Money for Nothing, Debt for Free

Is the payday loan industry cashing in on Hamilton's rise in precarious employment?

This report surveys the landscape of payday lending in Hamilton, including the increase in payday loan outlets and the decrease in bank branches over the past 15 years. The report also examines trends in precarious employment, and what changes are needed so workers in these jobs, and other people living at or near the poverty line, can access more affordable financial services.

Why do people access payday loans instead of credit cards for small-dollar loans?

For many people, credit card advances is one of the main ways to access short-term money if they have a financial need that can't otherwise be met. But for about 4% of Ontarians[1], payday loans are a short-term source of "small-dollar" loans, often because they have been refused by the credit card industry due to lack of credit history, negative credit history or other reasons.[2]

In exchange for lending money to a higher risk group (approximately 5% of payday loans are never repaid[3]), the payday loan industry charges very high interest, fees and penalties, written in contracts only available once a loan is approved. The payday loan industry argues that the higher fees and interest are due to the higher costs they face compared to the credit card industry, including more processing of smaller loans, higher overhead costs, and higher rates of bad debt.[4]

One of the most common criticisms of the payday loan industry is deceptive advertising, which critics say hides the true cost of borrowing.[5] This argument is supported by a recent B.C. study by Vancity (a credit union offering competing products to payday loans) that found consumers believe a $23 dollar fee on a $100 loan for two weeks means a 23% interest rate (similar to a credit card), when in fact it is a 598% interest rate.[6]

Table 1. Terms and conditions for credit cards compared to payday loans in Ontario

	Credit card	Payday loan	Criminal interest rate
Annual interest rate including fees	Generally in the 20%-23% range	546%	Maximum 60% (including fees)
Applicable laws	Federal banking legislation	Ontario Payday Loans Act	Criminal Code of Canada
Amounts	Small and large loans	Only short-term loans under $1,500 to remain legal	The "criminal interest rate" is the maximum rate for all loans in Canada, except payday loans. Since changes to the Criminal Code in 2007, the criminal interest rate does not apply to payday loans in provinces that have opted to allow this type of lending. Newfoundland and Labrador and New Brunswick are the only remaining provinces without payday loan legislation.
Requirements for approval	Usually need positive credit history.	Poor credit history not a barrier. Need proof of "steady income", which can include social assistance, child benefits or employment.	
Time for approval	A few weeks for approval and delivery of card. Once card is delivered, cash advance is available immediately.	Immediate access to money when loan is approved in person or online.	
Contract conditions available on websites for comparison shopping	Credit card companies post cardholder agreements listing interest, fees and penalties on their website for anyone to view.	Most payday lenders do not post their contracts or full fee and penalty schedule on their website before approving a loan.[7]	

SPRC Social Planning & Research Council of Hamilton

This report is published by the Social Planning and Research Council of Hamilton (February 2016). Prepared by: Sara Mayo, Social Planner GIS, and Grace Kennedy, BSW placement student. We are grateful to the Hamilton Roundtable for Poverty Reduction, including Tom Cooper, Laura Cattari and Melissa Cameron, for support in preparing this report. Thank you to the United Way of Burlington and Greater Hamilton for the funding that made this report possible.
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United Way Burlington & Greater Hamilton

15 repeat borrowers for every new customer

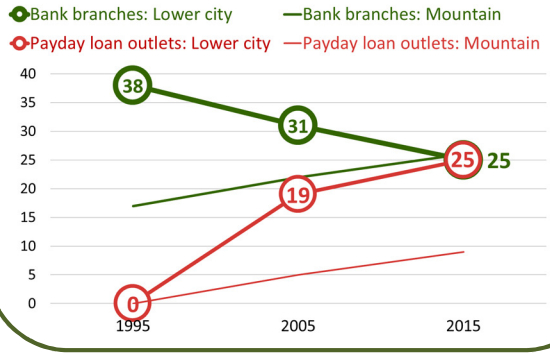
A study commissioned by the payday loan industry explained that their high operating costs mean they can only be profitable if they turn the vast majority of customers into repeat borrowers, "on average, payday lenders provide 15 repeat or rollover loans for each first-time loan they provide.[…] Until a steady customer base is developed, [new payday loan outlet] operators will be facing higher costs associated with signing up and processing first-time customers. Clearly, the long-run survival of a payday loan operator will depend on achieving a steady repeat customer business".[8] A former CEO of a payday lender said, "the theory in the business is you've got to get that customer in, work to turn him into a repetitive customer, long-term customer, because that's really where the profit is".[9] This may help to explain why a poll of payday loan users commissioned by the industry, found that payday loan companies had the highest negative ratings among a list of 5 types of financial institutions (26% not favourable).[10]

Hamilton's payday lending and banking landscape

Estimating from provincial figures, at least 16,000 Hamiltonians borrow about $50 million worth of payday loans annually[11], for an average of $3,125 in payday loan debt before fees and interest per borrower through approximately 7 loans per year.

Most payday loan outlets in Hamilton are in the lower city, which has the highest poverty rates within the city. In the last ten years alone there has been 19% drop in the number of bank branches in the lower city and a 32% increase in the number of payday loan outlets.[12] Looking back over 20 years (Chart 1), in 1995, there were no payday loan outlets in Hamilton, and 38 bank branches in the lower city. By 2015, the number of bank branches and payday loan outlets were equal at 25, a net loss of 13 bank branches across the five lower city wards.

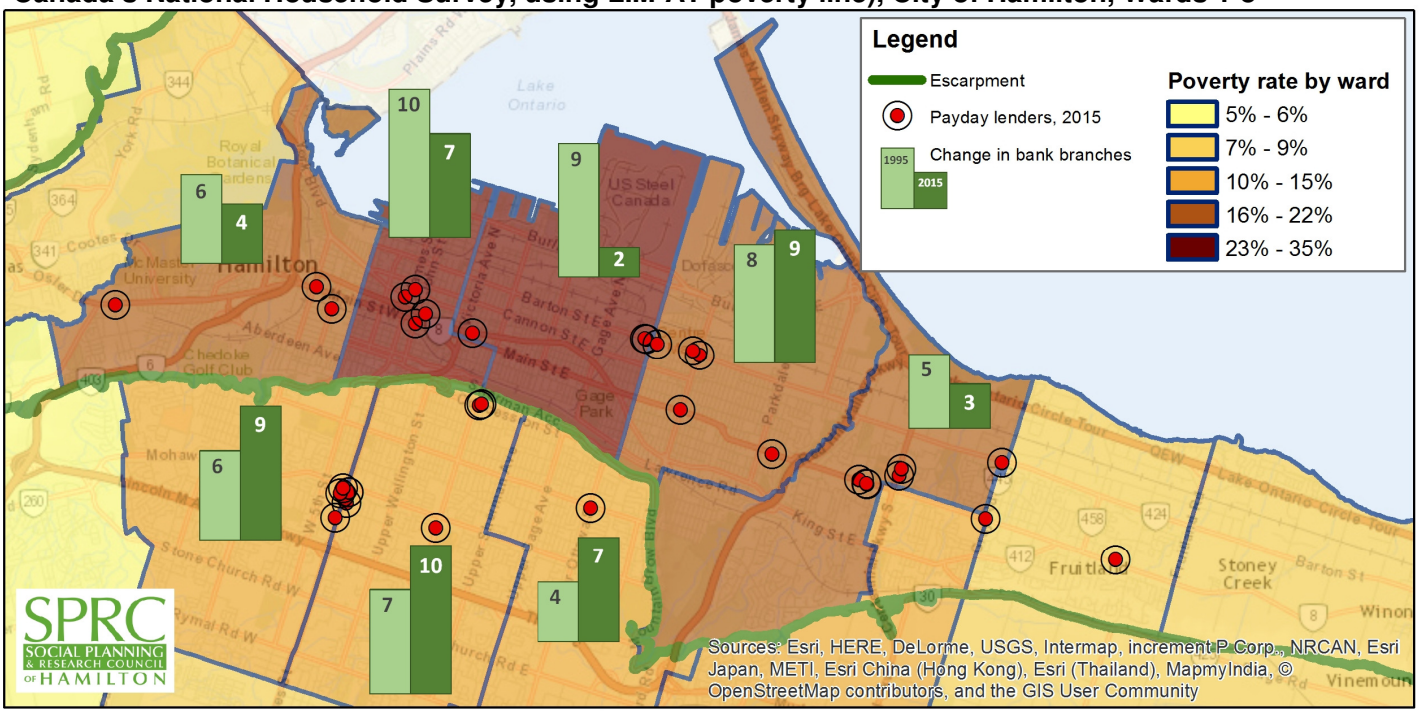
Chart 1. Change in bank branches and payday loan outlets, City of Hamilton (lower city and mountain), 1995-2015



On the mountain there has been a small rise in payday loan outlets, but due to population increase this part of the city has also seen a rise in bank branches, with a total now of 26. The lower city now has 1.4 bank branches per 10,000 residents, compared to 2.1 in 1995. On the mountain, there are 1.7 bank branches for every 10,000 residents.

The payday lender location and bank branches by ward map below shows that the steepest decline in bank branches has been in Ward 3 – Hamilton Centre, where only 2 bank branches remain as of February 2016, compared to 9 in 1995. The decline in banks in Ward 3 will continue in spring 2016, when the National Bank branch (in the No Frills plaza) will be moving to James North in Ward 2.

Map 1. Payday lender locations, change in bank branches (1995-2015), and poverty rates (Statistics Canada's National Household Survey, using LIM-AT poverty line), City of Hamilton, Wards 1-8



The growth of payday loan outlets and decline on banks is not random, rather it can be traced back to changes in government policies and legislation. Explaining the closure of banks in lower income areas, Dr. Olena Kobzar says, "quite simply, with mainstream banks increasingly pursuing those consumer credit markets with the highest potential return on investment (a competitive rush which was stirred by the initial financial services deregulation [in the 1980s]) poorer neighbourhoods by turn became for them a relatively less attractive market. And as banks increasingly made their profits from newer financial products, and from an ever–growing array of service fees, the monetary incentive for them to quit low- income markets, where individuals had marginal savings to begin with, was understandably powerful. [13]" On the payday loan side, their growth can be attributed in part to the lack of enforcement of the federal criminal interest rate before legalization of the industry, and the relatively weak consumer protections in Ontario's first Payday Loans Act enacted in 2009.

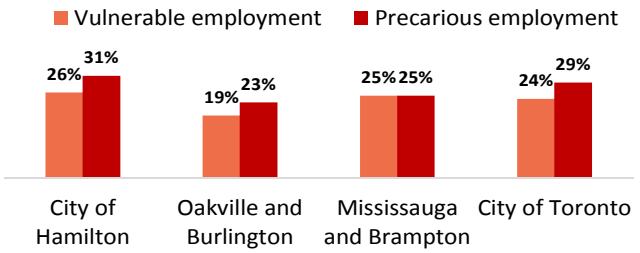
Precarious work increasing need for payday lending

The growth of payday loan outlets and decline of banks in lower income areas is also related to increasing concerns about the rise of precarious and insecure employment. A recent survey of over 8,000 workers found that Hamilton has the highest rate of insecure employment in the GTHA at 57% among workers aged 25-65. This includes 31% of Hamilton's workers who are precariously employed, who experience the most insecure working conditions, and 26% of workers in vulnerable employment situations.[14]

Table 2. Financial and family stress of payday loan users, workers aged 25-65 in the GHTA, 2014 (Precarious Employment in Southern Ontario survey)

	Payday loan user	Non payday loan user
No employer provided pension plan	67%	52%
No employment health benefits	69%	51%
Not paid if work is missed	71%	53%
Work more to manage bills	40%	22%
Use savings to manage bills	54%	35%
Use credit cards to manage bills	60%	38%
Rarely or never able to buy supplies and clothing for kids	22%	6%

Chart 2. Rates of vulnerable and precarious employment, workers aged 25-65, selected GTHA communities, 2011 and 2014 combined. (Precarious Employment in Southern Ontario survey)



This same survey of workers in the GTHA aged 25-65 showed that in 2014, 3% had used payday loans in the last year. Chart 2 shows that the payday loan users were much more likely to not receive benefits at work, including not being paid if they miss work for illness or other reasons, Payday loan users reported exhausting many other avenues for additional employment income, savings or other types of loans to make ends meet: 40% report working more to manage bills, and 60% use credit cards to pay bills. This indicates that payday loans may often be added to a person's other debts, making it even more difficult to pay the high interest rates.

The employment insecurity payday loan users experience also affects their children: 22% report rarely or never being able to pay for supplies and clothing for kids, compared to only 6% of non-payday loan users.

Notes and data sources

[1]VanCity. 2016. *Short-Term Gain, Long-Term Pain: Examining the Growing Payday Loan Industry in B.C.*

[2]Pyper, W. 2007. *Payday loans*. Statistics Canada: Perspectives. Catalogue no. 75-001-XIE

[3]VanCity. 2016. *Short-Term Gain, Long-Term Pain: Examining the Growing Payday Loan Industry in B.C.*

[4]Ernst and Young. 2004. *The Cost of Providing Payday Loans in Canada: A Report Prepared for the Canadian Association of Community Financial Service Providers.*

[5]Cooperative Baptist Fellowship. 2015. *Payday Lending: A Christian Response*

[6]VanCity. 2016. *Short-Term Gain, Long-Term Pain: Examining the Growing Payday Loan Industry in B.C.*

[7]Consumer Council of Canada. 2015. *Consumer Experiences in Online Payday Loans.*

[8]Ernst and Young. 2004. *The Cost of Providing Payday Loans in Canada.*

[9]Martin, N. 2010. *1,000% Interest, Good While Supplies Last: A Study of Payday Lending Practices and Solutions.* Arizona Law Review, 52:3, 563-621.

[10]Pollara. 2007. *Payday Loan Customer Survey - Ontario*. Commissioned by Canadian Payday Loan Association

[11]Deloitte on behalf of the Payday Lending Panel for the Ministry of Consumer Services, Ontario. 2014. *Strengthening Ontario's Payday Loans Act: Payday Lending Panel Findings and Recommendations Report.*

[12]Data about changes in payday loan outlets and bank branches compiled from listings in telephone directories from previous years and current online information. Thank you to assistance from staff at the Hamilton Public Library for access to archived directories. These figures only the 6 biggest banks in Canada and do not include credit unions, as numerous mergers in this financial sector made them more difficult to track over time.

[13]Kobzar, O. 2012. *Networking on the Margins: The Regulation of Payday Lending in Canada.* University of Toronto PhD thesis dissertation.

[14]Thank you to Dr. Wayne Lewchuk for providing access to data for this analysis of the Precarious Employment in Southern Ontario (PEPSO) survey.

[15]Ernst and Young. 2004. *The Cost of Providing Payday Loans in Canada.*

[16]Consumer Council of Canada. 2015. *Consumer Experiences in Online Payday Loans.*

[17]Pew Charitable Trusts. 2012. *Payday Lending in America: Who Borrows, Where They Borrow, and Why*

Recommendations to increase access to affordable financial services

Reduce the need for emergency debt by increasing access to opportunities for economic security.

"We cannot turn back the clock, but we can decide in what ways we can shape the labour market to better serve our economic and social goals. We have replaced one labour market system with another without recognizing the structural transformation that has taken place and how it informs so much of what is wrong with our present arrangement. As a consequence, we have muddled through with peripheral, incremental, and patchwork responses. But we have choices. And our first choice is to decide that we want to do something about it." – Tom Zizys in *Working Better: Creating a High-Performing Labour Market in Ontario*

As discussed in more detail in Hamilton's 2015 Vital Signs report *Hamilton's Economic Renaissance: A prosperity unevenly shared* published by the Hamilton Community Foundation and the SPRC, these directions have been recommended by a variety of experts to strengthen our economy for all:

1. Reform social assistance so that the income security system does not entrench deep poverty, making it harder to enter or re-enter the labour market.
2. Improvement in working conditions and increases to minimum wages to be closer to a living wage that allows workers to participate in community life.
3. Create more ladders into the middle class through improved access to education and employment support programs for youth and adults.
4. Modernize Canada's social safety net, including greater access to health benefits, affordable housing, and flexible, quality childcare.

Learn from jurisdictions with stricter regulations, and ensure better protection for consumers and a fairer marketplace for small-dollar loans.

Among the provinces that regulate payday lenders, Ontario has relatively mild laws currently in effect. Quebec, on the other hand, has the toughest regulations, as they limit the annual interest rate for all lenders to 35%, which has severely limited the growth of payday lending retail locations.[15] In provinces with weaker protections against payday lending, cities like Hamilton are moving to impose signage and other requirements on payday loan outlets.

"In states that enact strong legal protections, the result is a large net decrease in payday loan usage; borrowers are not driven to seek payday loans online or from other sources." – Pew Charitable Trusts in *Payday Lending in America*[16]

5. In addition to recently proposed amendments provincial financial services legislation, Ontario can harmonize legislation with other provinces by capping the post-default interest rate (about 30% in most provinces), limiting payday loans to 50% of a person's net pay, and requiring fees to be advertised in annual percentage terms.
6. Develop a "Payday Loan Consumer Bill of Rights" that is posted in all payday loan locations and websites. These rights should include information about cost of payment plans compared to paying in full and taking out a new loan, obliging clerks to take a partial payment if offered, returning pre-authorized debits and post-dated cheques to the client upon receipt of a partial payment, and the toll free number of the company's compliance department and how to make a complaint to Consumer Protection Ontario.

Support alternatives that provide more affordable and accessible services small-dollar loans than currently available.

A 2007 survey of Ontario payday loan users found that just over half (51%) reported that the quick and easy process was the top reason they chose payday loan over other sources of credit.[17] A further 18% chose payday loans because of their convenient locations and 15% had no alternative source for borrowing. Reducing barriers to increase access to alternative sources of credit other than payday loans would enable borrowers to meet their needs for credit in more affordable ways.

7. Banks and credit unions reduce barriers in their services and offer a greater variety of financial services to consumers who need short-term loans. For example:
   - Vancity credit union in B.C. offers a product called "Fair & Fast Loan" as a payday loan alternative. Customers can borrow $100-$2500 with 19% annual percentage rate, over a maximum two-year term. The approval process is somewhat longer than the typical payday lender, however the cost and borrower risk is exponentially less that the typical 500% interest rate on two-week payday loans.
   - Some U.S. banks offer deposit advances - similar to a small line of credit, but a financial instrument that is an extension of pre-existing banking service.
8. Postal banking: Allow Canada's extensive network of post offices and postal outlets to offer basic financial services and small loans. Postal banking existed in Canada until the 1960s, and currently exists in most developed countries.