DEBT: CANADA'S BORROWING BINGE

Payday loans: Predatory loan sharks or crucial fix in a pinch?

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This is part of a Globe series that explores our growing dependence on credit – from the average household to massive institutions – and the looming risks for a nation addicted to cheap money. Join the conversation on Twitter with the hashtag #DebtBinge

It all began with a pair of jeans.

Robbie McCall wanted to give his daughter a new pair for Christmas. But he was short of cash. Mr. McCall, 47, lives on a fixed disability payment of $1,350 a month and he just didn't have the money to buy them.

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Video: Drawing Conclusions: A look at what payday loans really cost

So he went into a nearby cash store in Ottawa to get a quick loan. This is how his debt trap began: When he returned in January to pay back the first $200 loan, plus $20 in fees (a promotional rate as a first-time borrower), he was encouraged to take out another, bigger loan – $300. But the second time, his bill, which included other fees, came to $86.

He couldn't pay, so he took out another loan. By the next loan, at $400, the fees had grown to more than $100.

"I just about had an aneurysm," he says. "I was beside myself. Now I couldn't afford to pay my rent, or I'd have to forgo my hydro. I'm on a fixed income, so every penny counts."

He dug himself out of his first payday-debt hole, only to fall down another the following year.

Like many in his situation, he borrowed from one payday lender to pay off another. He says his credit rating is shot. He figures he spent thousands on fees in recent years. Lack of cash meant having to go to food banks. "I was in a terrible loop I didn't know how to get out of."

Payday lenders, such as National Money Mart Co., Cash Money and Cash 4 You Corp., have proliferated in Canada since the industry – which offers short-term, small-sum loans – began in the mid-1990s.

Today, the sector has more storefronts and online lenders in the country than Royal Bank of Canada or McDonald's locations. Nearly two million Canadians a year use payday-lending services, the industry association says.

Canadian law prohibits lenders from charging more than 60-per-cent annual interest on loans. But the federal government introduced legislation in 2006 allowing provinces to exempt payday lenders from that limit if they created a regulatory system to govern the industry.

Seven provinces have legislation, but the approaches differ. Manitoba has the most stringent rules, capping payday loan fees at $17 per $100 borrowed, while Prince Edward Island allows lenders to charge up to $25 per $100.

The knock on the industry is the fees, which often end up hitting those who can least afford them. For example, a $300 two-week payday loan can carry a fee of $63, compared with just $5.81 for borrowing from a line of credit or $7.42 for a cash advance on a credit card, both of which include a $5 administration fee, according to the Financial Consumer Agency of Canada (FCAC).

In Ontario, a two-week payday loan costs up to $21 per $100 borrowed. That translates into an annual rate of 546 per cent. In Alberta, B.C. and Saskatchewan, the annual rate is 600 per cent.

Despite the high costs, the share of Canadians using payday loans has grown rapidly. The portion of people who say they or a family member have used payday loan services in the past year has more than doubled, to 4.3 per cent last year from 1.9 per cent in 2009, an FCAC survey shows.

The two-decade rise of the payday lending business has coincided with a record run-up in borrowing. Canadians have never been more indebted – total household credit topped $1.8-trillion as of March and the debt-to-disposable income ratio is at an all-time high of 163.3 per cent. A growing number of people are living paycheque to paycheque.

Most payday borrowers tend to have low to moderate incomes. Some – those without a credit history or low credit scores – don't have access to other, more affordable types of credit. They may not feel comfortable using a bank or have a branch in their neighbourhood.

For those in urgent need of cash – for a car repair, to pay a phone bill or to make ends meet until the next paycheque arrives – payday lenders offer extended hours and quick, friendly service.

The prevalence of the sector has deepened a rift between consumer advocates and the industry, which says there is clear demand for credit and that high fees reflect a higher cost of doing business. Community groups and some municipalities argue that the loans are predatory, and lead some – particularly those with low incomes – into a debt spiral.

Credit crackdown

Rising tensions over the sector can be seen in other countries. The U.S. is exploring tighter federal rules for payday lenders. And the U.K. capped fees this year, while what was once its biggest payday lenders, Wonga, has scaled back lending after a regulatory crackdown.

In Canada, some communities are clamping down – hard.

Last month, Maple Ridge, B.C., banned all new payday lenders from setting up shop. Surrey, B.C., amended its bylaw to require at least 400 metres separation between payday storefronts, while Burnaby, B.C., is considering limitations on locations and new outlets. “They’re legalized loan sharks,” says Burnaby city Councillor Nick Volkow.

Meanwhile, Nova Scotia tightened fees last month, to $22 per $100 loan from $25, as a study showed that more than half – and growing – of such loans issued were repeat loans. New Brunswick and Ontario are reviewing regulations for the sector. And now Calgary is weighing new rules.

Calgary’s tussle with the issue comes as the city is planning to implement a poverty-reduction initiative, which has identified a payday lending bylaw as one possible solution.

“They do target low-income people in low-income neighbourhoods. … They know who their target market is – people who can’t afford to pay the high fees and interest that payday lenders charge,” says Mike Brown, who works on public policy at Momentum, which runs community economic development programs in the city.

He says lower oil prices are adding urgency to the city’s efforts as “people get laid off – many Canadians don’t have an emergency fund, so they run into a problem of needing credit right away, and if they can’t get it from their banks, they’re more likely to go to a payday lender.”

Momentum has mapped 86 payday locations in Calgary and found 73 of them are located in areas with above-average incidences of poverty.

In Toronto, St. Michael’s Hospital this year released a study showing the density of cheque cashers and payday lenders is a proxy for poverty and self-harm, and says there is growing evidence that their presence has a negative impact on health and longevity.

In Winnipeg, Toronto and Saint John, research has found payday outlets are often located in lower-income neighbourhoods.

Calgary’s city council is looking to pass rules that will limit the distance between future locations so they’re not as clustered, which has given people the impression that this is the only opportunity for those in need. This has already been done in Winnipeg and 100 U.S. cities, Mr. Brown notes.

One province in Canada has effectively barred payday loans. Instead of exempting payday lenders from the 60-per-cent annual interest-rate limit, Quebec has instead lowered its interest-rate cap to 35 per cent a year, making it unprofitable for the payday loan industry to provide its conventional services in the province.

Newfoundland has no payday legislation, which means the federal loan rate of 60 per cent is in place, while New Brunswick has developed legislation that has not been enacted, so the federal loan rate continues.

Payday loans are becoming a growing issue for those with severe debt problems. They are the fastest-growing category of debt among clients of Credit Canada Debt Solutions, a not-for-profit agency that operates 17 centres in Ontario to provide free counselling for people with financial problems.

A third of new clients who came to Credit Canada last year had payday loans, an increase from 18 per cent just five years ago, says chief executive Laurie Campbell. For seniors, the growth is even more dramatic, with 45 per cent of Credit Canada's clients over age 60 holding payday loans in 2014 – a steep increase from 20 per cent in 2010.

In Vancouver, bankruptcy trustee Blair Mantin of Sands & Associates Inc. says he's seeing more people in the province in hot water with payday loans. He refers to them as the "crack cocaine" of the debt world because it's hard to stop with just one.

"I never see just a single payday loan on a list of debts," he says, adding that he has seen people with loans from as many as 10 different outlets.

In British Columbia, the number of payday borrowers climbed 35 per cent from a year earlier to nearly 200,000 last year, while the average loan amount grew to $449 from $441, according to Consumer Protection BC. A quarter of these loans initially defaulted.

Bankruptcy trustee Doug Hoyes, in Kitchener, Ont., is witnessing a similar shift. He has seen an increase in payday loan use by seniors, who often take out the loans to make payments on other debts such as credit cards.

His firm's recent review of 6,000 insolvency files of Ontario clients in 2013 and 2014 shows the highest-risk groups for insolvency are seniors, single parents and people with large student loans who do not qualify for traditional low-cost borrowing options such as lines of credit.

"If you've got a fantastic job and lots of equity in your house, the fact you can get a mortgage at 2 per cent is fantastic. But that's not everybody," says Mr. Hoyes, of Hoyes Michalos & Associates Inc.

"If I'm a senior on a fixed income or a low-income single parent, I don't have access to lines of credit and second mortgages and everything. I've got to resort to things like payday loans and fast-cash loans. Those are the people who are much more vulnerable."

He says 18 per cent of people filing for insolvency in 2013 and 2014 had payday loans, up from 12 per cent over the prior two-year period.

The average insolvent person with payday loans had 3.5 loans outstanding – but one client had 35 payday loans when he filed for insolvency.

"Once you're on the hamster wheel, you can't get off," Mr. Hoyes says. "We tend to get into habits, and payday loans are a habit. But you can't break out of it, that's the problem."

Ontario regulations do not allow payday lenders to provide a new loan until the first is paid off, so people should never have more than one loan at a time.

But Credit Canada says its clients with payday loans typically have three to five loans when they arrive for counselling, skirting the rules by going to rival lenders for new loans. It is often as simple as crossing the street.

Paying higher fees may seem irrational – but research has shown the impact that desperate financial straits has on decision-making.

"Things like a payday loan become attractive – because you just need the money right now. So you're willing to borrow to fix a problem right now," says Nicole Robitaille, assistant professor at the Queen's School of Business.

"I'm going to spend way more than I should to fix this urgent problem. You become so short-sighted that you lose any long-term thinking.

"The more you need the money, or the more you need your time, the more likely you are to use it poorly."

In Toronto, Shayan Khan says his payday loans became a trap, spiralling out of control in a matter of months.

The 40-year-old got his first $100 payday loan two years ago, and paid it back after two weeks. But he immediately borrowed more to cover living expenses.

Within a few months, he was borrowing $900 every two weeks, and paying another $189 in fees to cover the cost of the loans. The bi-weekly repayments were consuming his entire paycheque.

"They do make it pretty easy," he says. "They don't check any credit or anything. As long as you have a job, you get the loan. It's kind of too easy, compared to if you take any other credit. … It looks easy, but it's a trap, that's all I can say. For me, it was a trap."

The rise of an industry

For those in the business of payday loans, the situation isn't quite so simple. High fees, they say, reflect the higher costs of the service they offer – a service for which there is clear demand. New and proposed regulations, they say, go too far.

The danger, the industry argues, is that if regulations become too strict, companies will go out of business. Canada's largest player recently did – Edmonton-based Cash Store Financial Services Inc. ran out of cash, declaring bankruptcy last year, which it blamed in part on Ontario regulatory issues.

As a result, the industry can no longer be considered growing in Canada, notes Stan Keyes, spokesman for the Canadian Payday Loan Association, which represents most licensed payday lenders in the country.

He pegs the current total number of outlets at 1,459, which includes licensed storefronts and online lenders**.** He says the rapid growth occurred between 2000 and 2010. Since then, "growth in the industry has been flat or declined in provinces partly because of regulation."

Onerous regulations could hurt businesses and competition, which could result in far worse options for those in urgent need of a short-term loan, Mr. Keyes says.

Even if the industry is regulated to a point that it can no longer offer these services, demand for small-sum loans won't vanish, he says – and most banks and credit unions don't offer them. As a result, borrowers will be forced to "what, take their television off their wall and go to a pawnshop? What alternative does the borrower have if the industry is regulated to the point that they just throw up their arms?"

Increasingly, he says, people will turn to unlicensed, unregulated online lenders that charge even higher rates. And "where is this unlicensed lender operating from? Belize, or the Cayman Islands? Is there protection against the borrowers' bank again from being drained from an unscrupulous lender? What rate are they paying? Ninety-nine-per-cent chance that that rate is going to be far more than what the regulated licensed lender can offer. So be careful what you ask for."

It's difficult to pinpoint the size and growth of online lending, but dozens of firms such as My Canada Payday, 310-LOAN, Zippy Cash Inc. and CNU DollarsDirect Inc. are offering online loans. Some experts have suggested that online loans in Ontario account for 10 per cent of the market.

Mr. Keyes says the industry is not making exorbitant profits, noting that the cost of doing business is higher due to the cost of operations – wages, glass and security for each storefront, cost of credit and higher default rates from riskier loans.

The biggest player in the country is now Money Mart, which started in Edmonton in 1982 and was sold to U.S.-based Dollar Financial Group Inc. in 1996. Dollar Financial operates more than 1,500 locations in 10 countries including the U.S., Canada and the U.K., along with, more recently, Poland, Spain and Romania.

Canada appears to be a profitable market. Dollar Financial's operating margin in this country is 49 per cent, compared with 24 per cent in Europe and 25 per cent in the U.S., according to the company's financial statements.

Some say the rise of payday lending is at least partly the fault of the banks, arguing that traditional lenders have allowed the payday lending sector to flourish by not providing credit to low-income people. Terry Campbell, president of the Canadian Bankers Association (CBA), disputes such claims. He says banks offer small, short-term loan and credit options such as overdraft protection and credit-card advances, but some people don't know they exist or try to access them.

Many people, he says, turn to payday lenders when they are in financial distress without talking to their banks to see if there are better and cheaper alternatives. (The CBA's website says payday loans "aren't the answer" for small, short-term borrowing and "are extremely expensive.")

"We always encourage customers, if you are getting into difficulty, if you are getting into problems, don't suffer in silence. Come and talk with your bank," Mr. Campbell says.

His association's research shows people have many motivations for using payday lenders, and some simply prefer the relative anonymity because payday lenders do not require information about what the money will be used for, don't report loans to credit agencies and don't require notification of spouses or business partners. They also provide loans "late, late at night" for those who want spur-of-the-moment cash.

For those with more extreme debt problems, Mr. Campbell says banks feel it is "irresponsible" to keep lending to people who have no hope of repaying their loans, arguing they instead need debt-management advice.

What's next?

Regulating the industry is a complicated and delicate balancing act.

Jerry Buckland, dean of Menno Simons College at the University of Winnipeg, says regulators need more independent research to assess which regulations being adopted in various states and provinces are the most effective.

Mr. Buckland, who has extensively studied the sector, is convinced that one reform is critical – requiring payday lenders to publicly post their fees in the form of an annual interest rate. In some regions, lenders display their charges only in the form of a fee per $100 borrowed over a two-week period.

Payday lenders argue that their loans are only outstanding for two weeks and not for a full year, so annualized costs are misleading.

But Mr. Buckland says many other types of loans are not always outstanding for a full year – including credit-card payments, or in-store loans for new furniture. He says those costs are still displayed using an annualized interest rate, allowing borrowing options to be easily compared.

"That's the way we think about loans – we think of the price in the form of an interest rate," he says. "I think regardless of the product, if it's a loan, it should be in a standardized form."

Others agree that more data are needed. Payday loans can have "pernicious consequences" but it's difficult to know with certainty what proportion of people use the loans occasionally as a valuable service, and how many are caught in a borrowing spiral, says Ken Whitehurst, executive director of the Consumers Council of Canada.

Mr. Whitehurst, who was a member of the Ontario panel that reviewed the province's payday-loan legislation in 2014, says the payday industry lobbied for licensing on the basis that it was providing a convenience service for people with infrequent cash-flow problems. He says regulators need to know if many people are instead constantly taking out new loans as soon as they repay the old ones.

"Everyone would be concerned if renewal rates were commonplace, because that would be counter to one of the policy objectives in establishing these things," he says.

Credit Canada's Ms. Campbell believes the best solution is a centralized industry computer system to track who already has outstanding loans with any lender, preventing people from loading up on multiple loans at the same time.

"I'm convinced you've got to have a database that shows how many loans are outstanding," she says.

It's an idea that Mr. Keyes of the Canadian Payday Loan Association rejects over costs and privacy concerns. But 14 U.S. states now have centralized payday-loan tracking systems, which started with Florida in 2001, according to a report last year by an Ontario panel studying payday-lending regulations. The computer systems are funded by lenders based on a fee-per-transaction cost.

Centralized loan tracking opens other regulatory options. Many U.S. states also have limits on the number of times people can borrow from payday lenders in a year, or have introduced waiting periods between the time a borrower pays off a loan and can take out a new one. The hope is that people will change their borrowing habits or develop new financial plans if they cannot become reliant on payday loans to cover their living costs each month.

The Ontario panel studying regulatory reforms – which included representatives from both consumer groups and the payday loan industry – could not reach a consensus to make recommendations about centralized tracking or new loan restrictions. But it did call on the industry to provide more data to help understand the extent of risky borrowing habits, such as constant repeat borrowing.

Bankruptcy trustee Mr. Hoyes, however, is skeptical that more government regulation of the payday-loan sector will help, saying loan restrictions can be easily skirted, especially when many people get payday loans through Internet lenders. Rules that require waiting periods between loans, for example, could drive more people to borrow online from offshore lenders who are not bound by any Canadian regulations, he says.

Some think banks should step up. Until there is a real alternatives to payday loans, "these high-cost loans will continue to harm our communities, our families and, ultimately, the entire economy," says Marva Burnett, national president of Acorn Canada, which advocates for low-income families.

“Banks and credit unions need to step in and provide low-cost, short-term loans.”

Mr. McCall, in Ottawa, would like to see more regulations on the industry, including lower fees and restrictions on lending to people who are living on social assistance and disability payments.

He saw his fees spiral to a point where he simply couldn’t pay his payday loan costs on his disability income. Cheques were bouncing and NSF fees from bad cheques added more fees. Eventually, his bank stepped in and closed down his account, something he’s grateful for.

“These Cash Money stores are popping up and it seems to me like they’re only preying on welfare recipients, social-assistant recipients, [Ontario Disability Support Program recipients], people on pensions,” says Mr. McCall, who volunteers with Acorn.

He would also like to see clearer annualized rates posted on storefronts.

“I was paying $1,300-plus in interest over the course of a year. That’s insane. That equals one cheque for a whole month of what I have to live on.

“It’s stressful on every level.”

With files from reporter David Parkinson

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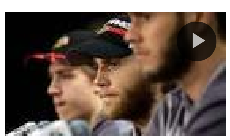

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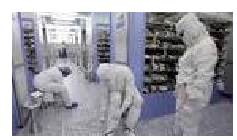

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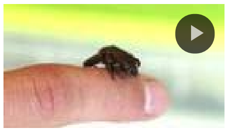

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