

**Consultation Paper on Framework Options
For Addressing Concerns With
The Alternative Consumer Credit Market**

prepared by: ACCM Working Group
Consumer Measures Committee
Autumn, 2002

The Consumer Measures Committee (CMC), created under Chapter Eight of the Agreement on Internal Trade, is a forum for Federal-Provincial-Territorial (FPT) government officials to cooperate to improve the marketplace for consumers in Canada. With an emphasis on consumer protection, the CMC provides support to and develops policy proposals for FPT Ministers responsible for consumer affairs.

A working group of the CMC has been asked to develop a proposal for improvement of consumer protection in the alternative consumer credit market (ACCM) which is described below. This paper outlines concerns in applying existing law to the ACCM and options for addressing these concerns. The working group would like your input on these options and specific questions are posed within the “Proposals” section and repeated in questionnaire form in Appendix 1. This paper concludes with contact information for forwarding your comments.

This paper reflects a follow-up consultation in an ongoing process that has included an industry round-table in Vancouver in 2000 and previous consultations on the ACCM generally. This paper asks for input specifically on potential amendments to the *Criminal Code of Canada* that may form the basis for recommendation from the Ministers responsible for consumer affairs to the Justice counterparts.

This paper represents only one aspect of consultation currently ongoing in respect of section 347. Please refer to the Uniform Law Conference of Canada web-site <http://www.ulcc.ca/en/home/> for information on an ongoing review as part of their Commercial Law Strategy.

The proposals herein are not law and would only become law upon enactment by the Federal Government.

WHAT IS THE ACCM?

The ACCM is the market for small sum, short term loans from non-traditional lending sources. Consumers in the ACCM are those that do not qualify for, or do not use, the small sum, short term credit products offered by traditional lenders (such as banks and credit unions). Instead of credit cards, overdraft protection or lines of credit, consumers of the ACCM use such credit-like instruments as payroll loans, cheque cashing services, pawn transactions and chattel mortgages.

A distinction is made between “traditional” and “non-traditional” lenders, since the former are subject to thorough existing regulatory regimes while the latter are not. Members of the ACCM industry are not regulated by the Federal *Bank Act* or the equivalent legislation which governs other federally, provincially or territorially regulated financial institutions.

CONCERNS WITH THE ACCM

While the ACCM provides credit to consumers who otherwise might not be eligible for it, concerns have been raised about the price of that credit and about other undesirable practices related to the credit, such as “rollovers” or aggressive collections practices. This

paper and the proposals for amendment to law do not reflect any endorsement by government of the credit products offered within this industry.

The CMC is concerned that consumers are often not aware of the relatively high costs associated with the credit they are obtaining when accessing the ACCM and the potential for entering into a cycle of debt that may be difficult to reverse. The CMC is also concerned that consumers are often not aware that ACCM loans are not tracked by the regulated credit reporting system – that an individual’s good history or repaying such loans will not be reflected in their credit rating.

The high cost of ACCM loans are only one concern that governments have with this sector. Given the growth of this industry in Canada, consumers themselves would seem to indicate that the up-front costs are acceptable – even if these translate into very high, and possibly illegal, annual interest rates (see next section). Purchasing decisions seem based on the actual dollar cost of the loan, or on the nominal interest rate for the term, rather than on the academic concept of an annual interest rate. An annual interest rate is “academic” in the sense that neither party to the loan perceives an annual rate as relevant to, for example, a 14 day term.

Governments are also concerned with the existence of, and further potential for, undesirable (possibly even “predatory” or abusive) practices within the ACCM. Such practices include the use of “rollovers” (the practice of rolling one loan into another, complete with additional administrative and penalty charges), pre-signed asset transfer documentation, wage assignments, excessive late or NSF charges, and threats or other inappropriate collection practices. Representatives of consumer, poverty and public interest advocacy groups have voiced similar concerns to government.

Some consider that full enforcement of existing law could have the potential consequence of shutting down the ACCM, leading consumers to less desirable credit options associated with loan-sharking and organized crime. The consistent message from stakeholders has been to address the undesirable practices within this industry in a manner that allows its continued existence. Provincial / Territorial (P/T) governments agree with this approach.

CRIMINAL CODE OF CANADA, SECTION 347

The text of section 347 is included at the end of this paper as Appendix 2. Titled “Criminal Interest Rate”, section 347 does the following:

- o establishes an effective annual interest rate in excess of 60% as a “criminal rate”;
- o makes it a criminal offence to enter “into an agreement ... to receive interest at a criminal rate” or to receive “payment ... of interest at a criminal rate”;
- o defines “interest” widely to be inclusive of “the aggregate of all charges and expenses” associated with the credit;
- o requires a certificate of a Fellow of the Canadian Institute of Actuaries as evidence in any proceeding; and

- o requires the specific consent of the Attorney General of a province for an action in that province.

Section 347 is not well suited to enforcement within the ACCM, despite many ACCM credit products being sold at arguably criminal interest rates. Enforcement difficulties include a lack of victims willing to aid prosecutions, a low level of harm done in relation to each individual ACCM loan, costly evidentiary requirements, and the uncommon requirement for specific Attorney General consent for actions (taken by some prosecutors to mean that this section is to be applied only in special circumstances).

Despite this, enforcement of section 347 within the ACCM occurs. Some jurisdictions have taken an active approach to enforcement within specific ACCM sectors – though with a focus on organized crime. Other jurisdictions continue to monitor the ACCM in order to utilize section 347 in prosecution of the most egregious of violations.

Governments have expressed concerns that section 347 precludes the use of other regulatory means to address the undesirable practices outlined in the previous section. Enforcement agencies are in a difficult position. Enforcement of section 347 could shut down the ACCM industry – something no one is advocating – while targeting undesirable practices in provincial or territorial regulations could be seen as a tacit acceptance of a breach of section 347.

The proposals below attempt to address this quandary by outlining options for both an amendment to section 347 and a provincial or territorial regulatory approach to address ACCM concerns.

PROPOSALS

To apply P/T consumer protection regimes to the ACCM, amendments need be made to section 347 of the *Criminal Code of Canada*. P/T governments find it difficult to establish a regulatory regime that would license or otherwise condone a practice that potentially contravenes section 347.

Q1 Do you agree that amendment need be made to section 347 in order to effect consumer protection within the ACCM?

The following options present two approaches to the amendment of section 347. Both approaches reflect making amendment to treat the ACCM different from other loans – the first by allowing each jurisdiction in Canada to tailor the application of section 347 to a provincial or territorial regulatory regime; the second by applying creating a more workable national standard applicable to all ACCM loans in Canada.

The various questions or sub-options that follow these options are applicable to either of these option, as either individual P/T regimes or a single national regime will need to address each of these items. Neither of these two approaches reflect a removal of consumer protections currently applicable to consumers of the ACCM. Rather, each is targeted to enabling effective enforcement of those protections.

- Option 1 Add both a definition of and an exemption for “small sum, short term credit”, to subsections (2) and (8) of section 347, respectively. Limit the exemption to apply only where a P/T regulatory regime is in place to address ACCM loans. Outline a P/T regulatory regime that would address the necessary elements to invoke this exemption.*
- Option 2 Create a special provision within section 347 for loans of up to \$X for a term of fewer than Y days, with a distinct (higher) “criminal rate” and separate evidentiary requirements.*

Option 1 leaves section 347 intact in those P/T jurisdictions that do not wish to introduce a separate standard for ACCM loans while giving the flexibility needed to those that wish to address the undesirable practices occurring within the ACCM. Jurisdictions would be able to choose between enforcement of the law as it currently exists or enforcement of the regulatory scheme they enact to address the undesirable practices outlined above. Where a jurisdiction chose the latter, criminal sanction using section 347 would still be available for addressing those within the ACCM that fail to comply with the provincial or territorial regulatory framework.

Option 2 introduces a new standard applicable in every jurisdiction. This introduces some enforcement flexibility to P/T governments by widening section 347 enough to allow development of regulatory regimes (despite a regulatory regime not being a distinct element of this option) without fear of licensing an illegal act.

The main benefit of option 1 is flexibility for P/T governments to apply enforcement regimes applicable to the scope of their industry. The main benefit of option 2 is the retention of one standard across Canada. The main detraction to both options is shared with the status quo – whatever the regulatory regime, enforcement is costly and equal enforcement will simply not occur across jurisdictions.

- Q2 (a) Do you support: option 1; option 2; neither; combination?
(b) If “neither”, what approach would you recommend for addressing the concerns outlined?*
- Q3 In either option, a definition is required for “small sum, short term credit”.
(a) What should the threshold be for “small sum” (i.e., loans of up to \$X)?
(b) What should the threshold be for “short term” (i.e., term of fewer than Y days or Z months)?*
- Q4 How should P/T regulatory regimes address undesirable practices? Should they:
(a) License?
(b) Limit either the actual dollar or the nominal interest rate fees allowed for ACCM credit products?
(c) Restrict “rollovers”, default charges and wage assignments?*

(d) Restrict the security which a lender may accept and the ability of lenders to realize that security upon default?

(e) Emphasize cost of credit disclosure requirements and prohibited debt collection practices?

(f) Other?

YOUR TURN

The intent of this paper has been to provide a brief overview of a complex enforcement issue and to introduce general framework options for improving consumer protections within the ACCM. Your comments can be forwarded by e-mail, fax or regular mail.

To e-mail comments, click [here](#) and be led through the questionnaire in Appendix 1. To forward comments by fax or regular mail, please print and complete Appendix 1 – then forward to:

Consumer Measures Committee Secretariat
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Appendix 1, Questionnaire

Q1 Do you agree that amendment need be made to section 347 in order to effect consumer protection within the ACCM?

- Yes No

Why or why not?

Q2 (a) Do you support (check one):

- Option 1: Add both a definition of and an exemption for “small sum, short term credit”, to subsections (2) and (8) of section 347, respectively. Limit the exemption to apply only where a P/T regulatory regime is in place to address ACCM loans. Outline a P/T regulatory regime that would address the necessary elements to invoke this exemption.*
- Option 2: Create a special provision within section 347 for loans of up to \$X for a term of fewer than Y days, with a distinct (higher) “criminal rate” and separate evidentiary requirements.*
- Neither?* *Combination?*

Please explain.

(b) If “neither” or “combination”, what approach would you recommend for addressing the concerns outlined?

Q3 *In either option, a definition is required for “small sum, short term credit”.*

(a) *What should the threshold be for “small sum” (i.e., loans of up to \$X)? Why?*

(b) *What should the threshold be for “short term” (i.e., term of fewer than Y days or Z months)? Why?*

Q4 *How should P/T regulatory regimes address undesirable practices? Should they (list not meant as a ranking – each item should be addressed on its own merits):*

(a) *License... Yes No*

Please explain: _____

(b) *Limit either the actual dollar or the nominal interest rate fees allowed for ACCM credit products... Yes No*

Please explain: _____

(c) *Restrict “rollovers”, default charges and wage assignments... Yes No*

Please explain: _____

(d) *Restrict the security which a lender may accept and the ability of lenders to realize that security upon default... Yes No*

Please explain: _____

(e) *Emphasize cost of credit disclosure requirements and prohibited debt collection practices... Yes No*

Please explain: _____

(f) *Other... _____*

Please explain: _____

Appendix 2
Section 347 of the Criminal Code of Canada
Criminal Interest Rate

Criminal Interest Rate

347. (1) Notwithstanding any Act of Parliament, every one who

- (a) enters into an agreement or arrangement to receive interest at a criminal rate, or
- (b) receives a payment or partial payment of interest at a criminal rate,

is guilty of

- (c) an indictable offence and is liable to imprisonment for a term not exceeding five years, or
- (d) an offence punishable on summary conviction and is liable to a fine not exceeding twenty-five thousand dollars or to imprisonment for a term not exceeding six months or to both.

Definitions

(2) In this section,

"credit advanced" means the aggregate of the money and the monetary value of any goods, services or benefits actually advanced or to be advanced under an agreement or arrangement minus the aggregate of any required deposit balance and any fee, fine, penalty, commission and other similar charge or expense directly or indirectly incurred under the original or any collateral agreement or arrangement;

"criminal rate" means an effective annual rate of interest calculated in accordance with generally accepted actuarial practices and principles that exceeds sixty per cent on the credit advanced under an agreement or arrangement;

"insurance charge" means the cost of insuring the risk assumed by the person who advances or is to advance credit under an agreement or arrangement, where the face amount of the insurance does not exceed the credit advanced;

"interest" means the aggregate of all charges and expenses, whether in the form of a fee, fine, penalty, commission or other similar charge or expense or in any other form, paid or payable for the advancing of credit under an agreement or arrangement, by or on behalf of the person to whom the credit is or is to be advanced, irrespective of the person to whom any such charges and expenses are or are to be paid or payable, but does not include any repayment of credit advanced or any insurance charge, official fee, overdraft charge, required deposit balance or, in the case of a mortgage transaction, any amount required to be paid on account of property taxes;

"official fee" means a fee required by law to be paid to any governmental authority in connection with perfecting any security under an agreement or arrangement for the advancing of credit;

"overdraft charge" means a charge not exceeding five dollars for the creation of or increase in an overdraft, imposed by a credit union or caisse populaire the membership of which is wholly or substantially comprised of natural persons or a deposit taking institution the deposits in which are insured, in whole or in part, by the Canada Deposit Insurance Corporation or guaranteed, in whole or in part, by the Quebec Deposit Insurance Board;

"required deposit balance" means a fixed or an ascertainable amount of the money actually advanced or to be advanced under an agreement or arrangement that is required, as a condition of the agreement or arrangement, to be deposited or invested by or on behalf of the person to whom the advance is or is to be made and that may be available, in the event of his defaulting in any payment, to or for the benefit of the person who advances or is to advance the money.

Presumption

(3) Where a person receives a payment or partial payment of interest at a criminal rate, he shall, in the absence of evidence to the contrary, be deemed to have knowledge of the nature of the payment and that it was received at a criminal rate.

Proof of effective annual rate

(4) In any proceedings under this section, a certificate of a Fellow of the Canadian Institute of Actuaries stating that he has calculated the effective annual rate of interest on any credit advanced under an agreement or arrangement and setting out the calculations and the information on which they are based is, in the absence of evidence to the contrary, proof of the effective annual rate without proof of the signature or official character of the person appearing to have signed the certificate.

Notice

(5) A certificate referred to in subsection (4) shall not be received in evidence unless the party intending to produce it has given to the accused or defendant reasonable notice of that intention together with a copy of the certificate.

Cross-examination with leave

(6) An accused or a defendant against whom a certificate referred to in subsection (4) is produced may, with leave of the court, require the attendance of the actuary for the purposes of cross-examination.

Consent required for proceedings

(7) No proceedings shall be commenced under this section without the consent of the Attorney General.

Application

(8) This section does not apply to any transaction to which the Tax Rebate Discounting Act applies.