Canadian Association of Private Lenders

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Office of Consumer Affairs
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Submitted electronically
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Re: Predatory Lending Consultation: - Feedback on Proposed Changes to the Criminal Rate of Interest

We write on behalf of the Canadian Association of Private Lenders, which represents the interests of private mortgage lenders, investors and administrators across Canada. One of the rationales for establishing this association is to focus private lending dialogue on regulatory reform.

In particular, we wish to provide commentary on the current consultation issued by the Federal Government, which seeks input from the public on the potential impacts of lowering the prohibited rate of interest contained in section 347 of the Criminal Code. As the consultation notes, the current criminal interest rate ceiling is a flat rate of 60%. We are aware of two current bills, which have passed first reading and seek to lower the criminal rate of interest and float above the Bank of Canada overnight rate (BCR); one is Bill S-239 which seeks to lower the rate to 20% above the BCR, and the other is Bill C-213, which seeks a rate ceiling of 30% over the BCR.

Our view is that it is highly improper for the government to seek to regulate commercial, non-criminal lending activity through the provisions of the Criminal Code. A myriad of financial sector regulators, from OSFI, FSRA, BCFSA, the Financial Consumer Agency to provincial high cost credit regulators exist to provide oversight over various lending sectors. We should let the regulators regulate and utilize the Criminal Code for its intended purpose of tackling loan sharking and racketeering. The rationale for this position is set out in greater detail below.

What is High-Cost Lending?

The consultation document explains that there is "no universal definition of a "high-cost" or "high-interest" loan, either in Canada or internationally". However, there are in fact three provinces in Canada, being BC, Alberta and Manitoba, which have created

relatively new licensing regimes for “high cost credit lenders”. They create licensing regimes for non-mortgage lenders which lend at an APR exceeding 32%. In addition, Ontario has issued a consultation on creating a high cost credit licensing regime, which could readily align with these three provincial regimes. Quebec has also such a regime, which is slightly different by creating a floating ceiling of 22% above the BCR. While it is true that not every province has a high cost credit licensing regime which would thereby create a universal definition of high cost credit, the enactment of these licensing regimes does establish a general consensus of it being set at an APR of 32%.

Regulatory Regimes Vs Criminal Law

Despite some of the provinces taking proactive measures to introduce high cost credit licensing regimes, the adoption of either Bill S-239 or C-213 would likely render these licensing regimes completely redundant. These regimes, in addition to mortgage lender and payday lender licensing regimes seek to regulate legitimate financial activity by creating standards, licensing qualifications, disclosure requirements, enforcement options and prohibited conduct for the purposes of consumer protection. This regulatory approach is balanced in that it seeks to permit commercial lending activity while controlling its industry participants and their conduct. It represents a wholly different consumer protection approach from that of the criminal justice system.

The purpose of criminal law, as set out by the Uniform Law Conference of Canada, in its report on the need to reform section 347, is to:

> “contribute to the maintenance of a just, peaceful and safe society through the establishment of a system of prohibitions, sanctions and procedures to deal fairly and appropriately with culpable conduct that causes or threatens serious harm to individuals or society.
>
> At its core, the criminal law is a limitation on freedom. It limits the freedom of all citizens by prohibiting certain prescribed conduct punishable through a variety of means including incarceration. The criminal law has also been described as a “blunt and costly instrument.”

The report appropriately admonishes parliamentarians to utilize criminal law sparingly and only when necessary by adopting the key principles of “restraint, the prevention of harm, retribution, proportionality, deterrence, denunciation and an insistence that new laws are crafted with clarity and apply equally to all.” An incontrovertible conclusion is that the regulation of ordinary lending activity through the criminal law is improper. There is no other regulated industry in Canada that we are aware of where government seeks to enlist the blunt instrument of the Criminal Code to regulate industry members. This point is underscored by the fact that licensing regimes already exist to regulate those industries.

Section 347 is Utilized Mainly in Civil Contexts

One further confounding challenge with the criminal interest rate prohibition in section 347 is that, in reality, criminal prosecutions are scarce and convictions almost non-existent. It is clear from an analysis of case law that judicial consideration of the criminal interest rate ceiling occurs predominantly in a civil context, with a dearth of criminal judgements. The Supreme Court of Canada observed that the criminal rate of interest prohibition is applied in civil proceedings to commercial loan transactions that bear no resemblance to criminal loan sharking activity. Loan APRs exceeding 60% are frequently challenged in civil courts by borrowers seeking to mitigate the consequences from loan default remedies, resulting in courts reading down any offending interest provisions to 60% under the doctrine of severance. The rationale behind severance orders is that unlawful contracts should not be enforced.

Criminal Law Requires Certainty

Either a conviction under section 347 or a civil application seeking to sever criminal interest requires the expert evidence of an actuary, who must calculate the effective annual interest rate taking into account the loan principal, contractual interest rate, lender fees, legal fees, amortization, term length and other factors. An obvious challenge with section 347, is that high interest lenders may not know whether they have crossed the 60% interest threshold, which pushes them into criminal offence territory, as they would not have had the benefit of obtaining the required actuarial evidence before making the loan. For instance, loans with a contractual interest of 48% with commercially acceptable nominal fees and rates can readily exceed effective annual interest rates of 60%. Relying on expert evidence to answer the ultimate judicial question of whether the offence was committed is problematic, as accused persons may never know in advance of such evidence being adduced of whether they are actually guilty of breaching section 347.

The concept of legal certainty requires that citizens have some clear idea as to what is legal and what is illegal so that they can regulate their own conduct. It is obvious that a drastic plunge in the criminal interest rate from 60% to somewhere in the region of 20% or 30% will move criminal conduct perilously close to or within a significant proportion of commercially acceptable transactions.

Equality

Section 347 creates an unusual criminal offence in that it requires the Crown to obtain the consent of the Attorney General prior to charging a person. Presumably, the Attorney General acts as a gatekeeper to ensure that only “real criminals” and not “legitimate commercial lenders” are prosecuted for charging a criminal rate of interest. This presumption, if true, is problematic in that under the standard tenets of criminal justice, the kind or nature of the offender should not be a factor in determining who should be held accountable for breaching any section of the Criminal Code. If the elements of an offence are satisfied, the system should not arbitrarily weed out

offenders who appear “mainstream” while sticking prosecutions to only those who appear “criminal”. The nature and personality of the accused should only be a factor for consideration by the court post-conviction, upon sentencing.

Some High Rates are Justifiable

The Criminal Code should not be used as an instrument to interfere with the capacity of parties to make sound loan contracts based on reasonable risk factors. It is reasonable for lenders to charge higher costs to borrowers who are higher-risk. High-risk borrowers may very well attract interest rates of 20, 25 or even 30% or higher once all costs and fees have been taken into account. This is particularly true, with short term loans, such as bridge loans or smaller principal loans, where closing costs such as a lawyer’s conveyancing fees are no cheaper despite the smaller principal amount. For instance, a friend who lends another friend the sum of $10 and receives repayment of $11 the following week is actually engaging in criminal conduct, as the APR is over 500%. In another example, a 90 day bridge mortgage for $20,000 with standard appraisal fees ($500), loan fees ($1,000) and conveyancing fees ($3,000) without any contractual interest being charged, results in an APR of well over 100%. In BC, the Court of Appeal in one recent case found that a mortgage with an APR of 92% was merited given the dodgy track record of the borrower, who happened to be a developer but used those funds to build 172 homes, which contributed to the much needed housing stock in the Vancouver Lower Mainland. The interest rate in this particular case was read down to the permitted criminal rate ceiling of 60%. The real paradox of section 347 is that it is permissible for loan sharks to coerce the repayment of a loan with an APR of 59%, while a commercially justified rate of 61% is deemed criminal.

Unintended Consequences

The criminal treatment throughout history of a number of high demand goods and services, such as alcohol, drugs, and prostitution, has demonstrated that criminal prohibitions often serve to drive access to those goods and services underground in a black market. Similarly, prohibitions on accessing high cost credit will only embolden unregulated lending and loan sharking through an underground credit market. This is certain to put consumers at extreme risk by offering no consumer protection other than from the possibility of the Attorney General authorizing a prosecution under the underutilized and problematic section 347.

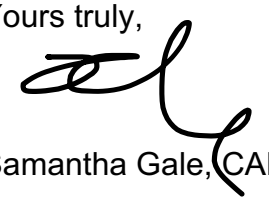
Conclusion

In Canada, the scant but arbitrary criminal enforcement of section 347 begs policymakers to review whether the provision should be removed from the Criminal Code as it serves no real criminal law purpose. Lowering the criminal rate of interest defeats the stated intentions of section 347 to protect the public from loan sharking and churns criminal law into some form of ineffective consumer protection legislation, while eliminating needed loan products from the reach of consumers. Borrowers seeking to rely on section 347 must proceed to the civil courts armed with expensive actuarial

evidence to extricate themselves from the criminal elements of their loan. This is hardly a process which small personal loan consumers, burdened with debt, can readily undertake. In addition, prosecutorial practices can readily change - lowering the criminal rate in section 347 would, despite current practices to seldom enforce it, put all lenders unreasonably at risk of criminal jeopardy. This result is untenable in a just and democratic society. A rational approach to protecting consumers from usuary interest rates should entrust current regulators, who are empowered with sector knowledge and modern licensing statutes, to perform their role of protecting consumers from problematic loan transactions.

We appreciate the government's focus on protecting borrowers and make the above comments in furtherance of this goal. Thank you for the opportunity to provide comments on this important subject. Please know that we are available to discuss these issues more fully if you wish.

Yours truly,



Samantha Gale, CAPL CEO