Legislative Summary **LS-541E**

BILL C-26: AN ACT TO AMEND THE CRIMINAL CODE (CRIMINAL INTEREST RATE)

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LEGISLATIVE HISTORY OF BILL C-26

HOUSE OF COMMONS		SENATE	
Bill Stage	**Date**	**Bill Stage**	**Date**
First Reading:	6 October 2006	First Reading:	
Second Reading:	6 November 2006	Second Reading:	
Committee Report:	13 December 2006	Committee Report:	
Report Stage:	31 January 2007	Report Stage:	
Third Reading:		Third Reading:	

Royal Assent:

Statutes of Canada

N.B. Any substantive changes in this Legislative Summary which have been made since the preceding issue are indicated in **bold print.**

Legislative history by Peter Niemczak

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BILL C-26: AN ACT TO AMEND THE CRIMINAL CODE (CRIMINAL INTEREST RATE)*

The Minister of Justice and Attorney General of Canada, the Hon. Vic Toews, introduced Bill C-26, An Act to amend the Criminal Code (criminal interest rate), in the House of Commons on 6 October 2006. Bill C-26 amends section 347 of the *Criminal Code of Canada*,(1) which criminalizes the charging of usurious interest rates.

The expanding presence of payday loan companies suggests that some Canadians are willing to pay rates of interest in excess of those permitted under the *Criminal Code* for their payday loans. Bill C-26 is designed to exempt payday loans from criminal sanctions in order to facilitate provincial regulation of the industry. Thus, the exemption applies to payday loan companies licensed by any province that has legislative measures in place designed to protect consumers and limit the overall cost of the loans.

BACKGROUND

A payday loan is a short-term loan for a relatively small sum of money provided by a non-traditional lender. Statistics from the Canadian payday loan industry suggest that the average payday loan is valued at $280 and is extended for a period of 10 days.(2) In order to qualify for a payday loan, the borrower generally must have identification, a personal chequing

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* Notice: For clarity of exposition, the legislative proposals set out in the bill described in this Legislative Summary are stated as if they had already been adopted or were in force. It is important to note, however, that bills may be amended during their consideration by the House of Commons and Senate, and have no force or effect unless and until they are passed by both Houses of Parliament, receive Royal Assent and come into force.

(1) R.S. 1985, c. C-46.

(2) Bob Whitelaw, "$280 till payday: The short-term loan industry says it provides a service the (average) Canadian needs, wants and appreciates," *Vancouver Sun*, 8 June 2005. Bob Whitelaw is the former President and CEO of the Canadian Payday Loan Association.

account, and a pay stub or alternative proof of a regular income. Payday lenders typically extend credit based on a percentage of the borrower's net pay until his/her next payday (generally within two weeks or less). The borrower provides the payday lender with a post-dated cheque, or authorizes a direct withdrawal, for the value of the loan plus any interest or fees charged.

In Canada, section 347 of the *Criminal Code* makes it a criminal offence to charge more than 60% interest per annum. If the rate of interest on payday loan transactions is calculated according to the definitions and methods specified in the *Criminal Code*, some payday loan companies appear to be charging interest in excess of 1,200% per annum.(3)

Shared federal-provincial jurisdiction over payday lenders has meant that they have been left essentially unregulated.(4) Provinces are unable to regulate the price of a loan, since any attempt to do so would conflict with section 347, and could therefore be challenged as *ultra vires* of the province. Moreover, section 347 has not been used in a criminal context to curtail the activities of payday lenders. The consent of a provincial Attorney General is required to prosecute an offence under section 347. Provincial governments have yet to prosecute a payday lender; they may fear that the lack of a payday loan company alternative would result in consumers using illegal alternatives such as loan sharks.

If the payday loan industry is not regulated, its future may ultimately be determined by a number of class action lawsuits currently proceeding through Canadian courts. These lawsuits claim that consumers were charged fees in excess of the *Criminal Code* rate, and seek to recover hundreds of millions of dollars' worth of interest. Should these class action lawsuits succeed, they could potentially bankrupt the payday loan industry.

Faced with jurisdictional challenges, federal and provincial/territorial governments have been negotiating a regulatory regime that would oversee payday lenders. The Consumer Measures Committee (CMC) Working Group on the Alternative Consumer Credit Market was established by Industry Canada and the provinces to explore ways of

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(3) For a fuller exploration of the payday loan industry, see Andrew Kitching and Sheena Starky, *Payday Loan Companies in Canada: Determining the Public Interest*, PRB 05-81E, Parliamentary Information and Research Service, Library of Parliament, Ottawa, 26 January 2006, http://www.parl.gc.ca/information/library/PRBpubs/prb0581-e.html.

(4) Financial institutions are regulated either federally or provincially/territorially, depending on which level of government incorporated them. The federal government has jurisdiction over interest rates, but the day-to-day regulation and licensing of payday lenders most likely falls under provincial jurisdiction, as part of their power over property and civil rights; see Peter Hogg, *Constitutional Law of Canada*, Carswell, Toronto, 1997. Territorial governments have the power to regulate payday lenders by virtue of powers delegated by the federal government.

providing standard levels of consumer protection across Canada. In December 2004, the CMC published a consultation document that contained a proposed consumer protection framework and a number of possible measures for discussion.(5) Consultations with stakeholders ensued.

Bill C-26 opts for provincial regulation of the market rather than an outright ban on payday loans.

DESCRIPTION AND ANALYSIS

Clause 1 of Bill C-26 updates the wording of section 347 of the *Criminal Code*. The clause replaces the word "notwithstanding" by "despite," following modern statutory drafting practices, and replaces "twenty-five thousand dollars" by "$25,000."

Clause 2 amends the *Criminal Code* by adding new section 347.1(1), which retains the definition of "interest" found in section 347(2),(6) and adds a definition of "payday loan." A payday loan is defined as "an advancement of money in exchange for a post-dated cheque, a preauthorized debit or a future payment of a similar nature but not for any guarantee, suretyship, overdraft protection or security on property and not through a margin loan, pawnbroking, a line of credit or a credit card."

Clause 2 of Bill C-26 then introduces new section 347.1(2), which exempts a person who makes a payday loan from criminal prosecution if:

- the loan is for $1,500 or less and the term of the agreement lasts for 62 days or less;
- the person is licensed by the province to enter into the agreement; and
- the province has been designated by the Governor in Council (Cabinet) under new section 347.1(3).

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(5) Consumer Measures Committee Working Group on the Alternative Consumer Credit Market, *Consultation Paper on Framework Options for Addressing Concerns With the Alternative Consumer Credit Market*, Autumn 2002, http://cmcweb.ca/epic/internet/incmc-cmc.nsf/vwapj/CMC_credit_e.pdf/$FILE/CMC_credit_e.pdf; see also CMC *Stakeholders Consultation Document*, December 2004.

(6) Bill C-26 defines "interest" in the same way that it is defined in section 347(2) of the *Criminal Code*. The existing definition of "interest" is, however, problematic in the sense that payday lenders have tried to avoid the provisions of section 347 by disguising interest as various fees and charges, including insurance charges. In one business model, payday lenders incur the operating costs associated with providing payday loans and charge customers a fixed fee and insurance-type premium on each loan transaction. The premium, which is designed to cover the cost of providing the loan as well as the risk of loan default, is assumed by an insurance company that may be owned by the payday lender. If the "insurance charges" argument were to be accepted before a Canadian court, it is unclear whether the exemption proposed under Bill C-26 would apply. This could result in problematic jurisdictional challenges of provincially imposed limits on the cost of borrowing.

New section 347.1(2) does not apply to federally regulated financial institutions, such as banks.

New section 347.1(3) states that the provisions outlined above will apply in provinces that are designated by the Governor in Council, at the request of the province. The designation is dependent on the province enacting legislative measures that "protect recipients of payday loans and that provide for limits on the total cost of borrowing under the agreements." New section 347.1(4) allows the Governor in Council to revoke the designation if requested to do so by the province, or if the legislative measures referred to above are no longer in force.

COMMENTARY

The recent growth of the payday loan industry has focused attention on the industry and its practice of charging relatively high rates of interest.(7) Critics have called for the prosecution of payday lenders under the existing *Criminal Code* provisions, even if such action reduces the profitability of the industry or results in its abolition.

Proponents of the industry point to the growth of payday loan companies as evidence that the industry is fulfilling an otherwise unmet need for short-term credit and/or convenience. Proponents have argued that instead of an outright ban on payday loans, the federal government should allow provinces to regulate the industry in the interests of restricting some of the more abusive industry practices, such as insufficient disclosure of contractual terms, aggressive and unfair debt collection practices, and the "rolling over" of loans. The payday loan industry itself has proposed self-regulation as a means of addressing some of the concerns associated with lending practices.(8)

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(7) See, for example, Bill S-19, An Act to amend the Criminal Code, 1st Session, 38th Parliament, introduced in the Senate by the Honourable Madeleine Plamondon on 4 November 2004. This bill called for the 60% interest rate ceiling under section 347 of the *Criminal Code* to be reduced to 35% above the Bank of Canada's overnight lending rate. It also called for the definition of "interest" in section 347(2) of the *Criminal Code* to be amended to include insurance charges, thus eliminating what some see as a deficiency in the current legislation that is being used by some payday loan companies operating under the insurance model.

(8) Canadian Payday Loan Association, "Payday Loan Industry Association Unveils Stronger Code of Best Business Practices to Protect Consumers," News release, 22 June 2005; *Code of Best Business Practices*, http://www.cpla-acps.ca/english/consumercode.php.

Since the introduction of Bill C-26, some commentators have suggested that the federal government has merely transferred the problem of payday loans to the provinces, which may or may not adequately regulate them.(9) Transferring responsibility to the provinces may also lead to a patchwork of different laws and regulations, and a lack of uniformity in enforcement.(10)

Other commentators advocate reforms to section 347 beyond those provided by Bill C-26. For example, the Supreme Court of Canada has stated that section 347 "is a deeply problematic law."(11) In addition, there is concern that the provisions set out in Bill C-26 could cause legal uncertainty in relation to negotiating larger-scale financial transactions, such as bridge loans and convertible debentures.(12)

Finally, a number of other stakeholders have made recommendations that they believe would reduce the need for payday loan companies, including:(13)

- government-led education programs designed to promote financial literacy;
- promotion of competition from traditional banks and other financial institutions in order to better control costs in the alternative consumer credit market;
- reforms to make the process of bank closure in low-income and rural neighbourhoods more onerous; and
- government aid for the establishment of community banking operations in low-income neighbourhoods.

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(9) Jacob Ziegel, "Pass the buck: Ottawa has paramount jurisdiction over interest rate regulation," *Financial Post*, 10 November 2006, http://www.canada.com/nationalpost/news/story.html?id=b3efb360-60fc-4c86-8818-b579b31fcd63.

(10) *Ibid*.

(11) *Garland* v. *Consumer Gas Co.*, [1998] 3 S.C.R. 112, para. 52.

(12) Corporate finance lawyers and academics have commented that any change to the section should include an exception for financial transactions such as demand loans and convertible debentures. Such amendments would either specifically exempt the two financial instruments, or would simply render the law inapplicable to commercial loans in excess of $250,000. See, for example, Jacob S. Ziegel, "Section 347 of the Criminal Code," Canadian Business Law Journal, Vol. 23, 1994, p. 321, and Mary Anne Waldron, "White Collar Usury: Another Look at the Conventional Wisdom," *Canadian Bar Review*, Vol. 73, 1994, p. 3.

(13) A number of government organizations, academics and public interest groups have studied the alternative consumer credit market in Canada, and have made policy recommendations. See, for example, Sue Lott and Michael Grant, "Fringe Lending and Alternative Banking: the Consumer Experience," Public Interest Advocacy Centre, November 2002; John Lawford, "Pragmatic Solutions to Payday Lending: Regulating Fringe Lending and Alternative Banking," Public Interest Advocacy Centre, November 2003; Jerry Buckland and Martin Thibault, "The Rise of Fringe Financial Services in Winnipeg's North End: Client Experiences, Firm Legitimacy and Community-Based Alternatives," Institute of Urban Studies, Winnipeg, August 2003; Iain Ramsay, "Access to Credit in the Alternative Consumer Credit Market," paper prepared for the Office of Consumer Affairs, Industry Canada and the Ministry of the Attorney General, British Columbia, February 2000.