Fintechs Canada

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Mark Radley,

On behalf of Fintechs Canada, I would like to thank you for the opportunity to provide the Department of Finance with our perspective on how the government can crack down predatory lending faster and increase access to low-cost, small-value credit in Canada.

Fintechs Canada serves as the collective voice for the most innovative financial technology companies. Serving millions of Canadians from coast-to-coast-to-coast, our membership consists of market-leading Canadian fintechs, fintech-friendly financial institutions, the technology companies that power the credit union space, and global fintech companies, among others. Our mission is to assist Canadians in accessing a more competitive and inclusive financial sector, while also protecting its integrity, stability and security.

In the rest of this submission, we provide our perspective in response to several of the government's questions.

## 1. What are the features of credit products that can help Canadians improve their financial positions?

Loans that help Canadians improve their financial positions often have the following features:

- **Transparent and comprehensive pricing**, letting borrowers easily compare the dollar cost of loans across providers and pick the one that's best for them.

- **Clear and accessible terms and conditions**, which show borrowers at the outset what is expected of them in terms of repayment.
- **A way out of debt**, which includes customer service support for those in financial difficulty, as well as flexible repayment options.
- **A commercial purpose**, which helps Canadians improve their financial positions by providing access to funding Canadians may not otherwise have access to.

Loans with a commercial purpose also help Canadians improve their financial positions by providing access to funding Canadians may not otherwise have access to. Small businesses and sole proprietors are increasingly relying on alternative, non-bank sources of funding to improve the financial position of their business, as many do not have access to loans from traditional banks. By providing access to funding and a wider range of lending products, non-banks can help Canadians grow their business in a way that traditional banking products can not. For that reason, non-traditional lending products, offered for a commercial purpose to Canadian businesses and entrepreneurs, are critical to economic development and business growth.

## 2. What protections from unreasonable fees for credit products, including payday lenders, could help Canadian consumers?

The government should focus on market conduct measures other than price controls to protect consumers from predatory lending. This includes measures to promote responsible advertising by lenders, such as by requiring that they be transparent with their customers about the costs of borrowing, as well as give their borrowers flexibility in how loans are repaid.

## 3. What marketing techniques target vulnerable Canadians into taking on high-cost debt, and what measures would protect Canadians from deceptive advertising?

The federal government should ensure lenders aren't providing their borrowers with false or inadequate disclosures, which obfuscate, if not outright hide, the true costs and risks of a loan. The government could do this by exploring ways to standardize the disclosure of information, and require certain elements of information to be included in such disclosures.

## 4. How could all types of credit lenders better provide Canadians with information on the costs of credit products, including associated fees and interest?

Lenders should:

- Equip borrowers with clear and transparent information about the terms and conditions of the loans on offer, including that related to fees and charges, the repayment schedule, and what happens if the borrower becomes insolvent.
- Provide customers with customer servicing contact points to seek support where needed.

Lenders should do this in non-technical language, and use multiple methods to present this information to ensure customers with disabilities are able to access and understand essential information.

## 5. What barriers do Canadian consumers face in accessing low-cost, small-value credit?

One of the barriers Canadians face in accessing low-cost, small-value credit is an inability for Canadians to safely, securely, and efficiently share their financial information with non-bank lenders.

For many Canadians, such as new Canadians or students without credit histories recognized by the financial sector, low-cost and small-value credit from traditional financial institutions, such as banks and credit unions is inaccessible. The only option left for such Canadians is to look elsewhere. Many consumers turn to predatory lenders, but there is another way that involves the safe, secure, and efficient sharing of their financial information.

According to the government's own consultation on "open banking" or "consumer-directed finance," there is international evidence that the ability to control and share one's financial information promises "great financial inclusion and access for consumers." For example,this would:

- **Give vulnerable Canadians better choices by improving their credit history.** Borrowers who don't have sufficient credit files are the most vulnerable to predatory loans. This demographic group includes Indigenous Canadians, newcomers to Canada, younger Canadians, older generations who use credit infrequently, seasonal and gig economy workers, low-income

Canadians, and self-employed workers. Open banking would help them by making it easier for credit bureaus to use alternative data sources to build credit profiles, such as rent payments.

- **Expand the market for low-cost, small-value credit.** Borrowers without sufficient credit often struggle to access loans from traditional financial institutions, such as banks and credit unions. But in countries where borrowers have the ability to share their financial information and seek out loans from alternative lenders, it's been observed that the probability of loan approvals go up and interest rates go down.

Right now, however, Canadians don't have a safe, secure, and efficient way to share their financial information. The only option many banks and credit unions give them is screen-scraping, which is unreliable and comes with certain risks.

### 6. What barriers do financial institutions, banks, and credit unions in particular, face in increasing their offerings for low-cost, small-value credit to a broader consumer base?

The same barriers described above. Though many Canadians seek to share their financial information with alternative providers of financial services, banks and credit unions would be free to access the same information, with customers' consent, in order to remain competitive. This could help banks and credit unions expand their own addressable markets for low-cost, small-value credit by relying on alternative data to make decisions about creditworthiness.

### 7. What could various levels of government, including provincial governments, do to improve, promote, and support access to low-cost, small-value credit?

It is important that the government address that the draft regulations on the new maximum allowable rate of interest will unfairly and disproportionately impact the smallest of Canadian businesses (sole proprietors) and will inadvertently exclude them from commercial lending access. Our members, who listen to the needs of entrepreneurs everyday, have emphasized that it is essential for sole proprietors to have access to credit for commercial purposes. Small-value credit is particularly important to sole proprietors looking to expand, that use funds to supplement cash flow, and that are operating in seasonal industries as they rely on low-value and short-term credit to ensure they can operate and grow over time.

The government should make clear that a natural person (individual) acting in their consumer capacity is distinct from a natural person (sole proprietor) acting in their business/commercial capacity. These are two distinct capacities and must be regarded and treated as such. While we understand it is the government's intention to protect consumers from predatory lending with criminal interest rate reform, it must be known that the blanket exclusion of "natural person" in the draft regulations, especially without a clear definition and scope for the use of credit, will result in confusion and inconsistencies in the application of the legislation to sole proprietors in market practices across provinces and territories. For example, consumer protection legislation across Canada generally applies to natural persons entering into a credit agreement for a non-business purpose, and with certain exceptions, excludes natural persons acting with a business purpose. This blanket exclusion of natural persons altogether in the draft legislation, will confuse lenders as to which credit products are accessible to sole proprietors which will lead to sole proprietors being shut out of commercial purpose lending. While this may protect consumers, it will unfairly and negatively impact sole proprietors across Canada.

Additionally, the federal government should begin the implementation of consumer-driven banking in budget 2024.

## 8. What could financial institutions, banks, and credit unions in particular, do to improve, promote, and support access to low-cost, small-value credit?

For the aforementioned reasons, they could give their customers a safe, secure, and efficient way to share financial information with the organizations that their customers choose.

## 9. Are there practices to improve the availability of low-cost, small-value credit within Canada or abroad that could be learned from?

The best practices around the world and within Canada the federal government should learn from include:

- **Focus on disclosures rather than hard caps.** Among other things, the Consumer Credit Directive ensures that lenders give consumers standardized information so that they can make informed decisions, prevents misleading marketing and advertising practices, and creates a right of withdrawal from a credit agreement for consumers.

- **Ensure sole proprietors have the same rights of access to credit as their incorporated competitors**: It is common practice in international jurisdictions, including Australia, the United Kingdom, and European Union, that business credit lenders require business credit borrowers (including sole proprietors) to sign a statement that the credit funds will be used (depending on the jurisdiction) solely or predominantly for business purposes:
    - In Australia, credit (including cost caps) is regulated at the national level by the National Consumer Credit Protection Act, which incorporates the National Credit Code. This exempts credit that is not for personal, domestic or household purposes from the National Credit Code. The corresponding regulations allow borrowers to sign a form of declaration that creates a presumption that the credit will be used wholly or predominantly for business purposes. But the declaration can be deemed ineffective if the lender "knew, or had reason to believe; or...would have known, or had reason to believe, if the [lender] had made reasonable inquiries" that the credit was going to be used for a consumer purpose. In practice, the law incentivizes lenders to conduct reasonable inquiry to avoid exposing themselves to legal liability.
    - In the United Kingdom, the Financial Services and Markets Act 2000 (Regulated Activities) Order 2011, Section 60C, allows for the exemption of business-purpose credit from the application of the Consumer Credit Act to a lending agreement. The business-purpose exemption is not unconditional. There are threshold restrictions on the loan amount, which further limit the range of credit that is exempted. What's more, while a declaration can create a presumption that credit is being extended for business purposes, the declaration can be rebutted in the event the lender has grounds to believe the credit is not for business purposes. Like in Australia, lenders are incentivized lenders to conduct reasonable inquiry to avoid exposing themselves to legal liability.

  Canada should follow a similar approach, such that business credit lenders should be able to legally rely on the borrower's statement if it forms a good faith belief that the statement is true. In practice, this will require that lenders maintain robust program controls that allow them to cleanly focus on business lending transactions. These will include ensuring that lenders are properly marketing to, and attracting, sole proprietor businesses, all of which will be apparent in its websites, advertising, and other collateral. It will also extend to underwriting, where lender guidelines include a review and verification of business-generated income (as opposed to employment-generated income). The controls will also include lenders reasonably conducting due diligence on borrowers' representations regarding use of funds, and rejecting applications where there is indication of non-compliant consumer use. Lenders will be properly incentivized to "get it right", since the cost of non-compliance or abuse is high, given the real risks of criminal liability, regulatory enforcement, civil litigation, and reputational scrutiny. Moreover, if provinces wish to extend the lower rate to certain protected industries that they have determined should be afforded extra protection, they will have the mechanisms to do so.

- **Give Canadians, both consumers and businesses, the ability to direct their banks to share financial information in a safe, secure, and efficient way.** The digital economy has given rise to thousands of non-bank financial services organizations, many of whom are in the business of lending. But in order for people to be able to access such services, they need to share their financial information. Europe, the United Kingdom, Australia, and the United States are making this easier to do for their citizens.

## 10. How much further beyond 35 percent APR should the criminal rate of interest be lowered?

The government should consider addressing the market conduct of lenders before further reducing the maximum allowable rate of interest.

It is important to note that what makes a loan predatory is not whether it's being issued at an interest of 36 percent or 34 percent. What makes a loan predatory has more to do with the structure of the loan, as well as the conduct of the lender vis a vis the borrower:

- **Hidden fees.** Predatory lenders may not be transparent about the true cost of a loan, impairing borrowers in their ability to make informed decisions in their best interest.

- **Obfuscated terms and conditions.** Predatory lenders may obscure the terms and conditions of their loans, which surprise borrowers throughout the term, such as with cost-prohibitive balloon payments or prepayment penalties.
- **No way out.** Predatory lenders may aggressively upsell or repeatedly push refinancing on borrowers, or structure loans in a way that compounds costs and offers no other flexibility when borrowers are unable to pay on time, leading to a vicious cycle of debt that becomes unpayable.
- **Aggressive collection tactics.** Predatory lenders may resort to high-pressure debt-collection actions, such as through incessant phone calls and other aggressive communications, which can exploit the vulnerabilities of their borrowers.

Price controls, such as hard caps on the maximum allowable rate of interest, fail to address these features of predatory lending. When not appropriately set, they can also make things worse, by constricting the market for credit.

The maximum allowable rate of interest, if significantly reduced, could also begin to affect the viability of certain credit cards in the Canadian market. According to Payments Canada, credit cards are the most used payment method, with most Canadians (i.e., 7 in 10) paying off their balance within a billing cycle. Payments Canada also reports that Canadians prefer credit cards mainly for the rewards they're able to claim. The federal government should take care not to render unviable a payment instrument that is valued by a majority of Canadians.