

Before the Manitoba Public Utilities Board

**ADDRESSING PAYDAY LENDING QUESTIONS FROM A
BUSINESS ETHICS PERSPECTIVE**

PRESENTATION AND RECOMMENDATIONS

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1. PRESENTATION

Good morning. Mr. Chairman, members of the Board, thank you for this opportunity to present. My presentation should take 20 minutes.

My name is Bruce Duggan. I teach in the Business Administration program at Providence College and Seminary in Otterburne. One of the areas we focus on is business ethics.

You have heard an economics perspective, a financial theory perspective, and cost analyses. A business-ethics perspective is equally important.

Because I teach in a Christian college, it will come as no surprise that my presentation approaches the question of business ethics from a Christian perspective.

Questions of debt and fair interest rates have received considerable attention from Christian thinkers.¹

1. The canon adopted at the Second Lateran Council (1139 CE) gives a flavour of the condemnation at its height: “Furthermore, we condemn that practice accounted despicable and blameworthy by divine and human laws, denounced by Scripture in the old and new Testaments, namely, the ferocious greed of usurers; and we sever them from every comfort of the church, ...let them be held infamous throughout their whole lives and, unless they repent, be deprived of a Christian burial.”

- *Decrees*, canon 13, cited by Fr. Gary Coulter, *The Church and Usury: Error, Change or Development?*, ch. 1, <http://frcoulter.com/presentations/usury/chapter1.html>; Internet; accessed 3 December 2007.

See also Jerome (400 CE), the Fifth Lateran Council (1515 CE), and the Jubilee debt-forgiveness initiative leading up to 2000, cited in:

- J. P. Migne, ed. *Patrologiae Cursus Completus*, (Paris, 1845), Vols. XXV, p. 177, CLXXXVII, p. 959, reprinted in Roy C. Cave & Herbert H. Coulson, *A Source Book for Medieval Economic History*, (Milwaukee: The Bruce Publishing Co., 1936; reprint ed., New York: Biblio & Tannen, 1965), pp. 170-171.
- John Salza, “Usury”, *Scripture Catholic*, <http://www.scripturecatholic.com/usury.html>; Internet; accessed 1 December 2007.
- Pope John Paul II, *Incarnationis Mysterium* (the Jubilee Bull), 29 November 1998.

The religious discussion of debt has not been confined to Christianity. The ethics of charging of interest—and the shared social responsibility for those in debt—is a prominent theme in the Jewish Bible² and in Muslim finance.^{3,4}

More recent church discussions, addressed directly to the question of payday loans, include:

- Ed Langlois, “Catholic leaders call payday loan outfits ‘predatory’, ask for interest rate caps.” *Catholic Sentinel*, 1 January 2006, http://www.catholicmediareport.org/story.php?story_id=211; Internet; accessed 1 December 2007.
- Steve Neill, “Catholic Advocacy Day has record turnout,” *The Catholic Virginian* vol. 82 no. 8, 12 February 2007, <http://www.catholicvirginian.org/archive/2007/2007vol82iss8/pages/2007vol82iss8.html>; Internet; accessed 1 December 2007.
- Ohio Bishops, “Background on payday lending,” *Catholic Conference of Ohio*, 27 June 2007, <http://www.ohiocathconf.org/I/EJ/paydaybishop627.pdf>; Internet; accessed 3 December 2007.

2. Numerous examples could be given. Highlighting only two:

- "If you lend money to one of my people among you who is needy, do not be like a moneylender; charge him no interest. If you take your neighbor's cloak as a pledge, return it to him by sunset, because his cloak is the only covering he has for his body. What else will he sleep in? When he cries out to me, I will hear, for I am compassionate. (Exodus 22:25-27, New International Version)
- “Suppose there is a truly good man who always does what is fair and right....He never cheats or robs anyone and always returns anything taken as security for a loan; he gives food and clothes to the poor and doesn't charge interest when lending money. He refuses to do anything evil; he is fair to everyone and faithfully obeys my laws and teachings. This man is good, and I promise he will live.” (Ezekiel 18:5-9, Contemporary English Version)

3. “And whatever you lay out as usury, so that it may increase in the property of men, it shall not increase with Allah; and whatever you give in charity, desiring Allah's pleasure-- it is these (persons) that shall get manifold.” (*The Holy Qur'an* 30:39, translated by M. H. Shakir)

4. See:

- Andreas A. Jobst “The Economics of Islamic Finance and Securitization,” *The Journal Of Structured Finance*, Spring 2007, <http://www.ijournals.com/JPF/DEFAULT.ASP?Page=2&ISS=23807&SID=684860>; Internet; accessed 1 December 2007.
- Abdulkader Thomas, Stella Cox, and Bryan Kraty, *Structuring Islamic Finance Transactions* (Euromoney Books, 2005).

These three religious traditions provide insights directly applicable to the situation you face with payday loans:

1. While Islam does not allow interest, it does allow transaction fees. However, those fees must be based on the time it takes to process the transaction. If they are on a sliding scale based on the amount of debt, they are not transaction fees, they are interest.⁵
2. Both Jewish and Christian traditions tell us we should be particularly concerned when the wages of working people become subject to debt.⁶
3. Jewish texts highlight the inequality of power that arises through debt.⁷ Even though the debtor and lender may have begun their relationship as equals,

• Angelo M. Venardos, *Islamic Banking And Finance In South-East Asia: Its Development and Future*, 2nd ed., (Asia-Pacific Business Series, vol. 3: 2006)
5. *Ibid.*

6. A Jewish text:

“Do not take a pair of millstones—not even the upper one—as security for a debt, because that would be taking a man's livelihood as security.” (Deuteronomy 24:6, New International Version)

A Christian text:

“You refused to pay the people who worked in your fields, and now their unpaid wages are shouting out against you. The Lord All-Powerful has surely heard the cries of the workers who harvested your crops.” (James 5:4, Contemporary English Version)

7. “The LORD will open the heavens, the storehouse of his bounty, to send rain on your land in season and to bless all the work of your hands. You will lend to many nations but will borrow from none. 13 The LORD will make you the head, not the tail. If you pay attention to the commands of the LORD your God that I give you this day and carefully follow them, you will always be at the top, never at the bottom.” (Deuteronomy 28:12, New International Version)

over time, power shifts from borrower to lender, and the borrower becomes increasingly vulnerable.⁸

4. Finally, all three traditions tell us the entire community must be concerned about that vulnerability, that debt is not simply a private matter between lender and borrower.⁹

Market Economy

How can we apply these insights to this place and time?

Adam Smith advocated for the market economy on ethical grounds. He claimed that each individual, pursuing their own interests, would provide the greatest possible material benefit to society.¹⁰ We have accepted that argument, and allowed the market to flourish...and it has provided exactly the benefits Smith predicted.

However, even the most ardent advocate of free markets—Milton Friedman—did not suggest markets should operate without constraint. He said they must operate “while

8. “The rich rule over the poor, and the borrower is servant to the lender.” (Proverbs 22:7, New International Version)

9. “If one of your countrymen becomes poor and is unable to support himself among you, help him as you would an alien or a temporary resident, so he can continue to live among you. Do not take interest of any kind from him, but fear your God, so that your countryman may continue to live among you. You must not lend him money at interest or sell him food at a profit. I am the LORD your God, who brought you out of Egypt to give you the land of Canaan and to be your God.” (Leviticus 25:35-38, New International Version)

10. “...he [every individual] intends only his own security; and by directing that industry in such a manner as its produce may be of the greatest value, he intends only his own gain, and he is in this, as in many other cases, led by an invisible hand to promote an end which was no part of his intention. Nor is it always the worse for the society that it was no part of it. By pursuing his own interest he frequently promotes that of the society more effectually than when he really intends to promote it.” Adam Smith, *An Inquiry into the Nature and Causes of the Wealth of Nations* (London: Methuen and Co., Ltd., ed. Edwin Cannan, 1904), bk. 4, ch. 2, para. 9, <http://www.econlib.org/library/Smith/smWN1.html>; Internet; accessed 2 December 2007.

conforming to the basic rules of the society, both those embodied in law and those embodied in ethical custom”.¹¹

And that is why we are here: to determine for this industry, what the basic rules of our society are—both from law and from ethical custom—to which they must conform.

Two Questions

I have read over a fair amount of material relating to these hearings. You have my sympathies. It seems to me that, clearing away the underbrush, you are faced with two simple questions:

1. What is the role of the Public Utilities Board in this matter?
2. What should the definition of interest in these regulations be?

I think I can show that answering these two questions will resolve almost all the issues you have been wrestling with.

I will try to give answers to both questions, and to convince you to adopt them.

11. “In a free-enterprise, private-property system, a corporate executive is an employee of the owners of the business. He has direct responsibility to his employers. That responsibility is to conduct the business in accordance with their desires, which generally will be to make as much money as possible while conforming to the basic rules of the society, both those embodied in law and those embodied in ethical custom.” Milton Friedman, “The Social Responsibility of Business Is to Increase Its Profits” *New York Times Magazine*, 13 September 1970.

Role of the PUB

What should the role of the Board be?

By setting payday loan rates, you will be giving those rates legitimacy. You will be saying, on our behalf, that our society sees them as fair and reasonable.¹²

Payday advocates have wanted you to concentrate on their financial viability. One of their expert presenters referred to these proceedings as a rate hearing.¹³ This would be true, if payday loan companies were a public utility.

They are, of course, not a public utility, and this is not a rate hearing.

Instead of focusing on the viability of the industry, I think there is convincing evidence that your mandate is to protect consumers:

1. The legislation does not instruct you to consider whether or not these businesses are able to earn a profit. You are free to consider that question, but are not required to do so.

12. “And if it gets to the CEO level, then you remind the CEO that as a member of a regulated industry his firm now has certain obligations that come with the privileges of being a regulated industry, because if you are a regulated industry -- whether you like it or not as a Board -- that is -- that is going to be presented by the firms as an official stamp of approval and in return for that respectability that the industry gets for being licensed and so on and so forth.

“And they'll probably put little stickers on -- on their windows saying, you know, We're licenced by Manitoba Public Utilities Board.

“In return for that privilege, they – they have certain obligations and it would be quite normal regulatory practice to tell the CEO, Look, this is not what we expected to happen. You as a regulated firm have these privileges, and you do have certain obligations to the public. And you can spell out in specific terms what you think those obligations are.” Kevin Clinton (Rentcash panel), Public Utilities Board hearing transcripts, 28 November 2007, p. 1564. All hearing transcripts: <http://www.pub.gov.mb.ca/miscrans.html>; Internet; accessed 27 November and 2 December 2007.

13. “As this is a rate Hearing and if you're looking at costs, if someone spends a dollar (\$1) on something, they have to get a dollar (\$1) back as a rate to cover that off.” Dean Schinkel (Deloitte & Touche), PUB hearing transcripts, 20 November 2007, p. 964.

2. In the Speech from the Throne, the bill was described solely as a means of consumer protection.¹⁴ In debating the bill in the legislature, and in his appearance before committee, Mr. Selinger, on behalf of the government, repeatedly referred to the bill's goal as consumer protection.¹⁵ In fact, Mr. Selinger said consumers were in need of protection from criminal activity:

14. "In the coming session, our government will continue to make improvements to consumer protection in Manitoba. The Payday Loans Act will be enacted, and we will introduce new legislation to prevent identity theft, regulate pawn shops and provide RRSP creditor protection. Our government will also work to ensure that consumers do not end up out of pocket due to misleading gift cards or certificates." Hon. John Harvard (Lieutenant-Governor of the Province of Manitoba), "Speech from the Throne," *Hansard*, 38th legislature, 5th session, vol. 1 (Winnipeg: The Legislative Assembly of Manitoba, 15 November 2006), http://www.gov.mb.ca/legislature/hansard/5th-38th/vol_01/h01.html#st; Internet; accessed November 29, 2007.

15. "But the Public Utilities Board also has the right to hear other concerns about the payday lending industry. If they believe there are other public policy recommendations that are required to be made to government, they have the authority, under this legislation, to recommend to us other measures that we could take to better protect consumers.

"...because of the members' foolishness with filibustering this spring and ringing the bells and then refusing to pass the bill, which they allegedly support, we have left Manitobans without any protection at all, any civil remedies at all. So, first of all, I hope that they will not delay the bill any further, because it's constituents all across Manitoba and citizens that are being affected by this unnecessary delay now

"...if they would pass this bill in a speedy fashion, it would allow the police departments to focus on the larger, more usurious loans and move in on those, while we protect consumers for the amounts that we have in this bill under the guidelines we have in this bill....

"But the Public Utilities Board also has the right to hear other concerns about the payday lending industry. If they believe there are other public policy recommendations that are required to be made to government, they have the authority, under this legislation, to recommend to us other measures that we could take to better protect consumers. All of these things are being stalled by the members opposite because they want to play games in this Legislature with this bill. They want to stall it instead of moving it forward. If we moved it forward, we could protect Manitobans as quickly as possible." Hon. Greg Selinger (Minister of Finance), "Report Stage Amendments", *Hansard*, 38th legislature, 5th session, vol. 9, 27 November 2006, http://www.gov.mb.ca/legislature/hansard/5th-38th/vol_09/h09.html#rsa; Internet. (All Legislative Assembly of Manitoba *Hansard* transcripts accessed via Internet 29 November 2007).

See also the second reading of the Amendment to the Act when it was presented by the government, 24 May 2006, http://www.gov.mb.ca/legislature/hansard/4th-38th/vol_75/h75.html#bill25.

It is our opinion that right now the industry...is actually operating outside of the Criminal Code and is, in fact, illegally charging interest rates which go beyond the 60 percent maximum prescribed...¹⁶

3. The CPLA tried to get business viability written into the Act, to have it equal with consumer protection. They presented an amendment and flagged it as their top priority.¹⁷ This attempt failed. No-one from any political party advocated for their amendment in committee. And, when the bill came back to the house, no-one advocated for it there either. They cannot secure here what they failed to achieve there.
4. Finally, we should consider the name of the act under which these hearings are operating—the Consumer Protection Act. Its name is its purpose.

Protection

Considerable time has been spent in these hearings attempting to demonstrate that profits in this sector are not excessive. From a consumer protection perspective, this question is irrelevant.

16. “I just want to get your views. It is our opinion that right now the industry under the Criminal Code, the current Criminal Code provisions, is actually operating outside of the Criminal Code and is, in fact, illegally charging interest rates which go beyond the 60 percent maximum prescribed by the Criminal Code. Would you care to make a comment on that? Is the industry, as presently operating, illegal under the Criminal Code?” Selinger, “The Standing Committee on Social and Economic Development,” *Hansard*, 38th legislature, 4th session, vol. 11, 8 June 2006, http://www.gov.mb.ca/legislature/hansard/4th-38th/sed_11/sed_11.html.

17. “We noted in our presentation on our hit list that a priority amendment for us would be in the direction that is given to the Public Utilities Board, that there is some type of preamble statement that says that the Public Utilities Board mandate in setting rates for the industry should be to ensure a viable and competitive industry.” Michael Thompson (President & CEO, Canadian Payday Loan Association), “The Standing Committee on Social and Economic Development,” *Hansard*, 38th legislature, 4th session, vol. 11, 8 June 2006, http://www.gov.mb.ca/legislature/hansard/4th-38th/sed_11/sed_11.html.

We prohibit the sale of cocaine, not because drug dealers make too much money, but because cocaine causes harm.

If a company is selling lead-contaminated toys, we do not ask if their profits are excessive, we ask only whether or not the toys cause harm.

This is the test in consumer protection—does the product cause harm? And, if so, is that harm significant?

Harm

So:

- Does the payday loan industry cause harm?

Here you have been presented with contradictory evidence.

Some witnesses insist that payday loan companies cause grave harm to vulnerable and desperate people.

On the other hand, payday advocates insist customers are rational decisionmakers,¹⁸ choosing their services because they are convenient.^{19, 20}

18. “I think this evidence shows to me that the consumer here in -- with -- with respect to this product, is making a rational decision based on a number of factors.” Steve Sardo (owner, Cash X), PUB hearing transcripts, 13 November 2007, p. 275.

19. “More than two-thirds (2/3s) of respondent payday loan customers in Manitoba think ‘easy to use, convenient, fast and long hours of operation’ best describe payday loan providers compared to other financial institutions.” Michael Marzolini (Chairman, Pollara Research), PUB hearing transcripts, 19 November 2007, p. 658.

20. A representative excerpt:

“Our evidence from Pollara clearly indicates that customers are educated, informed, and deliberate in choosing the payday loan product. They consciously choose a payday loan even where they have available credit options at banks and at credit unions. Customers want the convenience of borrowing small sums of money for short periods of time. And they pay their loans back on time. Customers in Winnipeg focus groups didn't appreciate the betrayal [portrayal]

The CPLA says their portrayal is backed by polling and focus group data. There are problems with this data. Because it was done by telephone, the poll did not capture a representative sample. It did not include:

1. People who would not answer their phones because they were being hounded by collection agencies.
2. Those who had lost their phone service because they could not pay their bills.
3. Those who had moved frequently, either by choice or by necessity.

I am not suggesting that the survey was deliberately skewed to omit these people,²¹ but the most transient and the most vulnerable were omitted nonetheless.

The second problem is the focus groups. The picture is not as positive as payday advocates would like. Four of the 16 participants expressed reservations, calling the fees “crazy”²² and “horrendous”,²³ and describing the cycle of debt payday loans can create.^{24,25}

of them as poor, uneducated, and not aware of what they were getting themselves in too [into].” Hon. Stan Keyes (President, Canadian Payday Loan Association), PUB hearing transcripts, 19 November 2007, p. 634-5.

21. “...Pollara is a gold seal member of the Market Research Industry Association, as such we are audited every year in terms of our methodology to ensure that our methodology is scientific, objective....Public opinion, the measurement of such, is a public trust. You know, public opinion should never be skewed in any way. It should never be twisted. It should never be misrepresented.

“It is sacred. You cannot tax it. You can't take it away from people. It is -- it is really the - as we call it, the most powerful currency in civilization.” Marzolini, PUB hearing transcripts, 19 November 2007, p. 644-5.

22. “...but the amount you borrow, the amount you have to pay back is -- is crazy. It is. It is high” Marzolini, quoting focus group participant “Bartoo”, PUB hearing transcripts, 19 November 2007, p. 782.

Witnesses who are not payday advocates describe payday users as poor,²⁶ burdened with multiple loans,²⁷ sometimes unable to meet basic needs because their bank accounts have been emptied out by lenders.²⁸ They report families whose entire social assistance or pay cheque is consumed in repaying debts.²⁹ These are not isolated

23. "I hate using it, but I'm glad it's there, because the charges are horrendous." Byron Williams, quoting focus group participant "Trevor", PUB hearing transcripts, 19 November 2007, p. 782.

24. "And -- and you know what? The clientele are probably f-u-c-k-e-d, because before like you...(pointing at John), you get into a rut. I've got into a rut before too." Williams, quoting focus group participant "Evan", PUB hearing transcripts, 19 November 2007, p. 773.

25. "We've got Justin saying: 'Yeah. But you know in the spring, because you know -- you get a payday loan right? Let's say for the maximum for which you're allowed, 40 percent or whatever, and then your next payday comes and you have to pay 40 percent plus their fees, right? So you're left with like half a pay cheque, right? And then you need to get another one to cover that other half.'

"Trevor says: 'So it gets very difficult.'

"Justin says, 'It goes on and on and on like that.'" Williams, quoting focus group participant "Evan", PUB hearing transcripts, 19 November 2007, p. 776

26. "...our records reflect that the average payday loan customer is not the average consumer on the -- on the marketplace. It -- our records reflect that the average consumer's income has an income of less than 20 percent of the provincial averages. So it -- it tells us that consumers with modest incomes are approaching us with difficulties as a result of financial difficulties with payday loans." Scott Hannah (President and CEO, Credit Counselling Society), PUB hearing transcripts, 13 November 2007, p. 124.

27. "...today it's not uncommon for us to see consumers with five (5) or more outstanding payday loans." Hannah, PUB hearing transcripts, 13 November 2007, p. 126.

28. "Clients will have their bank accounts emptied and left -- and be left unable to meet their basic needs and/or default on other payments they have because their -- their money's been gone to the payday loan company." John Silver (Executive Director, Community Financial Counselling Services Inc.), PUB hearing transcripts, 13 November 2007, p. 137.

29. "And they reduce the amount of food and clothing provided to the family. Often people will come We've had reported breakdown of family leading to divorce and separation. The families just can't deal with the debt load. They're fighting, they're arguing, even where the family is employed at times the whole paycheque is going to repay the debt and so they have no choice but to go back and reborrow the full amount if they're to make ends meet. So often what will happen is the mother and children will go onto welfare where they can at least afford to house and feed the children at some level, and the father will carry the loan or default on it, and the family is basically destroyed. We see an increase in alcohol and drug use just dealing with that issue.

instances. You have heard testimony that the majority of women in 10 shelters across Manitoba have had similar experiences.³⁰ That testimony has not been challenged by anyone.

You have heard witnesses report all these things, but there is one witness you may not have heard. David Love, a counsellor in East Kildonan, appeared before the legislative committee as a private citizen. He described three clients of his who use payday companies to feed gambling and alcohol addictions. He said:

...these people...have exhausted their friends and their families for money, and still they continue in their addictions...these institutions of finance, if we wish to call them that, help them to be in a position of continuing their addiction... Why

“There's a loss of self esteem, depression and anger and that can lead to family violence, it leads to an increase in abuse of children. As I said, there's an increase of alcohol and drug use. It's due to an easy access to the cash and also as a way of coping with the financial problems.” Dale Morrison (North End Women's Centre), PUB hearing transcripts, 13 November 2007, pp. 164-165.

30. “In my conversations with the ten (10) executive directors across the province, it is very apparent that the large majority of the twenty-seven hundred (2,700) plus women that we see a year also have little choice but use payday lending outlets or other businesses offering this same service....

“The majority of the clients are low- income families with a history of social assistance and are either still on assistance or working for minimum wage -- or close to it -- with a poor credit history or no credit history. Many have never had a bank account and neither -- and now either don't have access to a banking facility or feel they aren't welcome at regular banking facilities. With banking facilities' policies on putting three (3) or five (5) or even seven (7) day holds on deposits -- even cash deposits at their ATM outlets -- many people have no real choice but use alternative financial outlets....

“The stories I was privileged to hear from many of our clients are remarkably similar. The root of all these stories was that in many cases people had no idea what their rights were, what other options were available, and what people who were lucky enough not to use payday lenders were paying for their services. Many of the people I spoke to did not and would not complain or demand their rights as they saw them -- as they saw them in case they were not able to borrow the next time they needed to. And again, needing to is often formula, food, diapers. In all cases they felt like they had no options but to use payday lenders and had no concept of the amount of interest, charges, et cetera, that they were paying.” Anna Pazdzierski (on behalf of Manitoba Association of Women's Shelters and as Executive Director of Nova House), PUB hearing transcripts, 13 November 2007, pp. 171-173.

are charges not being laid? Why are these places not being closed down? Why are people able to flaunt the law in the face of society?³¹

31. "...I am a counsellor. I work with people who are addicted, people who suffer from alcohol, cocaine and gambling addictions, and with the families of those people who are affected by those addictions within our society. As I look at the number of payday loan establishments in our community, I can tell you that we as a society are losing the battle, that more and more people will become poor and affected by the drugs, the alcohol and the gambling in our society, and are turning to these institutions to supplement money for them to be able to pay bills to live on.

"I am going to speak to you briefly on the profiles of three individuals whom I am counselling and have counselled most recently.

"One, this person was affected by gambling. This person was divorced and has children. The reason that they were using the payday loan establishments was because of their addiction. Payday would come along. They would find themselves going to the gambling institutions, and they would lose a great portion of their paycheque. They would then turn around and go to these payday loan places for an interim loan so that they could pay their rent or buy groceries.

"An alcoholic. This person was divorced as well and had children. This person's income was in excess of \$50,000 a year, by the way. As a result, this person was having to use the payday loan establishments to meet the demands of her bills because she was spending money on alcohol and having trouble controlling that.

"A gambler. Income in the mid-thirties. Again, divorced, with children, looking for some way to pay bills. Gambling is a problem for her, so she would go and she would gamble.

"All three of these people have considered bankruptcy. They have exhausted their friends and their families for money, and still they continue in their addictions....People who use these types of establishments are people who are working hard to support their families and the needs of their families. As a result of their addiction, these institutions of finance, if we wish to call them that, help them to be in a position of continuing their addiction....

"I believe we as citizens have to be aware of that, for the value of any society is not how we treat the best in society, but how we treat the worst, the people who are suffering, the people who are in need. To me, these institutions of lending that charge 60 percent and up are a blight on our society. They cause great pain and anguish to many people.

"I just ask you to look back a few years ago when there was not one in our community. Now we have many in the area of Elmwood where my office is located. I look and I see many of these institutions being there. In fact, one has closed its doors because there are too many, but when is enough, enough? When do we put people before profit? When do we put their pain before profit?

"...the question is, if this is illegal under the Criminal Code of Canada, and, having been a policeman for 15 years, why are charges not being laid? Why are these places not being closed down? Why are people able to flaunt the law in the face of society?" David Love (Private Citizen), "The Standing Committee on Social and Economic Development," *Hansard*, 38th legislature, 4th session, vol. 11, 8 June 2006, http://www.gov.mb.ca/legislature/hansard/4th-38th/sed_11/sed_11.html.

You will remember Milton Friedman saying that businesses must operate within commonly-held ethical norms. That was the sound of those ethical norms being violated.

In my view though, the most compelling portrayal of vulnerability and desperation does not come from opponents of payday loans. It comes from Kent Taylor, who supplies insurance to people who take out payday loans.

You probably remember this. Mr. Taylor pointed out that “a lot of people get comic relief out of” it. It is the one-finger rule, where the insurance company will make good the loan if someone breaks two fingers, but not if they break only one. When asked why, he said his actuaries had concluded that, to get out from under a \$300 loan, someone might be willing to slam one finger in a door, but probably not two.³²

That is a pretty good working definition of “desperation”.

And if actuaries, working for an insurance company, not in direct contact with borrowers, know of that desperation, it is reasonable to conclude that the lenders on the front lines know of that desperation as well.

32. Allan Foran: “-- one third (1/3) of the page. And under that and -- and again, this is just -- candidly, out of curiosity, but under bone breaks, I was curious about two (2) things.

“My first curio -- curious -- curiosity was you're covered for everything but fingers and toes, so -- except if you break two (2) fingers.

“Why are you not covered if you break one (1) finger?”

Kent Taylor: “It's a good question and a lot of people get a comic relief out of that, but the bo -- the bottom line is is I guess the actuarials -- because that's ultimately -- that's the fees.

“They ask that -- they figure the question then for three (3) to five hundred dollars (\$500) it might be worth breaking your finger.”

Allan Foran: “Okay.”

Kent Taylor: “But somebody might not want to slam both fingers in the door for three hundred dollars (\$300).” PUB hearing transcripts, 15 November 2007, pp. 577-578.

A Balancing Test?

If we grant that at least some people are being harmed, the question now is:

- Is that harm significant?

The President of the CPLA has said:

...I believe there are examples of payday loan customers that have been badly taken advantage of by unscrupulous and greedy payday loan companies, but this is not the experience for the majority of customers.³³

Unfortunately for the CPLA, consumer protection is not a balancing test. We do not weigh up the benefits and harms and, if 60% of people are benefited and 40% of people are harmed, leave the product in the marketplace. We do not sacrifice the minority for the majority. Instead, we ask:

- In the normal course of events, does this product cause harm to a significant number of people?

There is no numerical test for what “significant” means. In our society, we require regulatory bodies—like you—acting on our behalf, to decide whether or not these people are significant.

Are they significant...or should they be ignored?

To ask the question is to answer it.

So:

- What is the role of the Public Utilities Board in this matter?

33. Hon. Stan Keyes (President, Canada Payday Loans Association), PUB hearing transcripts, 19 November 2007, p. 635.

The answer, I think, is:

- To prevent the significant harm payday lending causes.

Defining Interest

The second question is:

- What should the definition of interest in these regulations be?

Last January, the CPLA proposed a fee of \$20 per \$100 loaned.³⁴ By September, when Professor Gould presented his report,³⁵ the range had crept up to \$20-\$23—plus regulatory costs. When Mr. Schinkel appeared before you on November 20th, it had jumped to \$26.87³⁶. On November 28th, when Dr. Clinton spoke, the number was raised

34. “I was looking for any documents which might have been provided in addition to the Ernst & Young report and the Deloitte Touche report. It's pretty obvious from Dr. Gould's report that he had those two (2) documents with him, but I'm not too sure whether he had any other CPLA documents setting out CPLA's position on any number of things, including its position set out earlier in the press release of twenty dollars (\$20) per hundred (100).” Antoine Hacault (counsel for Rentcash Inc.), PUB hearing transcripts, 28 November 2007. p. 1403.

35. Lawrence I. Gould, *Determining The Maximum Allowable Fee For Payday Loans*, 17 September 2007 (unpublished).

36. “So it would change from twenty-six dollars and eighty-seven cents (\$26.87) to eighty-nine (89) cents.” Dean Schinkel (Deloitte & Touche), PUB hearing transcripts, 20 November 2007, p. 887.

It is important to note that Mr. Schinkel was not recommending this amount. As he pointed out in the previous day's testimony: “When we completed our report and during the completion, it was always meant to provide factual data on actual payday loan providers in Manitoba. As we state in our report, it was never meant to give Deloitte's opinion, or my opinion, on what an appropriate rate would be to charge. Instead, it was supposed to represent factual information that we received.” Schinkel, PUB hearing transcripts, 19 November 2007, pp. 824-825.

to \$35 dollars.³⁷ (I wonder, if these hearings continue much longer, how high that number might go.)

Payday advocates have asserted that these fees are not interest.³⁸ There are two difficulties with this assertion.

First, if they are not interest, they must be transaction fees. However, fair and reasonable transaction fees must reflect the time required to process the loan.

Unfortunately, as the owner of Cash X has said, “When you come into my office and I underwrite you for a hundred (\$100) dollar loan, it takes the same amount of time and the same amount of cost, barring the bad debt, as the five hundred (\$500) loan takes.”³⁹ To be fair and reasonable, then, the \$500 loan should have the same fee as the \$100 one.

This is not what any payday advocates have proposed. They want the fee you sanction to increase as the loan increases. A fee pro-rated to the amount of the loan—and therefore to the risk of the lender—is interest. Calling it by another name is a misuse of language.

37. “Yes, Mr. Chairman, I came up with a recommendation for a fee limit of thirty-five (\$35) dollars [per \$100 dollars]. And I haven't been asked to look at ancillary services, so I'm -- I'm excluding all that sort of stuff.” Kevin Clinton, PUB hearing transcripts, 28 November 2007, p. 1534.

38. “...the \$60 fee in this example [of a \$300 loan] is not interest, but interest plus an administrative charge.” Gould, *Determining The Maximum Allowable Fee*, p. 5.

39. Steve Sardo, PUB hearing transcripts, 14 November 2007, p. 360.

Second, and more importantly, the Criminal Code of Canada clearly defines these fees as interest:

"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...⁴⁰

Payday advocates have said that they are part of the financial sector.⁴¹ Every other lender in Canada, every other financial services entity, lives within this definition of interest. If the credit unions or banks were to start offering smaller, short-term loans, as many have urged them to do, this is the definition under which they would compete.

How is it fair and reasonable that only one, small⁴² part of the financial sector should not have to live under this constraint?

We regulate financial institutions because we have concluded that a well-regulated financial sector benefits our society. We use exactly the same rationale for regulation that Adam Smith used for the market economy.

The regulations are extensive, and they constrain the actions and options of businesses. They mean that some loans which both lenders and borrowers would like to complete, do not go ahead.

40. "Criminal Interest Rate", *The Criminal Code of Canada*, section 347, subsection 2 ("Definitions"), (Department of Justice Canada), http://laws.justice.gc.ca/en/showdoc/cs/C-46/bo-ga:l_IX-gb:s_347/en#anchorbo-ga:l_IX-gb:s_347; Internet; accessed 29 November 2007.

41. For example: "...we also anticipate providing some information on the social impacts of the Board's decision. How your decision-making process may impact consumers and their availability to this important financial service." Allan Foran (counsel to Canadian Payday Loan Association), PUB pre-hearing conference, 6 July 2007, p. 33.

42. "...when you're talking about financial services here, you're talking about a huge sector of the economy....When you're talking about payday lending, you're -- you're talking about a very small industry. It's tiny." Clinton, PUB hearing transcripts, 28 November 2007, p. 1468.

We do not regulate the sector because we believe lenders are greedy or malevolent. We regulate because we know a stable, low-cost pool of credit is essential to a robust economy.

We regulate because we know from bitter experience that, when under-regulated, financial markets cause harm. To take only the most recent example: the ongoing US sub-prime mortgage crisis clearly demonstrates the effects of the under-regulation of debt markets. The damage to individuals can be severe; the damage to the economy as a whole can be equally grave.

The scale with payday lending is much smaller, but the principle is the same.

To carve out a separate definition of interest for one class of financial services, is to separate them off from the regulatory mainstream in the financial sector and to give them an unfair competitive advantage.

You will recall my second question was:

- What should the definition of interest in these regulations be?

And my answer is:

- Tie it directly to the Criminal Code. This will ensure that we do not end up with a patchwork system, with payday lenders in a separate regime, and credit unions and banks constrained from competing with them.

Will Payday Loan Companies Survive?

Payday advocates argue that living under the definition of debt in the Criminal Code will destroy their industry.

I am not convinced. The same apocalyptic scenario was painted when the government restrained tax rebaters.⁴³ Companies would be wiped out, consumers would be deprived of the money they so desperately needed. And yet, here we are, 20 years later, with tax rebates still available, with companies still in business.

The market economy may well be the most creative thing ever invented by human beings. The free market has an astonishing ability to generate profits while, as Mr. Friedman says, “conforming to the basic rules of the society, both those embodied in law and those embodied in ethical custom.”

Will the Borrowers Survive?

Payday advocates have argued that, if they do not survive, those who use their services will be in desperate straits—that payday lending is an essential social service.

Payday lenders should be cautious in portraying themselves as providing a social service. As Adam Smith has said: “I have never known much good done by those who affect to trade for the public good. It is an affectation, indeed...”⁴⁴

In fact, there are already models of potential solutions in place. You have heard from Aski Financial,⁴⁵ which provides a service very similar that of payday lenders,

43. “...’minimum consideration’, in relation to a refund of tax, means an amount equal to

“(a) where the refund of tax is equal to or less than three hundred dollars, eighty-five per cent of the refund of tax, or

“(b) where the refund of tax is greater than three hundred dollars, two hundred and fifty-five dollars plus ninety-five per cent of the amount by which the refund of tax is greater than three hundred dollars;” “Interpretation”, *Tax Rebate Discounting Act*, section 2, subsection 1, R.S. 1985, c. T-3. <http://laws.justice.gc.ca/en/frame/cs/T-3//en>; Internet; accessed 29 November 2007.

44. Smith, *ibid.*

while adhering to the Criminal Code. You are also aware of the Buckland and Martin study⁴⁶ which documents alternatives currently active in Florida, Arizona, New York, Quebec, Ontario, British Columbia, and (here in Winnipeg) in West Broadway and Winnipeg's North End.

Access to short-term credit at fair and reasonable rates is important. However, payday lenders are not part of the solution; they are part of the problem.

45. Crystal Laborero (CEO, Aski Financial), Rob Valentine (COO, Tribal Wi-Chi-Way-Win Capital Corporation), PUB hearing transcripts, 13 November 2007, pp. 150-161.

46. Jerry Buckland and Thibault Martin, with Nancy Barbour, Amelia Curran, Rana McDonald, and Brendan Reimer, *The Rise of Fringe Financial Services In Winnipeg's North End: Client Experiences, Firm Legitimacy And Community-Based Alternatives* (Winnipeg Inner-City Research Alliance, Institute of Urban Studies, University of Winnipeg, August 2003), <http://ius.uwinnipeg.ca/WIRA/PDF/fringe-banking-Chesya.pdf>; Internet; accessed 29 November 29.

2. RECOMMENDATIONS

For all lenders and loans under your jurisdiction:

1. Require all lenders to adhere to the definition of interest, the maximum allowable rate of interest, and the method of calculation of that rate from *The Criminal Code of Canada*.
2. Set a maximum amount for all administrative fees which can be charged for any loan under \$1,500 no greater than the average fee set by the schedule 1 chartered banks of Canada for a consumer loan of \$15,000.
3. Adopt all 16 points of the proposed consumer protection framework and measures for discussion from the Consumer Measures Committee Working Group on the Alternative Consumer Credit Market, Stakeholder Consultation Document, published December 2004.
4. Prohibit a lender and its associated companies from providing a borrower with more than one loan at a time.⁴⁷
5. Prohibit “back-to-back” loans and revolving debt by prohibiting a lender and its associated companies from providing another loan to the same customer within one month of the previous loan being paid off.
6. Permit loans up to 1/2 the total take-home pay of the borrower’s previous paycheque.
7. Permit loans only against payments for ongoing salaried or hourly work.
8. Prohibit all loans against any government payments which are not ongoing salaried or hourly work.

47. Granted, neither recommendation 4 nor 5 will ensure that borrowers do not carry multiple debts from separate lenders. However, the likely social costs of a single database, accessible to all lenders under your jurisdiction, probably outweigh the benefits.