F-2 at Part 9.

¹⁴⁸ *Ibid.* s. 67.

¹⁴⁹ *Ibid.* s. 68.

¹⁵⁰ *Ibid.* s. 72.

that there is an interest free period, they must disclose information required by the regulations. If not done, the interest-free period is deemed unconditionally interest free.¹⁵¹ There are also requirements to disclose any changes to the interest rate or credit agreement.¹⁵² Section 96 requires the refund of any amount paid in non-compliance with the Act.

The Saskatchewan *Cost of Credit Disclosure Act* specifies that any duties that apply to a lender also apply to the loan broker, and any brokerage fees must be included in the APR calculation for fixed credit.¹⁵³ A borrower can cancel any optional continuing services, and repay any outstanding balance without penalty.¹⁵⁴ The amount a lender can charge for a loan in default is restricted to the reasonable amount incurred to collect payment or for related legal costs.¹⁵⁵ Part III applies specifically to fixed credit. It places disclosure requirements on advertising that states the interest rate, payment amount, or that there is an interest-free period.¹⁵⁶ Criteria for the written agreement include the term of the agreement, the interest rate, and nature of other charges among other criteria.¹⁵⁷ The borrower can also recover payments made contrary to the statute.¹⁵⁸

iii. Payday Loan Statutes

Pursuant to the British Columbia *Business Practices and Consumer Protection Act*, the consumer debtor has until the end of the next business day after receiving the loan to cancel.¹⁵⁹ Section 112.06 specifies detail provisions that should be included in the written agreement, such as the principal, term, and APR of the loan. Specific to the British Columbia statute is the requirement that payments must be first put towards interest, then to other permissible charges, and finally to the principal itself.¹⁶⁰ The borrower is not liable to pay fees to a lender that contravenes the statute, and borrowers are entitled to a refund if they pay such fees in excess of what they truly owe.¹⁶¹ The statute also contains a relatively long list of prohibited activities for payday lenders, such as rollovers, loans in excess of income, accepting assignment of wages, or requiring real or personal property as security for the loan. There is no licensing requirement, and no mention of brokers and fees they can charge; nor are there any specific sections relating to fees that can be charged on default of the loan.

Part 18 of the Manitoba *Consumer Protection Act* is specific to payday loans.¹⁶² Lenders need a license to provide loans,¹⁶³ and the documents provided at the initial advance must fulfill certain criteria, including the statement that the loan is a high cost loan.¹⁶⁴ Any ambiguous terms are to be interpreted against the lender.¹⁶⁵ The borrower may cancel the loan with 24 hours with no fees.¹⁶⁶ In addition, wage assignments and loans in excess of net pay are forbidden.¹⁶⁷ No charges are payable on default unless allowed by the regulations,¹⁶⁸

¹⁵¹ *Ibid.* s. 76.

¹⁵² *Ibid.* s. 78, 79.

¹⁵³ Saskatchewan *Cost of Credit Disclosure Act*, 2002, SS 2002, c C-41.01, s. 13.

¹⁵⁴ *Ibid.*, ss. 16, 17.

¹⁵⁵ *Ibid.*, s. 18.

¹⁵⁶ *Ibid.*, ss. 23, 24.

¹⁵⁷ *Ibid.*, s. 25.

¹⁵⁸ *Ibid.*, s. 46.

¹⁵⁹ British Columbia *Business Practices and Consumer Protection Act*, SBC 2004, c 2 at Part 6, s. 112.05.

¹⁶⁰ *Ibid.*, s. 112.07.

¹⁶¹ *Ibid.*, s. 112.10.

¹⁶² Manitoba *Consumer Protection Act*, CCSM, c C200, Part 18.

¹⁶³ *Ibid.*, s. 139.

¹⁶⁴ *Ibid.*, s. 148.

¹⁶⁵ *Ibid.*, s. 148.

¹⁶⁶ *Ibid.*, s. 149.

¹⁶⁷ *Ibid.*, ss. 151, 151.1.

and brokerage fees must be disclosed and included in the calculation of the APR.¹⁶⁹ There is no liability for the borrower if he or she does not make payments that contravene the *Act*.¹⁷⁰ The *Act* also establishes the Manitoba Payday Borrowers' Financial Literacy Fund, funded by levies in the *Act* and funds the Legislature decides to assign.¹⁷¹

The Ontario *Payday Loans Act* is the lengthiest of the payday loans statutes, enacted in 2008.¹⁷² The licensing requirements and conditions are extensive.¹⁷³ The statute contains numerous provisions aimed at the protection of borrowers.¹⁷⁴ Loan brokers cannot charge for assisting a borrower to obtain a payday loan, the loan agreement must meet any prescribed requirements, and the borrower can cancel an agreement until the second day after the requirements of the agreement are met.¹⁷⁵ The *Act* restricts the charges that can be levied on borrowers who default on their loans to reasonable charges related to legal costs and those that the lender incurs related to the default.¹⁷⁶ Any ambiguities in the interpretation of the loan agreement will benefit the borrower,¹⁷⁷ and the statute sets out how the registrar is to deal with complaints about a licensee.¹⁷⁸ Lastly, section 66 establishes the Ontario Payday Lending Education Fund, which is contributed to by fees from the licensees and money received from "any other source".

Finally, the Nova Scotia *Consumer Protection Act* is relatively short, but a number of sections apply specifically to payday loans, including requiring a permit to lend.¹⁷⁹ Lenders must give a written statement meeting specified requirements to the borrower, including the date on which repayment is due and an itemization of all fees.¹⁸⁰ There are a number of specified prohibitions in respect of payday loans, such as requiring security, providing a loan in excess of the borrower's income, granting rollovers, and penalizing a borrower who pays the loan in full.¹⁸¹ The borrower is not liable for fees required by the lender in contravention of the *Act*,¹⁸² and the borrower can cancel the loan until the end of the next business day after it is borrowed.¹⁸³

Hence, the standards and practices are highly uneven across Canada, both in terms of interest rate caps for payday loans and the breadth of consumer protection provisions offered. Arguably, this unevenness creates unfairness to consumer debtors, based on the region in which they live. The unevenness is partially due to the ability of payday loan industry advocates to influence legislative change and to the fact that organizations representing consumer debtors have limited resources and face information asymmetries in their efforts to try to protect consumer debtors.

Buckland observes that the growth in numbers of payday loan outlets in Canada is the only most prominent example of the growth of "fringe bank" lenders, and that other forms of credit, such as rent-to-own, auto and regular pawn shops, income tax refund advancers, and

¹⁶⁸ *Ibid.*, s. 153.

¹⁶⁹ *Ibid.*, s. 20.2.

¹⁷⁰ *Ibid.*, s. 147.

¹⁷¹ *Ibid.*, section 161.6.

¹⁷² Ontario *Payday Loans Act*, SO 2008, c. 9.

¹⁷³ *Ibid.*, s. 6.

¹⁷⁴ *Ibid.*, ss. 24 -36.

¹⁷⁵ *Ibid.*, ss. 28, 29 and 30 respectively.

¹⁷⁶ *Ibid.*, s. 33.

¹⁷⁷ *Ibid.*, s. 41.

¹⁷⁸ *Ibid.*, s. 46.

¹⁷⁹ Nova Scotia *Consumer Protection Act*, RSNS 1989, c 92, ss. 11, 18D.

¹⁸⁰ *Ibid.*, s. 9.

¹⁸¹ *Ibid.*, s. 18N.

¹⁸² *Ibid.*, s. 18P.

¹⁸³ *Ibid.*, s. 18Q.

second-hand 'buy-back' schemes are growing in number in Canadian inner-cities, offering a form of credit when consumer debtors cannot access affordable credit from banks, affordable meaning credit that more closely resembles interest rates and fees charged to middle-income debtors.¹⁸⁴ He suggests that such lenders are convenient and accessible, but their fees are high in comparison with more traditional credit. Buckland found that payday loans, rent-to-own arrangements, and pawn loans often involve fees that amount to 250% to 750% APR.¹⁸⁵

7. Financial Literacy

In this study, as in a number of others, financial literacy was indentified as a significant concern. Financial literacy is defined as "having the knowledge, skills and confidence to make responsible financial decisions."¹⁸⁶

The large data set of 4,000 insolvent consumer debtors revealed considerable issues in financial literacy, with many references in the declared causes to not understanding the debt load, inability to manage finances, failure to have any kind of budget, and multiple and unsustainable monthly payments. Many credit professionals interviewed observed that there is far too little consumer financial literacy training to counterbalance cultural pressures to spend now on credit. Almost universally, bank managers, credit union managers and credit counsellors discussed the need for more consumer education regarding interest and repayment terms and real costs of payday loans, credit card debt, home equity finance loans and personal loans, so that consumers are informed when comparing rates and overall costs. One manager observed that while clients compare interest rates, they generally only take into account interest rates and not whether they can pay the debt off or how they will be treated at both the loan granting stage and later in the lending relationship.

Consumers should be given a better appreciation of both hard and soft costs associated with borrowing. Financial literacy should be acquired at school age, but also as part of life-long learning, to understand budgeting and in order not to be unnecessarily charged for financing fees and high interest rates. One repeated observation was that there are uneven rules for payday lending, which is not prudentially regulated, and thus issues of transparency of loan costs, etc. are different.

A recent Canadian Financial Capability Survey (Statistics Canada 2009) reports that one third of participants did not know what happens to their buying power when the inflation rate is higher than the interest they earn on an investment.¹⁸⁷ Nearly one quarter did not track their finances or plan ahead for retirement; and more than one third admitted they are struggling

¹⁸⁴ Jerry Buckland, *supra*, note 12.

¹⁸⁵ *Ibid.* at 5, where Bukcland observes: "Payday lending involves a 2-week unsecured loan, for perhaps \$350, with fees ranging from \$20 to \$30 per \$100 loaned, amounting to APRs from 300 to 750%. An exemption from section 347 of the *Criminal Code* (Criminal Rate of Interest) allows payday lenders to operate in jurisdictions that regulate such lenders. A typical pawn loan is for a 15- or 30-day term, the loan might amount to \$50-\$200, and it is secured by a consumer item ranging from a CD to a car." He also found that an innovation in pawn brokering is the growth in the number of second-hand stores and franchises with a 'buy-back' option at considerable fees, high than regular pawn fees.

¹⁸⁶ Task Force on Financial Literacy, *Canadians and Their Money Building a brighter financial future*, (Ottawa, Federal Government, December 2010), www.financialliteracyincanada.com See also the Task Force Consultation Documents, *Leveraging Excellence* (February 2010) and *What We Heard* (September 2010), www.financialliteracyincanada.com at 4. Knowledge refers to an understanding of personal and broader financial matters; skills refer to the ability to apply that financial knowledge in everyday life; confidence means having the self-assurance to make important decisions; and responsible financial decisions refers to the ability of individuals to use the knowledge, skills and confidence they have gained to make choices appropriate to their own circumstances, *ibid.* at 10.

¹⁸⁷ Soman, *supra*, note 13 at 8.

with keeping up with their budgeting decisions.¹⁸⁸ US studies have shown that debt literacy is low, particularly among the elderly, women, minorities and consumers with low income and wealth; and that consumers with lower levels of debt literacy tend to transact in a high cost way, incurring high interest rate borrowing and user fees.¹⁸⁹ Debt literacy is defined as the ability to make simple decisions regarding debt contracts, applying basic knowledge about interest compounding, measured in the context of daily financial choices.¹⁹⁰ Lusardi and Tufano have estimated that less knowledgeable consumers in the US pay 46% more fees than do the financially literate.¹⁹¹ Moreover, their studies have documented that consumers tend to self-report higher debt literacy than they actually possess.¹⁹²

The Canadian Government commissioned the Task Force on Financial Literacy (TFFL), with a mandate to find strategies to strengthen the financial literacy of various segments of the population.¹⁹³ It found that individuals that are at particular risk of becoming victims of financial fraud include the elderly, the immigrant community, and consumers living on low income and with high levels of debt.¹⁹⁴ In February 2011, the Task Force proposed a national strategy with five priorities: shared responsibility for financial literacy; coordination of initiatives with multi-stakeholder participation; lifelong financial learning, commencing at school and through key life events; resources and innovative approaches to raise the awareness of good financial behaviour; accountability, with progress and impact of interventions measured by solid indicators.¹⁹⁵

TFFL observed that "teachable moments" in life regarding credit include decision points such as joining a pension plan or workplace retirement savings scheme, seeking financial advice or considering the purchase of a financial product, or determining one's eligibility for benefits from a government program.¹⁹⁶ It found that even for those consumer debtors' with the information and education they need to make sound financial decisions, a wide range of psychological, social and institutional influences can impede rational decision making.¹⁹⁷ TFFL focused on how individuals can navigate the ever-changing financial marketplace and buy the products and services that make the most sense for their own needs; the report making the assumption that individuals have the resources to do so.

TFFL reported that 49.8% of adult Canadians struggle with simple tasks involving math and numbers; and 42% of adult Canadians struggle with reading.¹⁹⁸ Although informational

¹⁸⁸ *Ibid.* at 8.

¹⁸⁹ Annamaria Lusardi and Peter Tufano, "Debt Literacy, Financial Experience, and Over-indebtedness", World Bank, (2008),

<http://siteresources.worldbank.org/INTFR/Resources/LusardiandTufano122208.pdf>.

¹⁹⁰ *Ibid.* at 1.

¹⁹¹ *Ibid.*

¹⁹² *Ibid.* at 22.

¹⁹³ *Ibid.*

¹⁹⁴ *Ibid.* at 65.

¹⁹⁵ *Ibid.* at 3.

¹⁹⁶ *Ibid.* at 7.

¹⁹⁷ *Ibid.* at 7 See also J. Yoong, (2010). "Retirement Preparedness and Individual Decision Making: Implications for Canada." Research paper prepared for the Task Force on Financial Literacy, www.financialliteracyincanada.com; J Turner, (2006) "Designing 401(K) Plans that Encourage Retirement Savings: Lessons from Behavioral Finance." (2006), AARP Public Policy Institute, assets.aarp.org/rgcenter/econ/ib80_pension.pdf; Thaler, R. H., & Sunstein, C. R. (2009). *Nudge: Improving Decisions about Health, Wealth, and Happiness*, (2009, New York: Penguin Books Ltd.).

¹⁹⁸ *Ibid.* at 17, citing Statistics Canada. (2010). ABC Life Literacy Canada. "Submission to the Task Force on Financial Literacy". Types of financial services providers: Banks, credit unions and caisses populaires; Trust companies; Securities dealers, mutual fund companies and distributors; Insurance companies (life and health, and property and casualty); finance and leasing companies; Independent

materials regarding credit are readily available to consumers, much of this material is complex and is not presented in simple, accessible language. TFFL found that financial services providers have a responsibility to ensure that their informational materials are developed, written and designed to be readily understood; and institutions should have well-trained front-line and advisory staff that can provide accurate information and helpful guidance to customers.¹⁹⁹

Among the 55 credit professionals interviewed, a number reported some linguistic issues regarding banking practices for consumer debtors and bankrupts whose first language is not English or French. They observed that immigrants do not necessarily have experience with debt and credit as they frequently come from countries that do not have consumer credit systems. They can get into a lot of trouble relatively quickly without consumer debt training.

TFFL recommended that provincial and territorial governments integrate financial literacy in the formal education system.²⁰⁰ For employees experiencing financial strain, employee assistance programs should offer access to personalized financial crisis counselling.²⁰¹ It has recommended making loans, mortgages and credit, including alternatives such as payday loans and "buy now, pay later" schemes, eligible for approval only after the consumer has had a face-to-face meeting with the creditor in which the borrowing details and the cost of credit are carefully explained.²⁰²

There are a number of international models for life-learning of financial literacy. For example, Austria issues a "financial driver's license" called Fit for Money, a program that mainly covers debt prevention.²⁰³ Australia's financial literacy curriculum covers the nature and forms of money, how to apply financial knowledge in a range of contexts, the ability to manage risk-taking, and the importance of making responsible financial decisions.²⁰⁴ Japan has one of the most comprehensive financial literacy curricula, integrating financial education with core subjects such as mathematics from grade 1 through high school.²⁰⁵

Many bank and credit union managers observed that people are becoming much more aware of how long it will take to get everything paid off; and that the new rules that the government passed requiring the banks to tell consumers how long, in years and months, it will take to pay off their debts, have really helped consumers become more aware of their financial situation. Consumers are starting to appreciate how long it will take to pay things off, such as paying the interest on their line of credit but not taking out any more money.

As financial products become more complex and people assume greater responsibility for their retirement savings with the diminution in access to registered pension plans, reliance on investment advisors has been more prevalent. More than half of respondents to a 2009 Canadian Securities Administrators (CSA) Investor Index Survey indicated that they relied on

advisors, financial planners, insurance brokers and accountants; and alternative banking facilities (e.g., payday loan providers, cheque-cashing outlets), at 21.

¹⁹⁹ *Ibid.* at 22.

²⁰⁰ *Ibid.* at 35, citing Rabbior, G. (2010). "Case Studies of International Financial Education Initiatives." Canadian Foundation for Economic Education. Research paper prepared for the Task Force on Financial Literacy, www.financialliteracyincanada.com.

²⁰¹ *Ibid.* at 41.

²⁰² *Ibid.* at 42, including a consumer test or questionnaire as part of this process as a means of evaluating consumers' understanding and raising their level of awareness.

²⁰³ Charles Fadel, "Financial Literacy and 21st Century Skills", 2011, Research paper prepared for the Task Force on Financial Literacy, <http://www.financialliteracyincanada.com/documents/research-reports.html> at 11.

²⁰⁴ Australian Government, "Understanding Money", www.understandingmoney.gov.au and www.mceecdya.edu.au/mceecdya/national_financial_literacy_framework_homepage.14429.html

²⁰⁵ Fadel, *supra*, note 25 at 12.

a financial advisor for investment information.²⁰⁶ TFFL recommended that individuals need to know more about the role and obligations of financial practitioners, including assessing clients' needs, identifying their objectives, preparing retirement plans, and allocating savings to various investment vehicles suitable for their risk-tolerance profile.²⁰⁷ TFFL encourages, as a supplementary tool, the adoption of mechanisms prompting employees to maximize their retirement savings through "auto-enrolment" and "auto-escalation" programs.²⁰⁸ However, the Task Force made no mention of advisors' obligations, fiduciary or otherwise, an area in need of considerably more research and policy discussion.

Yet the TFFL report was not comprehensive in its recommendations. In a background research report for the TFFL, Buckland identified four principal ways in which financial literacy needs vary.²⁰⁹ He observed that greater financial literacy is needed to deal with the growing complexity of our economy, often related to the increasing role of financial markets in everything from pension savings to self-directed investments.²¹⁰ Buckland's survey of the literature found that financial literacy needs vary over the course of one's life, the very young and very old have modest financial literacy needs, when they are borrowing from others or from their own savings, and young and middle-aged adults have relatively greater financial literacy needs because of the need to make strategic investment decisions about retirement savings. However, Buckland argues that financial position and financial goals vary among people at any point in time, and thus affect financial literacy needs as well.²¹¹

Buckland made a series of comprehensive recommendations that were not endorsed by the TFFL. While space here does not permit an analysis, they warrant brief mention as they make the linkage between financial literacy and access to affordable credit. Buckland suggests that for indicators of financial literacy to be meaningful, they must measure something that is important to people, linking their financing, credit and other needs with literacy education. Basic financial literacy education should combine the knowledge, skills, and attitude needed by low- and modest middle-income groups, and advanced literacy training might include what is needed by wealthier segments of the population.²¹² Second, he suggests that financial services need to be more accessible for low-income people as there is an important cause-and-effect issue in the relationship between financial literacy, access to financial services, and well-being; and the design of literacy policy needs to take account of these linkages.²¹³ Buckland recommends that the government should promote financial literacy programs for low-income people that to a significant extent meet their felt needs in a convenient way, either as a component of other programs or as stand-alone programs.²¹⁴

Significant for this paper, Buckland recommends that the federal government require mainstream banks to demonstrate a contribution to financial inclusion, by requiring the banks to contribute to a financial inclusion fund funded by the banking industry, which would be used to support financial inclusion such as access to credit and savings accounts; and he

²⁰⁶ Ipsos Reid. (2009). *CSA Investor Index 2009: Final Report*. Canadian Securities Administrators (CSA); www.securities-administrators.ca/uploadedFiles/General/pdfs/CSA%20Investor%20Index%202009%20Final_EN.pdf?n=6519.

²⁰⁷ *Ibid.* at 43.

²⁰⁸ *Ibid.* at 58.

²⁰⁹ Jerry Buckland, "Money Management on a Shoestring A Critical Literature Review of Financial Literacy & Low-income People", Research Report Completed for the Canadian Task Force on Financial Literacy, February 2, 2011, <http://financial-exclusion.uwinnipeg.ca/>.

²¹⁰ *Ibid.* at 12.

²¹¹ *Ibid.* at 14.

²¹² *Ibid.* at 47.

²¹³ *Ibid.* at 48.

²¹⁴ *Ibid.* at 49. He also recommends that "cost evaluations be done of programs for low-income people which have a financial literacy component, e.g., Learn\$ave. The costs should be compared with the costs for other programs, such as other registered pension programs", *ibid.* at 50.

recommends that the federal government should regulate fringe banks as they do with mainstream banks, in order to protect low-income consumers. He recommends that point-of-sale financial literacy should be promoted through Canadian government programs and banks, as that is when consumer debtors are most likely to be engaged such that the information is retained. Buckland also recommends that the government require staff at relevant agencies and financial institutions be trained on the financial needs and barriers faced by low-income people.²¹⁵

8. *Financial Institutions Taking Responsibility for Credit Granted and for Creating More Accessible Affordable Credit*

The evidence shows that there is a problem with consumer debt being granted on terms such that little or no realistic possibility of repayment exists. In addition, credit is being granted in situations where the consumer, if there is any sudden shock, such as illness or economic downturn, will not be able to repay creditors and will likely end up in insolvency proceedings of some kind. Taken individually, credit granting institutions may say that they assessed the individual's ability to repay their loan at the interest and fees they offer, but no institution or agency is taking any responsibility for the collective debt burdens assumed by consumer debtors, which are growing beyond their ability to repay. It is beyond the scope of this report to offer detailed policy recommendations as to how these problems may be addressed; however, it seems clear that these trends will impact the degree and number of insolvencies by consumer debtors under the *BIA*. Consideration should be given to policy instruments that may address these issues.

Buckland *et al* report that income-levels affect consumer debtors' experience with banks and what they refer to as "fringe banks".²¹⁶ Fringe banks such as payday lenders, rent-to-own businesses and sub-prime credit card issuers, scored poorly on information accessibility and understandability, particularly payday lenders.²¹⁷ The low-income shoppers received little written material, did not feel that the teller was eager for their business, and were often not encouraged to arrange a follow-up meeting.²¹⁸ In contrast, community banking projects offered a more positive experience of banking services for low-income people, providing a set of simplified services appropriate for the needs of low-income people.²¹⁹ Their empirical study found that there were a couple of mainstream banks that all shoppers consistently had positive experiences with, demonstrating that it is possible for mainstream banks to provide a supportive atmosphere for clients from low-income backgrounds.²²⁰ Buckland *et al* recommend development of a more holistic notion of basic banking that services the needs of low-income people, including access to the type of services other people access, such as savings and access to credit.²²¹

In another study, Buckland examined the availability of affordable credit in seven countries, offering an excellent analysis of the range of types of more affordable and accessible credit

²¹⁵ *Ibid.* at 52; also recommending that the government ensure that evaluations with a process component are integrated into financial literacy programs intended for low-income people.

²¹⁶ Jerry Buckland, Marilyn Brennan and Antonia Fikkert, "How Well Are Poor People Served by Canadian Banks? Testing Consumer Treatment Using Mystery Shopping", Research Paper, Institute for Urban Studies, University of Winnipeg, December 1, 2010, http://financial-exclusion.uwinnipeg.ca/sites/financial-exclusion.uwinnipeg.ca/files/mys_shop_report_final.pdf

²¹⁷ *Ibid.* at 39.

²¹⁸ *Ibid.* at 38.

²¹⁹ *Ibid.* at 39, 40.

²²⁰ *Ibid.* at 41.

²²¹ *Ibid.* at 42.

that could be developed by banks and credit unions in Canada.²²² Examples include the no interest loans scheme and step-up programs in Australia; the goal of these projects is to demonstrate that small loans can be delivered at a fraction of the fees charged by fringe banks.²²³ In Belgium, banks and credit unions have offered small consumer loans packaged with financial advice and support designed to allow low income individuals who are unable to obtain bank loans because of low income, welfare receipt, to improve their daily wellbeing and overcome social exclusion.²²⁴ Buckland notes that a European Commission country study concluded that "this pilot project has been a clear success: good repayment rates, satisfying legitimate financing needs, a strong social impact through the financing provided (a better quality of life, enhanced self confidence and the enhanced employability of a substantial number of customers) and in terms of preventing over-indebtedness."²²⁵ France has banks offering consumer micro-loans and has a government program of loan guarantees of half the value of loans, in order to encourage banks to provide credit to people who otherwise lack access to mainstream bank credit.²²⁶ In the UK, HM Treasury has a strategy to get banks to create more accessible services, including a Growth Fund to assist credit unions and community development financial institutions to provide affordable loans to vulnerable consumers.²²⁷ Buckland's cataloguing of these programs offers a wealth of ideas that would enhance credit availability and decision making in Canada.

Buckland suggests that there are generally two types of consumer loans that offer affordable credit for vulnerable consumers. First, are social consumer micro-loan programs that have economic and social objectives, with little or low interest rates and longer (1 to 3 year) repayment periods. He observes that these services do not cover their costs and so require additional resources from elsewhere, often from the state and non-profit organizations.²²⁸ The second type of loan, a consumer micro-loan, is closer in character to a payday loan, but is generally offered by a financial institution, with terms that are close to those found with other mainstream bank credit products (e.g., credit cards and lines of credit), including interest rates between 11% and 36% APR, sizes ranging from \$50 to over \$5,000, but most

²²² Jerry Buckland, "Affordable Credit Options for Vulnerable Consumers: Identifying Alternatives to High-cost Credit in Australia, Belgium, Canada, France, Germany, the UK, & the US", Research Report for the Canadian Consumer Measures Committee, November 2, 2010 at 8.

²²³ *Ibid.* at 14; observing that the Good Shepherd Youth and Family Services developed the No Interest Loans Scheme (NILS) in 1981 for low-income people, and it is now delivered through 280 community organizations, with National Australia Bank providing loan capital and pledging a further Aus \$130 million, State governments providing support for operating costs, and the loan agreement is between the community organization and the client. The loan size ranges from \$800 to \$1,200. The step-up program offers loans of Aus \$2700 to provide short-term assistance to low-income people and to bring people into mainstream banking.

²²⁴ Buckland reports that *Crédal L'Argent Solidaire*, along Dexia Bank Foundation, 18 and regional governments offer *Crédit Social Accompagné* (Guided Social Loan). *Crédal Plus* began offering small loans for businesses in 2000, introduced small consumer loans in 2003, and expanded the small consumer loans program in 2005. The regional government provides loan guarantees and pays a portion of the staff costs. *Ibid.* at 20.

²²⁵ *Ibid.* at 20, citing O. Jerusalem, (2007). *Belgium country study report stage II*. Brussels: Directorate-General for Employment, Social Affairs and Equal Opportunities, European Commission, at 8.

²²⁶ *Ibid.* at 27, for example, The *Crédit Solidaire* is offered by the *Caisse Régionale de Crédit Agricole du Nord-est*, a consumer micro-loan that is available to vulnerable people in North-eastern France; and *Fonds de cohésion sociale/Social Cohesion Fund*, a government program of loan guarantees commenced in January 2005, citing G. Gloukoviezoff, (2007) *France country study stage II*. Brussels: Directorate-General for Employment, Social Affairs and Equal Opportunities, European Commission, at 5.

²²⁷ *Ibid.* at 26, reporting that from July 2006 to August 2009, there were more than 182,832 loans made, valuing almost £80 million; the average size of the loan was £435, and HM Treasury estimated that 85% of the loans were received by low-income people in areas of highest financial exclusion, citing HM Treasury, *Financial inclusion: An action plan for 2008-11*. London: HM Treasury at 19.

²²⁸ *Ibid.* at 45.

ranging from \$100 to \$1,000. Buckland observes that, in some cases, these loans mimic the payday loan two-week period and in other cases, they have longer repayment terms of three to twelve months, and they are offered in a manner that allows the lender to cover its costs in the short or longer term, yet offer credit on much less expensive terms than payday loans. Buckland's work offers a comprehensive set of strategies that have yet to be taken up in most parts of Canada, and which deserve immediate public policy attention if we are to create more affordable credit.

VI. Conclusion

The issues surrounding consumer access to credit and consumer indebtedness are complex and difficult. Access to consumer credit is influenced by many factors, such as amount and security of the consumer's income, and credit card company and financial institution practices. Access is also driven by numerous social, cultural and cognitive factors, including consumer understanding of the cost of credit; perceptions regarding ability to repay; cognitive influences regarding immediate consumption and delayed payment; understanding of the benefits and risks of debt to economic security; and the conflicts of interest inherent in the business of lending. Overall, bank and credit union credit has tightened since the global financial crisis. For many Canadians, there is access to credit, but not access at reasonable cost and on reasonable terms.

Much of the reported need for credit in the past two years has been the need to bridge income loss from job loss, reduced hours of employment and small business failures, which make access to credit integrally linked to employment policy. Many individuals that could not access personal loans from their bank or credit union turned to alternate, more expensive, forms of credit, such as merchandise finance company loans, increasing credit card debt, skipping monthly payments on loans, and payday loans. Consolidation loans have been increasingly viewed as a debt management strategy, yet there are problems associated with consolidation. The growth in home equity lines of credit, originally intended to bridge financing for emergencies or a significant purchase, are now being used more akin to account withdrawing, portending future issues in respect to debt load and longer term economic security.

Consumers face the direct costs of high interest rate charges and loan and broker fees. There is evidence to suggest that costs that increase when consumer borrowers do not understand how interest rates and terms work, and thus may be paying considerably more for their credit than they may need to. The lack of financial literacy is a major concern in that many consumer debtors do not fully appreciate the costs of carrying expensive credit. There are also significant indirect costs to the consumer, such as foregone basic necessities because of excessive debt load, health costs associated with the stress of over-indebtedness, and the costs to society, borne by creditors or the general tax base, when consumers default on loans or file for insolvency or bankruptcy.

There is also evidence that the consumer debtor does not understand that the lender's interest is in selling its own product and appropriately pricing its risk, and it is not in any kind of fiduciary relationship with the consumer borrower.

While this paper suggests some initial measures that would address the problem of expensive credit, considerably more research and policy development is required to make consumer access to credit more understandable, affordable and accessible on a fair and reasonable basis. While financial literacy is an important goal, there is also an urgent need for the federal government to complement its current work in financial literacy with a much more comprehensive program regarding consumer credit.

