Executive Summary

Payday Lending in Manitoba: A Mature Industry with Chronic Challenges

By

Jerry Buckland, PhD

&

Gail Henderson, SJD

Date: 21 March 2016

Table of Contents

Introduction

Payday lending in Manitoba, as with other jurisdictions, has been a contentious business. On the one hand, thousands of Manitobans take advantage of this short-term credit option; many find it convenient and the service friendly. On the other hand, compared with other credit products, it is expensive, and the model, critics claim, leads some borrowers to repeatedly take out the two week loans. This study examines payday lending in Manitoba from a number of angles, including the industry's finances, physical locations, and pricing and practices; how consumers are affected by payday loans at the national and local levels; and what some mainstream Financial Institutions are doing with respect to establishing alternative loan products to payday loans.

The evidence and analysis in this report come from an interdisciplinary team of academics and researchers from Economics, Finance and the Social Sciences more generally. They apply different methods to assess the Manitoba payday lending sector. The purpose of the research is to attempt to understand better the industry, the product, and the impact of the product on the consumer. The approach that was taken was to look for data that could assist us to determine if payday loans are contributing to the public good or, conversely, are there data that suggest that they are contributing to social harm. The research was prepared by these specialists for a coalition of consumer organizations that are interveners in the upcoming Public Utilities Board hearing on payday lending regulations. The mandate of the hearing is to review the current regulations relating to rate caps and maximum loan amounts to determine if they are working for the public good. The research conducted for this project, therefore, focused on this question, with particular attention paid to the good of the consumer, as this is the group represented by the interveners.

The data on payday lenders and consumers of payday loans is limited, unfortunately, which makes it difficult to draw conclusions about the overall social utility of these loans. This problem applies to payday lending on both a local and a global scale. In particular, there is a lack of data on internet payday lenders, which, as Professor Chris Robinson notes in his report (Tab 3), makes it difficult to incorporate into the assessment of a just and fair fee for payday loans in Manitoba. One of the main conclusions we draw from the reports summarized here, therefore, is the need for further research on the payday loan industry and the circumstances and experiences of payday loan consumers.[1] The planned web-based survey of payday loan consumers by the Financial Consumer Agency of Canada will assist in completing this complex puzzle.

The existing evidence suggests a) that a $15 per $100 fee is appropriate and feasible; and b) that repeat borrowing is harming vulnerable consumers, and that regulation to address this particular concern is urgently needed. Our report recommends requiring payday lenders to offer repayment by installment. This recommendation is discussed further below.

Based on the evidence gleaned in our study, the "consumer" the Public Utilities Board is concerned with in this hearing is likely to be low-income and low wealth and does not own a major asset such as a house. Although there is some evidence of increased use of payday loans by middle-income consumers, an increasing number of payday loan consumers are borrowing – and repeatedly borrowing – against a non-employment source of income, such as a CPP cheque. These consumers are less likely to have access to other forms of credit, such as credit cards. The highest completed level of education of payday loan borrowers is likely to be high school.

Nationally and in Manitoba, it appears that Aboriginal People are over-represented among borrowers. Quantitative analysis of national survey data indicates that individuals who identify as aboriginal are over-represented among payday loan borrowers. This appears to be supported by the number of respondents to a survey conducted in Winnipeg for this research project – 48% of 130 respondents.

Payday loan consumers are likely to use payday loans to cover necessary expenses – food, rent, utilities and clothing – between payments of their main source of income. They appreciate the convenience and friendly service provided by payday lenders. They understand that these are high fee loans, but they may not understand exactly how high these fees are as calculated using an annual percentage rate ("APR"). The lack of understanding of APR and the effect on consumers' ability to compare the cost of payday loans to other credit products is evidenced in the focus groups conducted for this research project (**Tabs 6A and 6B**).

An overarching concern that arises from the reports summarized below is that the consumers engaged in the most problematic use of payday loans, who are repeatedly borrowing one loan after another, are extremely financially vulnerable in the sense that their income is insufficient to cover their basic needs. Based on the existing literature for Canada and the US, and the attached reports, it is clear that a significant proportion of payday loan borrowers are

[1]This research likely has implications beyond the payday loan industry to the adequacy of existing social assistance programs and may point to the need for a guaranteed minimum income.

using payday loans to cover regular, basic expenses, such as their utilities bill. Their budgets are so tight that repaying the payday loan leaves them short for the month, forcing them to take out another loan, and leads to a cycle of borrowing. Some payday loan borrowers are taking out one or more payday loans each month (see Tab 6). Because their budgets are so constrained, they may focus on restricting the amount and duration of the loan over the cost of borrowing, a practice behavioural economists label "tunnelling" (see Tab 2). There is a concern that this group of repeat borrowers is increasingly made up of those who rely on non-employment sources of income, such as social assistance, and may include an increasing number of older Canadians (Tab 4). Again, however, more data is needed.

Professor Chris Robinson recommends requiring payday lenders to offer borrowers the option to convert a payday loan into an installment loan at the first due date (see Tab 3). There is ample support for the need for this type of regulation from this research project. Providing for repayment by installment over a longer period of time would, as one participant in one of the two focus groups conducted stated, provide "a light at the end of the tunnel" and a chance to end to the cycle of repeat borrowing. As evidenced by the Small Loans Workshop (Tab 9), credit unions are working to offer small loans that are repaid over a longer period of time; however, these are not widely-available currently and **none are available in Manitoba**.

The Executive Summary is organized as follows: First, we describe the research methodology of the research project. Second, we provide a brief summary of the existing academic literature on payday loans and their use by consumers. Third, we describe the financial analysis of the payday loan industry. Fourth, we describe the studies of the consumer experience of payday loans in Canada – who uses payday loans, how they use payday loans, why they use payday loans and how they feel about payday loans. Fifth, we summarize the evidence with respect to the mapping of payday lenders in Manitoba. Finally, we summarize a workshop discussion focused on exploring alternatives to payday loans.

Research Methodology

The research for this project was undertaken by an interdisciplinary team of experts that brings together different analytical and methodological tools. Interdisciplinary research has become one of the most effective ways to study social problems and programs. It enables in-depth disciplinary analysis and broad-based interdisciplinary examination. The principal methods used to generate and analyze the data are from Economics, Finance, and the Social Sciences more generally. The methodologies used include econometric analyses (probit regression), financial analyses (comparing payday lender density across jurisdictions with different rate caps), and field research and analyses (survey, interview, focus groups, pricing and practices assessment).

One of the challenges in doing research on commercial businesses is that data about their operations such as revenue, costs, and returns are limited. Moreover, national level data on the impact of payday lending on consumers are limited to a small number of questions in two national surveys. The data for this study relied on these limited data and on data collected by the research team through field research.

The research for this report comes from primary and secondary sources and, with regard to primary sources, we follow a mixed methodological approach. The mixed methodological approach is one of three broad methodologies used in the social sciences, the other two being the scientific approach and the qualitative approach. It is a relatively new methodological school having roots in the 1980s in a variety of social science disciplines including Sociology, Geography, Anthropology, and International Development.[2] However, it is a practical research approach that pre-dates this in that it has been used in applied areas such as program evaluation for many years.

At a philosophical level, the mixed methodological approach is rooted in both the 'realist' approach associated with the scientific method and the 'interpretation' approach associated with the qualitative method. As the name suggests, it uses both quantitative and qualitative methods to examine social problems and projects. The rationale for using both types of methods is that qualitative methods are best suited for endeavors such as deep engagement with small numbers of people on particular topics, which can lead to new insights and theories.

Quantitative methods are best suited to confirm hypotheses and to measure the magnitude of known causal relationships. Using both types of methods can boost the research project's ability to understand real people and their situations, to gain accurate measurements of the strength of causal factors, and can therefore lead to new insights. While one mixed method

[2] John W Cresswell & Vicki L. Plano Clark, *Deigning and Conducting Mixed Methods Research*, 2nd ed, (Thousand Oaks, US: Sage Publications, 2011); Jeremy Holland & John Campbell, eds., *Methods in Development Research: Combining Qualitative and Quantitative Approaches* (Warwickshire UK: Practical Action, 2005); Abbas Tashakkori & Charles Teddle, eds., *Handbook of Mixed Methods in Social & Behavioral Research* (Thousand Oaks US: Sage Publications, 2003).

cannot generate high levels of validity and reliability, the use of triangulation, whereby two or three different methods are used to examine the particular issue, can enhance these features.

This research project relies on quantitative methods including the financial analysis undertaken of the payday lending industry (Tab 3), and the econometric analyses of two iterations of two major national surveys (Tabs 4 and 5). This project also relies on qualitative methods in the form of a survey and follow-up interviews and focus group discussion (Tab 6). We have also used a combination of methods to collect data about payday lender locations, pricing, and practices (Tabs 7 and 8).

Summary of the Literature (Tab 2)

Payday loans are a relatively new credit product that are unique in that they are very short term, two-week, loans that are tied to the borrower's future receipt of a payroll, or, in some cases, a government cheque. Available data suggests the industry started in the late 1990s/early 2000s and rapidly grew through the mid-2000s but its growth has slowed more recently.

Modern payday lending has its roots in the US in the 1990s and began in Canada in the early 2000s. It grew rapidly in Canada in terms of the number of outlets through the mid-2000s, and some evidence suggests it is still growing in the US. Despite being a relatively new financial product, the payday loan industry could be described as mature: it appears that if there is growth, it has slowed from when the industry began. Other evidence of maturity is its expansion to other countries, including several in Europe and some global South countries such as South Africa. Moreover, the industry is consolidating within a corporate framework in which additional related services are added to their product offering, taking advantage of economies of scale (larger size reduces per unit costs) and scope (more products spreads costs out over more revenue streams).

The maturation of the industry has not weakened the voice of its critics in the US and elsewhere. Payday lenders face chronic criticism from opponents who find ethical, economic, and social problems with the industry. Particular areas of critique relate to the location of the outlets in predominantly low-income neighbourhoods, the high fees charged for the loans, the reliance on repeat borrowers, and the use of internet payday loans. The voice of payday loan opponents in the US is particularly strong. Evidence from the US finds that the impact of payday loans on the average consumer is still unclear, but there is evidence that the impact of payday loans on the repeat borrower is problematic, particularly if they are underbanked, i.e., a person with minimal bank products like an account, but lacking access to other bank services, such as a credit card or line of credit.

Studies have examined who uses payday loans and the findings are that its clients include low-income through modest-middle income to middle income consumers. One common group is underbanked people who have few credit options. Another common group is the over-indebted, those who have access to credit from mainstream financial institutions ("FI"), but have 'maxed out' this source of credit. Recent studies of payday loan consumers find that some consumers may not be acting in their own self-interest in taking out payday loans; rather, they are harming themselves by using payday loans. For example, scarcity of financial resources can cause consumers to focus on the short-term at the expense of the long-term, described as "tunneling". Payday loan advertising can contribute to irrational behaviour by describing the product in a way that downplays the size of the fees.

A smaller number of studies have examined online payday lenders. US studies estimate the online payday market at one quarter to one third of the total payday loan market. The limited data on consumers of online payday loans indicate that they tend to be younger, higher-income and better educated than in-store consumers. The main concern with online payday lenders is the challenge in enforcing local regulations regarding licensing and disclosure. One US study found a higher number of consumer complaints regarding online payday lenders compared to storefront lenders. Some online payday loans are structured to encourage repeat borrowing.

Repeat borrowing has been identified as a major issue in the US, so much so that the US Consumer Financial Protection Bureau is exploring major new regulations that will either limit the number of loans or require underwriting of loans. Caskey (2010) notes that almost one-fifth of California borrowers took out 15 or more loans in a 1.5 year period, while the Pew Charitable Trusts (2012) research on payday lending finds that repeat borrowing is the norm, not the exception in payday lending in the US. The Pew study noted that for states with a $15 per $100 rate, a new borrower must take out 4 to 5 loans before the payday lender generates a profit on that borrower.

In Canada the data that are available demonstrate repeat borrowing is a problem. Data from the regulators in British Columbia and Nova Scotia found repeat borrowing common. In BC, the average borrower in 2014 had 4.3 loans and the number with more than 15 loans in that year increased by 34%. In Nova Scotia for 2013-14 it was found that 52% or all payday loans were repeat loans. National data results on repeat loans are discussed further below.

In terms of the impact of regulation on the payday loan market and consumers, the Pew Charitable Trusts undertook a major research project in the US. The Pew Charitable Trusts (2012) investigated this question using their nationally representative dataset in which almost 50,000 people were screened through an omnibus survey leading to 451 participants of a full-length survey and eight focus groups specifically on payday lending. They explored the question of how state regulations affected payday loan use.[3]

They found that in states with restrictive regulations people do not increase their use of online payday loans or other fringe banks products (Pew Charitable Trusts 2012, p.22-24). States with more restrictive regulations have fewer payday loan outlets and people simply use fewer physical and online fringe bank loans. Pew Charitable Trusts found that where payday loans were not available people cut back on expenses, delay paying some bills, borrow from friends/family, and/or sell or pawn personal possessions (Pew Charitable Trusts 2012, p.16). The Pew Charitable Trusts study revealed that the majority of payday loan customers want more regulation of payday lending (Pew Charitable Trusts 2013, p.47-50).

Economic Analysis of the Payday Lending Industry in Canada (Tab 3)

The economic analysis of the Canadian payday lending industry is based on direct and inferential data due to limited access to data about the industry. Data sources include annual reports (e.g., DFC Global's 2013 10K Report), US data, and some provincial level data where regulation requires its collection. Analysis is undertaken using basic financial indicators and tools, such as comparing outlet density across jurisdictions with different regulated rate caps to infer underlying profitability. This economic analysis concludes that a rate cap of $15/$100 will permit payday lenders to earn a fair rate of return.

The industry in Canada is made up of approximately 1,500 outlets which provide approximately $2.5 billion in loans each year, for an average of $1.67 million loaned per outlet per year, prior to the exit of Cash Store Financial from the industry. This implies that the average outlet, beyond its cheque-cashing and other services, provides ten loans per day, suggesting a

[3]For their study the Pew Charitable Trusts categorized U.S. states into 3 categories: (1) Twenty-eight 'permissive' states, where most Americans live, where the payday loan rate caps are greater or equal to $15/$100; (2) 'Hybrid' states where rate caps are approximately $10/$100, there are restrictions on the number of loans each borrower can take, and sometimes borrowers are allowed to repay the loan over several pay periods; and (3) 'Restrictive' states where the rate cap is placed at 36% APR, and payday loan storefronts are not found (Pew 2012, p.20).

small volume of business per outlet.

The industry in Canada is highly consolidated in the three largest payday lenders, National Money Mart, Cash Money and Cash4You, which have grown substantially in the last three years. National Money Mart operates 40% of all outlets and is probably responsible for half of the loan volume in Canada. This is in part due to consolidation of the industry through National Money Mart's purchase of a large part of the Cash Store/Instaloans network, closing some stores and rebranding others. Cash Store Financial's rapid expansion in 2010-12 and bankruptcy in 2014 may explain the recent dip in the number of outlets. The continued strong presence of National Money Mart and other national lenders, in the face of Cash Store Financial's bankruptcy, suggests that the business is profitable at current rates. Furthermore, LoneStar's takeover of National Money Mart's parent company, Dollar Financial, is evidence of this company's profitability, of which the Canadian operation is the largest and most profitable.

With respect to their business model, payday lenders share a number of characteristics: they require little capital (unlike mainstream FIs) and hence low barriers to entry; their costs are mainly fixed operating costs, meaning that profits change a great deal with changes in volume of business; they have limited economies of scope compared with mainstream FIs – only two business lines make a significant contribution to their profitability, payday loans and cheque cashing. Payday lenders benefit, however, from economies of scale through national advertising and common computer systems.

Recent evidence suggests a very large increase in internet loans, although verifiable data is scarce. In Manitoba, the consumer must visit a storefront payday lender to complete the transaction. The lack of data makes it difficult to incorporate into consideration of rate caps and fair rate of return. On the one hand, loan losses from internet loans are likely to be higher. On the other, operating costs – the main cost for storefronts – will be lower.

There is evidence that the industry, to be viable, relies on repeat borrowers. As might be expected, the costs of lending to a repeat borrower are substantially lower than to a first-time borrower; a report by Ernst & Young concluded that the "long-run survival of a payday loan operator will depend on achieving a steady repeat customer business." Data on repeat borrowers come from national surveys and inferential data, but because of gaps in the data, there is better evidence for the US than for Canada. Analysis of loan volume suggests that repeat borrowers may have under-reported their payday loans in response to the national surveys discussed in the reports at Tabs 4 and 5 and summarized in the next section, below.

We recommend lowering the rate to $15/$100. Based on evidence from the US, where there is a larger variation in rate caps, efficient payday lenders are able to operate with a $15/$100 cap. In Canada, payday lenders invariably charge fees at the rate cap, meaning that competition among payday lenders does not eliminate economic rents – that is, profits above what a payday loan operator would expect in a competitive market. This is likely due to the characteristics of most payday loan borrowers, including their lack of access to or marginalization from mainstream FIs.

In addition to recommending a reduction in the rate cap to $15/$100, it is recommended that the regulator require that payday lenders, under certain circumstances, offer an installment repayment option to borrowers who are struggling to repay. Requiring payday lenders to offer this option likely would benefit consumers more than a reduction in the 30% of income borrowing limit. From the point of view of the payday lender, it has already recovered its fixed operating costs through the high fee charged on the initial loan. The US state of Washington has an installment repayment option and although having such a requirement decreases payday lender profits, Washington still has an active payday loan industry. An alternative to this would be to require that payday lenders underwrite their loans, but since this is not within the PUB's mandate we have not included this as a recommendation.

Canadian Consumers' Experience of Payday Loans

Who Uses Payday Loans and How They Use Them (Repeat Borrowing): Econometric Examination of Payday Loan Consumers (Tabs 4 and 5)

Statistics Canada administers two national surveys that include questions about payday loan use by consumers: the Survey of Financial Security (SFS) (2005 and 2012) and the Canadian Financial Capability Survey (CFCS) (2009 and 2012). The SFS is intended to examine financial behaviour and status while the CFCS is intended to examine the financial literacy of the Canadian population as a whole. A small Manitoba sample was identifiable from the SFS but not the CFCS. The quality of these surveys is high but the number of questions related to payday lending is limited. This is why the Financial Consumer Agency of Canada is currently undertaking a nation-wide web-based survey of payday loan users (Personal Communication).

Standard econometric analysis was undertaken using the *probit* regression model[4] with each of the two datasets separately. The purpose of the regression[5] analysis was to understand correlates and characteristics of payday loan consumers.

Results from the surveys confirm previous findings that payday loan borrowers are mostly lower income households compared to non-borrowers, but are not the poorest households. Results from the CFCS suggest a slight increase in non-poor users of payday loans but results from SFS found no increase. Results from both surveys for both years found that assets and liabilities were lower for payday loan borrowers as compared with non-borrowers. Borrowers are less likely to be home owners compared with non-borrowers. According to results from the CFCS analysis, the percentage of payday loan borrowers using credit cards is up from 2009 to 2014, but SFS assessment shows borrower use of credit cards is considerably lower than non-borrower use, and regression analysis demonstrates that households using credit cards are significantly less likely to use payday loans.

Payday loans, by their title, are intended to be used by the employed, who are able to borrow against their next paycheque; however, they are also provided to people receiving other types of payments such as CPP and Child Tax Benefits. Data from the SFS suggests that non-employment sources of payday loans increased from 2005 to 2012: the percentage of payday loan borrower households whose main source of income was wages and salaries dropped by 4.6%, while the drop for non-borrowers was only 2.7%. The CFCS survey also suggests that repeat borrowing by borrowers relying on non-employment income is increasing.

In terms of other correlates with payday loan use, payday loan users are more likely to be Aboriginal People: according to the CFCS, just over 15% of borrowers are Aboriginal People compared to 4.2% of non-borrowers. Payday loan consumers have lower education levels than non-borrowers, but both datasets found that this gap declined between the two surveys.

The SFS analysis found that gender of the major household earner is a factor affecting probability of payday loan use. In 2005, female major income earner households were over-represented as compared to male ones in the payday loan borrower sample. This continued into

[4] A probit model is a form of regression analysis that is appropriate when there are only two outcomes of the dependent variable (borrowing or not borrowing).

[5] Regression analysis refers to a statistical technique that attempts to determine the strength of the relationship between one dependent variable (in this case, the incidence of payday loan borrowing) and a series of other independent variables (in this case, characteristics of payday loan borrowers). It provides an estimate of the impact and statistical significance of a single independent variable on the likelihood of payday loan borrowing aside from the impact of other independent variables.

2012 but the gap diminished.[6] The age of the major income earner is also a factor with the SFS indicating that the major income earner was younger for borrower families in both 2005 and 2012. While sample size is small in the SFS, households residing in the province of Manitoba are more likely to take a payday loan compared to households residing in the rest of Canada.

With respect to how Canadian consumers use payday loans, the CFCS provided some evidence with respect to repeat borrowing (Table 1), but more research on this phenomenon is urgently needed. The analysis found that users taking out only one loan remained steady over the period, the share of users taking out 2 payday loans increased and the share of consumers taking out 3 or more declined. As noted above, however, financial analysis of loan volume in Canada (Tab 3) suggests that the survey data underestimates both the frequency and the number of repeat borrowers; in other words, responders to the survey might be under-reporting their frequency of payday loan use. There also is a concern that surveys generally under-represent Canadians with low incomes. What the survey data does show is that a growing percentage of repeat borrowers belong to households relying on social assistance: these households constituted 30% of those taking three or more payday loans in CFCS 2014 compared to only 18% in CFCS 2009. In addition, a larger proportion of payday loan users cited public retirement income (CPP/QPP/OAS/GIS) as their principal source in 2014 compared to 2009.

Table 1. Repeat borrowing among CFCS sample, 2099 and 2014

	All Borrowers		Borrowers reporting public retirement income (CPP/QPP/OAS/GIS)	
	CFCS 2009 (%)	CFCS 2014 (%)	CFCS 2009 (%)	CFCS 2014 (%)
Only one payday loan	27.6	23.4	12	18
Two payday loans	26.8	57.0	18	33
Three or more payday loans	45.6	19.6	4	15

Overall, analysis of the SFS identified lower income and wealth, a lower level of education, use of credit cards, home ownership, the number of earners, and age of the major income earner as key determinants of payday loan borrowing (Table 2). Analysis of the CFCS

[6] The male and female shares (payday loan respondent to non-borrower respondent) in 2005 were 0.82 and 1.29, respectively, and these shares were 0.94 and 1.09 in 2012.

dataset reached similar results: lower household income, lower assets, employment, lower education, younger age, unmarried individuals, and financial responsibility for children were identified as key determinants of payday loan borrowing. These factors increase both the likelihood of borrowing and the likelihood of repeated use of payday loans, even when other factors are considered in regression analysis.

Table 2. Summary of the Variables that Raise the Probability of Payday Loan Use, by Dataset

Variable Type	SFS	Relationship	CFCS	Relationship
Economic	Income and wealth	Negative	Household income, household assets	Negative
	Credit card use	Negative	Employment	Positive
	Home ownership	Negative		
	Number of earners in household	Positive		
Social	University degree of the major income earner	Negative	Some university	Negative
	Age of the major income earner	Positive	Age	Negative
			Unmarried individuals	Positive
			Financial responsibility for children	Positive

Note: 1) 'Positive' means a positive relationship between the variable and payday loan us, i.e., SFS found that as credit card use increased, so did payday loan use; 2) 'Negative' means a negative relationship between the variable and payday loan use, i.e., CFCS found that payday loan use was more likely among people with lower income and assets.

How and Why Consumers Use Payday Loans and How They Feel About Payday Loans and Payday Lenders: Field research (Tab 6A and 6B)

Between November and March, field research was conducted for this research project, made up of a survey, semi-structured interviews and two focus groups. Individuals qualified for the survey if they had taken out a payday loan in the past twelve months. Interview and focus group one participants were recruited from survey respondents. Respondents for focus group two were recruited from a separate pool of people. The use of three methods is a common means within a mixed research methodology approach to enhance validity and reliability of the results.

The 24-question survey was administered online (21 responses) and in-person at various payday loan outlets and community organizations in Winnipeg (109 responses). Forty-eight per cent of the survey respondents identified as Aboriginal. Forty-eight percent of survey respondents used their payday loans for necessities, including food, rent, utilities and clothing. Thirty-one per cent of respondents had taken out seven or more payday loans in the past twelve months. The top three reasons for repeated borrowing were unexpected expenses, inability to pay back the payday loan and still meet current expenses, and emergencies. Sixty-five per cent of survey respondents did not know the annual interest rate (APR) on their last payday loan.

The interviews focused on repeat borrowers. Nine interviews were conducted. Seven of the interviewees had taken out one or more payday loans *per month* in the past twelve months. Six interviewees heard about payday loans from a friend or family member who told them it was a 'quick and easy' source of money. Interviewees liked payday loans for the convenient hours and location. Interviewees elaborated on their use of payday loans for necessities, explaining that they used payday loans to cover expenses between income payments, including from government sources, or to cover expenses during seasonal layoffs from work. One interviewee reported using payday loans for the first time after an injury, and another to pay the Manitoba Hydro electricity bill.

Repeat borrowing was necessary when the payday loan was due at the same time as other bills, or because repaying the first payday loan left the interviewees short of money for other expenses. One interviewee explained that he used repeated payday borrowing to maintain his desired lifestyle. Interviewees who take out at least one loan per month reported that payday loan employees who recognized them would waive fees for missed payments or extensions. On the other hand, another interviewee spoke of difficulties fixing an automatic withdrawal error.

A third of the interviewees understood the APR on their payday loans and these represented the most frequent users among the interviewees. Generally, interviewees were aware of the risks of relying on high-fee payday loans, and reported pushing back payday lenders' offers of larger loans or other products. They reported that attempts to obtain credit from mainstream FIs failed because the FIs offered more credit than they needed, or because of prior bankruptcy. Interviewees also discussed their negative customer service experiences with mainstream FIs in contrast with payday lenders. Some interviewees spoke of avoiding credit cards, even prepaid ones, due to prior bad experiences. These practices of focusing on loan amount and avoiding lower interest rate credit cards might represent examples of "tunnelling" behaviour, discussed above.

Respondents thought that payday loans were accessible. For instance once client commented that they were available 24 hours a day and noted that in terms of location they are "all over."

Two focus groups were undertaken to explore payday loan clients' views regarding other small loan products, which might serve as alternatives to payday loans. There were 7 and 9 participants, respectively, in focus group one and two. Each group was diverse in terms of socio-economic indicators, including age, ethnic background, income, and employment.

In the process of investigating different small loan models we found that some payday loan clients prefer the current Manitoba payday loan while others prefer other options, most notably the Vancity Fair and Fast loan (see Small Loan Workshop Report for description). In some cases people used payday loans infrequently and in other cases participants used them frequently. We heard stories of participants being harmed by payday loan dependence and stories of participants who were helped by using the loans in a strategic fashion. In both cases the evidence supports the view that consumers demonstrate bounded rationality, i.e., behaviour inconsistent with that assumed by neoclassical economics.

Many focus group participants in both sessions explained that for them there were few alternative loan products currently available that they viewed as meeting their needs. Some of them were unable to get credit from mainstream banks, due to bankruptcy, poor or no credit rating. For some of these participants, friends/family and pawn loans were one of the few options for these underbanked people. However relationship-based loans and pawn loans are small as compared to payday loans. Also, pawn loans require depositing a household item with the pawnbroker.

Some respondents noted that due to the high cost of repaying the loan they fell into a dependence on payday loans. Two participants from focus group two who took out at least twelve payday loans per year struggled with addiction issues. They noted that the consequences of their personal and financial struggles were bankruptcy or accumulating unrepayable debt. For these participants, payday loans were not helping them, but were delaying their need to address personal and financial issues. Moreover, the accumulation of unrepayable debt added an additional challenge.

Other borrowers did not take out as many loans, perhaps 3 to 6, and referred to other reasons for using the loans, such as convenience and ease of accessing them. Some of these focus group respondents talked about using payday loans in a more strategic way in that they limited the number of loans they would take and these funds would be devoted to certain items, e.g., paying particular bills, or for emergency purposes. One respondent in the second focus group explained that she had adequate savings to pay for bills, but preferred to use payday loans for some bills in order to keep her savings intact. This approach to using payday loans is consistent with 'mental accounting,' a term used in behavioural economics, associated with a bounded rational strategy undertaken by individuals facing constraints. Rather than seeing money as perfectly fungible it is understood to fit in different categories, e.g., employment income, benefit income, emergency expense, gift expense.

The principal purpose of the focus groups was to explore participants' views about alternative financial products. The first focus group involved four different options plus the 'common' Manitoba payday loan, for a total of five models. In order to gain more insight on participants' views on the basic concept behind these models a second focus group was held which presented two models plus the Manitoba payday loan for a total of three models. The results of both meetings were instructive.

Participants in both focus groups sessions were asked about their interest in the Colorado 6-month installment payday loan and the Vancity 12 to 24 month installment Fair and Fast loan. Several respondents in the second focus group were quite interested in the Vancity loan because of its longer term and lower annualized interest rate. They felt that this loan would be easier to pay off because of the installment plan and the lower fees. Some participants in focus group one thought that the 17% fee for the Manitoba payday loan was the APR and so thought that the Vancity loan, at 19%, was more expensive. Thus, some focus group one participants preferred the Manitoba payday loan over the Vancity loan because they thought it was cheaper.

In both focus group meetings there were participants who preferred the short term one-time repayment for reasons such as: 'less worry,' 'pay it off and be ok for a little bit.' Other participants in focus group two talked about 'not trusting' oneself with a larger or longer-term loan. For them the small-sum and short-term loan offered them the discipline to limit their borrowing. Once again these strategies seem consistent with a bounded rational strategy in which people are making decisions with limited information, time, and self-control. For them there is a benefit to short-term one-time repayment so that this product is worth the cost. The focus on the short-term is not always a choice, but rather may be the result of getting into a cycle of repeat borrowing. One focus group participant who relies on two different payday lenders each month spoke of his financial planning becoming "extremely short-term."

In focus group one, participants were asked what types of changes they would like to see with payday loans. In some cases participants said that they would like the interest rate to be reduced. Other participants wanted a more flexible repayment plan including allowing an extension on the repayment deadline by a few days to six months. Other participants called for mainstream FIs to offer small loans.

Prices & practices (Tab 7)

The research project included a limited investigation into the information provided by storefront and online payday lenders to potential consumers. This investigation was conducted through phone and in-person interviews with payday lender employees, and by reviewing payday lenders' websites. The interviewer identified himself as a researcher for the Public Interest Law Centre. Further research is needed to gain a better understanding of consumers' experience of the application process, and what information they are given about the payday loan.

All payday lenders reviewed conform to the regulated cap of $17 per $100 borrowed and the maximum amount of 30% of income. Money Mart, the dominant payday lender, does not display the APR in the store, although it does online. Two storefront payday lenders clearly displayed the $17 per $100 fee and the APR. One payday lender employee stated that they do not disclose the APR unless the consumer specifically asks; an employee of another lender stated that it is not necessary to disclose APR. One online lender provided a warning about the high cost of payday loans, and disclosed the APR; however, they also state that "you are not borrowing money for an entire year". Another online lender did not provide information on fees until the consumer has finished filling in the loan application.

This study also reviewed practices regarding the kinds of cheques against which payday lenders were willing to provide loans on and the information they required from the consumer. Almost all lenders reviewed will loan on non-employment sources of income. Almost all lenders asked customers for their social insurance number.

Payday Lender Outlet Mapping (Tab 8)

The project mapped payday loan locations in Winnipeg from 1994 to 2015 in order to help to determine the characteristics of consumers at which payday loans are aimed and who are more likely to access payday loans (Table 3). The maps were generated for every four years from 1994 to 2010 and then from 2010 every year to 2015.

The mapping exercise found that the number of outlets in Winnipeg peaked in 2008 and 2009, with 64 outlets, and has declined since then, particularly between 2009 and 2012, to 27. The decline in the number of outlets from 2008 to 2015 is most marked before 2013 and that decline is partly related to the closure of Rent Cash Financials Cash Store and Instaloans outlets and the consolidation in the industry after the initial enthusiasm regarding the profit earning potential of payday lending.

Table 3. Payday Loan Outlet Numbers in Winnipeg, by Inner-city or Suburb Location, 1994-2015

Year	Inner-city	Suburban	Total
1994	3	0	3
1995	5	0	5
1996	5	0	5
1997	5	0	5
1998	6	0	6
1999	5	2	7
2000	6	2	8
2001	7	8	15
2002	13	10	23
2003	14	11	25
2004	18	16	34
2005	24	20	44
2006	24	22	46
2007	27	25	52
2008	27	37	64
2009	28	36	64
2010	21	32	53
2011	21	32	53
2012	21	25	46
2013	13	14	27
2014	12	14	26
2015	13	14	27

Alternatives to Payday Loans: Small loans workshop (Tab 9)

As a part of the research for this project a one-day workshop was held in January with representatives of a number of Canadian credit unions and credit union industry associations, and financial inclusion researchers. The purpose of the workshop was to examine existing small loan offerings by credit unions and to discuss obstacles and opportunities to providing small loans more broadly. The reason for working with credit union representatives is because they are the source of the three current small loan projects in Canada, and there are indications that they may do more work in this field.

The workshop examined three existing small loans programs, and considered other opportunities such as new technologies, crowd sourcing, and peer-to-peer lending. The three products examined were Vancity credit union's *Fair & Fast Loan*, First Calgary credit union's *Cash Crunch Loan*, and the Desjardin Federation's *Co-opme Loan*. These small loan products vary in their administrative and product features. The Vancity product is designed to replicate the speed of a payday loan, but is 12 to 24 months in duration and repayment is by installment. The First Calgary and Desjardins Federation loans are geared more for people who want to move out of reliance on payday loans.

The workshop also examined obstacles that prevent other FIs from offering these types of products. Obstacles identified included finding ways to deliver the product quickly; ensuring the market and the products are financially viable; determining the target clientele; accessing data about the payday loan business and their clientele; addressing the credit history of prospective clients; and delivering good customer service.

Participants then discussed opportunities associated with the small loans market. These include: forming partnerships among credit unions and between credit unions and community organizations; increasing staff training to improve product delivery; addressing the harmful consequence of taking out many small loans (e.g., payday loan repeat borrowing); using new technologies to streamline the approval process; leveraging the existing mandate of credit unions and FIs to provide banking services to all Canadians; advocating for regulatory changes to create a more conducive environment for small loan products; and accessing capital available to fund these types of products. It was thought that the government should be more pro-active in collecting data about the payday loan industry to better protect and understand consumers.

Conclusion

This report provides as comprehensive a study of the payday lending industry as possible, given the data available currently. It uses a number of analytical approaches and methods that were undertaken by an interdisciplinary team of academics and researchers. The literature on payday lending finds that it is contentious in that opponents have identified characteristics of the product that could be harmful to the consumer, in particular low-income borrowers and repeat borrowers. Given the evidence that unlicensed internet lenders are less likely than licensed lenders to follow regulations, the potential exists for substantial consumer harm; more research on internet lending is therefore needed. The study finds that the industry through its consolidation and apparent slower growth in the province is mature in terms of product innovation cycles. This means that the industry is established in Manitoba and reforms to it will require more evidence to be justified.

Generally speaking, payday lenders price their loans at the rate cap, limit borrowing to 30% of net income, and will provide a payday loan on types of cheques other than paycheques issued by an employer, but they are unable to limit borrowing from another outlet. The mapping exercise found that the number of outlets in Winnipeg peaked in 2008 and 2009, with 64 outlets, and has declined since then, particularly between 2009 and 2012, to 27. In the early 1990s all or almost all outlets were located in the lower-income inner-city, but by 2008 almost 58% were located in the better-off suburbs. The latest data for 2015 finds the inner-city share has risen since 2008 to 48%.

National level data finds that, as compared with non-borrowers, payday loan consumers have lower household income and fewer assets, are less well educated, younger, unmarried and financially responsible for children. Field level research confirmed evidence from national data that a higher ratio of borrowers are Aboriginal People. Non-employment income as the main source of income among payday loan borrowers increased between 2005 and 2012.

Interviews conducted for the study revealed that two-thirds of the interview participants did not understand Annual Percentage Rate. Field level research also explored why people use payday loans repeatedly and it was found that in some cases, paradoxically, it is an attempt to limit the consumer's level and duration of debt. In other words, the consumer is focusing on the small amount and short time frame of the payday loan over the very high fees. The Small Loans workshop conducted for the study provides some indication that mainstream FIs are working on developing viable short-term loan products that will provide consumers with a market alternative to payday loans.