



Fintechs Canada

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On behalf of Fintechs Canada, I would like to thank you for the opportunity to comment on the draft regulations that were [published late last year on the maximum allowable rate of interest](#).

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.

The federal government's intention with the regulations is to lower the maximum allowable rate of interest on certain consumer loans that are predatory, not commercial loans, which aren't predatory. As the government wrote in its regulatory impact statement:

Commercial lending does not require the same degree of regulatory oversight as personal loans. Often commercial loans require high rates of return to attract capital investments and are usually undertaken by parties that understand risk versus return trade-offs occurring as a part of diversified portfolios designed to hedge risks. Overly restrictive rules on these types of loans could have a cooling effect on transactions that, all factors considered, would be beneficial to both parties and the economy.

Moreover, commercial loans do not trap individuals in Canada in a cycle of debt. In addition to capturing certain commercial lending practices that are outside the policy intent, further lowering the criminal rate could restrict the ability of sophisticated commercial entities to engage in borrowing transactions. This is why the proposed Regulations would exempt commercial loans from the new lower criminal rate.

The proposed regulations, as they're currently drafted, fail to exempt many commercial loans serving small and growing business owners from the new maximum allowable rate. Unless the regulations are amended, the government will disproportionately restrict Canada's smallest businesses and entrepreneurs from accessing the credit they need to invest in their businesses and grow.

In the rest of this letter, we:

1. Describe a few features of the market for commercial credit in Canada
2. Identify the unintended consequences of the draft regulations
3. Submit three recommendations for how to amend the regulations to avoid the unintended consequences

1. The market for commercial credit in Canada

The availability of commercial credit is becoming scarcer in Canada and around the world due to economic factors. Business lending conditions in Canada have been tightening, according to [a survey by the Bank of Canada](#). Such is the case around the world. According to recent bank lending surveys by the [European Central Bank](#) and [Federal Reserve](#), banks in the EU and the United States have also been tightening their standards for commercial loans to firms of all sizes and across industries.

Meanwhile, the Canadian Federation of Independent Business, which surveys thousands of businesses on a regular basis, [reported](#) this year that:

- Demand for credit in Canada's community of small- and medium-sized businesses is increasing. Businesses reporting a need for financing increased from 35 to 58 percent from 2012 to 2022. Small businesses—those with 49 employees or fewer—reported a greater need for financing than other businesses.
- Especially among traditional lenders, such as large financial institutions, financing requests were denied for about one in five of the smallest businesses—those with four employees or fewer.

Because they're being shut out of the market for commercial credit from traditional lenders, many small businesses are turning to "non-traditional" sources of credit, such as financial technology companies.

The current financial system, which relies heavily on established credit scores and credit history, fails to effectively accommodate "thin-file" borrowers such as low-income individuals, minority communities, immigrants, and young entrepreneurs. The proposed regulations create real risk that these classes of entrepreneurs will be disparately impacted when it becomes more difficult for them to gain access to the financial system.

2. Regulations don't exempt low-value commercial loans for Canada's smallest businesses

According to the draft regulations, loans would be exempt from the new maximum allowable rate of interest if:

- The borrower is not a natural person
- The borrower has entered into the agreement or arrangement for business or commercial purposes
- The amount of credit received is in between \$10,000 and \$500,000 and the APR doesn't exceed 48%

The exemption criteria, as currently drafted, mean sole proprietors, who can be dieticians, freelance photographers, graphic designers, and hairdressers, will be excluded from commercial purpose lending. These types of sole proprietors take out innovative, low-dollar amount loans that have flexible repayment schedules and no requirements to pledge personal collateral. Sole proprietors need access to such loans in order to grow their business, whether it's to buy a large quantity of supplies to fulfill new orders, sub-contract consultants, or to invest in learning new skills to grow their business.

The proposed exemption criteria create a material risk that sole proprietors who already have struggled to gain access to loans from traditional means will lose access to low-dollar amount commercial credit from our members, as alternative lenders for commercial purposes may be forced to downsize operations or cease providing these loan products to sole proprietors altogether. Our members invest in innovations and flexible terms that enable them to responsibly offer loans to sole proprietor borrowers and this needs to be adequately recognized in the regulations.

For example, consider a newcomer, who is working on building her doula business and has already worked with a few clients. Suppose she's been asked to take on a job that will pay her \$5,000, but she doesn't have all the necessary equipment. Suppose she needs to buy birthing comfort supplies worth \$3,000 to complete the job, but doesn't have enough cash on hand, her credit card limit isn't high enough, and while she is creditworthy, the size and age of her business means a traditional bank will not offer her financing. She also can't be assured that she'll get paid in full in a month or three months after completing the job, despite how clear the payment terms are in her invoice. There are financial technology companies in the market right now that can offer the doula a loan with a flexible repayment schedule based on when the money is received.

Based on the government's exemption criteria, such loans will be prohibited from the benefits of the commercial exemption, under the government's draft regulations as currently written, even though they are essential for many sole proprietors to build and grow their business.

The flexible repayment schedule of such loans is one of the most appealing features, but it also can influence whether the APR is higher or lower. For example, suppose after taking out the loan and buying equipment, our hypothetical doula's job is cancelled due to a client's unexpected miscarriage. Though she gets to keep a small deposit, it's not enough to cover the loan. The aforementioned loan is beneficial because it's structured such that she can pay the loan back whenever she earns income, which gives her the flexibility to find other clients and pay the loan back over a longer period of time without incurring extra cost.

Furthermore, the exemption criteria do not consider the importance of commercial-purpose loans under \$10,000. According to internal member data, which represents tens of thousands of commercial borrowers, the median commercial-loan value in 2023 was nearly \$5,500. For sole proprietors, this median loan value was even lower, coming in around \$4,000 in the same year. Our members fund around \$200,000,000 in commercial-purpose loans. The draft regulations as written would severely impact entrepreneurs by putting the availability of these funds at risk, removing an essential funding stream for tens of thousands of entrepreneurs across the country.

3. Our proposal for improving the commercial-purpose exemption criteria

The government's intention is to exempt commercial loans, but there are commercial loans, such as the aforementioned type offered to sole proprietors, which the regulations fail to exempt.

We recommend that:

- The government exempt from the new maximum allowable rate of interest natural persons taking out the loan for a business, trade or commercial purpose.
- The government lower the minimum threshold for exempted credit to \$2,500 so long as the maximum threshold is \$500,000, the annual percentage rate of interest does not exceed 48%, and the borrower is taking out the loan for a business, trade, or commercial purpose.
- The government require that lenders conduct reasonable inquiries to ensure that a borrower is going to use the exempted loan for a business, trade or commercial purpose. The government should also require that lenders conduct reasonable inquiries that the commercial borrowers have an existing, operational business.

By making each of the aforementioned changes to the regulations, the government would be exempting commercial loans more equally for all business sizes while still safeguarding against loopholes for predatory lenders to prey on vulnerable consumers.

In other jurisdictions that exempt commercial loans, the exemptions for commercial loans are broader than Canada's proposed one. But this is made possible without creating loopholes because lenders are still liable for using reasonable effort to verify the commercial purpose of a loan. For example:

- 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 to conduct reasonable inquiry to avoid exposing themselves to legal liability.

In practice, this requires lenders to review and verify a potential borrower's business-related income history (rather than employment-generated income) before approving the loan to determine whether there is, in fact, a commercial purpose. It also requires that lenders reject loan applications where there is evidence of non-compliant use, such as when they will be used for personal consumption. It also incentivizes such lenders to market to and attract customers in need of commercial-purpose loans, rather than personal ones, which is apparent in such lenders' websites, advertising, and other collateral.

Failing to exempt all commercial loans will disproportionately hurt the smallest businesses

Financing for small businesses is already scarce, but it is likely to become even more scarce and under-serving of even more entrepreneurs if the government doesn't amend the draft regulations so that commercial loans for sole proprietors and commercial loans above \$2,500 are exempted from the new maximum allowable rate of interest. It's important for the regulations to be amended to allow for a competitive commercial loan market in Canada that protects consumers and promotes business growth, which is the government's stated intention.

Fintechs Canada thanks you for considering our perspective on how the government can avoid these unintended consequences for business owners, while protecting Canadians from predatory lenders who may look for loopholes and prey upon the most vulnerable in society.

We'd be happy to discuss our views and elaborate on them, providing more detail and context wherever we can. We look forward to working with you and continue to support the government's efforts to crack down on predatory lending. In a

separate letter, we recommended some things the government could do to complement the new maximum allowable rate by addressing the market conduct of predatory lenders.

Sincerely,

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