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|---|---|---|---|
| **Document:** | CAC Pre-Filed Evidence, Tab 4, *A Profile of Payday Loans Consumers Based on the 2014 CFCS* | **Page No.:** | 32 |
| **Topic:** | Payday Lending Consumers | | |
| **Subtopic:** | | | |
| **Issue:** | Demographics | | |

## PREAMBLE TO IR (IF ANY):

## QUESTION:

Please provide an electronic link to the 2014 Canadian Financial Capability Survey (CFCS) and indicate where the numbers in the CFCS are used to support Table 9 in Dr. Robinson's report.

## RATIONALE FOR QUESTION:

To assess the reasonableness of the average number of payday loans.

## RESPONSE:

Table 9 in Dr. Robinson's report is based only on our classification of loan frequencies (1, 2 or 3 or more loans) and not on data actually contained in the CFCS data set. We chose to report these classifications of loan frequencies based on question FM_Q04B of the CFCS as described at http://www23.statcan.gc.ca/imdb/p3Instr.pl?Function=assembleInstr&lang=en&Item_Id=201522#qb201580

## RATIONALE FOR REFUSAL TO FULLY ANSWER THE QUESTION:

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|---|---|---|---|
| **Document:** | CAC Pre-Filed Evidence, Tab 4, *A Profile of Payday Loans Consumers Based on the 2014 CFCS* | **Page No.:** | 3 |
| **Topic:** | Payday Lending Consumers | | |
| **Subtopic:** | | | |
| **Issue:** | Demographics | | |

## PREAMBLE TO IR (IF ANY):

Dr. Simpson and Islam note a trend that payday loan use by Canadians in the 55 to 64 age category is increasing.

## QUESTION:

Please provide any information Dr. Simpson and Islam have to explain this trend.

## RATIONALE FOR QUESTION:

To understand factors influencing change in demographics of borrowers.

## RESPONSE:

Our observation of an increased use of payday loan services by older Canadians (55-64) is based solely on our regression analysis, which looks at which factors are correlated with use of payday loan services. Unlike earlier results in Simpson and Bazarkulova (2013) for the 2009 CFCS, we find that those in the 55-64 age category are more likely to take out a payday loan than those in the youngest 18-24 category. This result is also consistent with the finding in the report that public pensions (CPP/QPP/OAS/GIS) are more likely to be a major income source for payday loan borrowers in CFCS2014 than in CFCS2009.

## RATIONALE FOR REFUSAL TO FULLY ANSWER THE QUESTION:

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|---|---|---|---|
| **Document:** | CAC Pre-Filed Evidence, Tab 4, *A Profile of Payday Loans Consumers Based on the 2014 CFCS* | **Page No.:** | 8 |
| **Topic:** | Payday Lending Consumers | | |
| **Subtopic:** | | | |
| **Issue:** | Demographics | | |

## PREAMBLE TO IR (IF ANY):

Dr. Simpson and Islam cite a decline in proportion of borrowers using payday loan services three times or more in the last twelve months: 71.65% in CFCS 2009 and 48.78% in CFCS 2014.

## QUESTION:

Please provide basis for statement made by Dr. Simpson and Islam that the number of repeat borrowers relying on other sources of income must have risen in the period from 2009 to 2014.

## RATIONALE FOR QUESTION:

To understand reasons for conclusion reached.

## RESPONSE:

The observation is that “the proportion of borrowers who used payday loan services three or more times in the last twelve months **and whose principal source of income was wages and salaries** decreased from 71.65% in CFCS 2009 to 48.78% in CFCS 2014” (emphasis added). This implies that “the proportion of repeat borrowers r. . . relying on other sources of income must have risen” i.e. principally those relying on social assistance and public pensions (as shown in Figure 8).

## RATIONALE FOR REFUSAL TO FULLY ANSWER THE QUESTION:

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|---|---|---|---|
| **Document:** | CAC Pre-Filed Evidence, Tab 4, *A Profile of Payday Loans Consumers Based on the 2014 CFCS* | **Page No.:** | 8 |
| **Topic:** | Payday Lending Consumers | | |
| **Subtopic:** | | | |
| **Issue:** | Demographics | | |

## PREAMBLE TO IR (IF ANY):

Dr. Simpson and Islam cite information that households relying on social assistance taking three or more payday loans in CFCS 2014 rose to 30% compared to 18% in CFCS 2009.

## QUESTION:

Please advise if Dr. Simpson and Islam have any information explaining the trend of an increase in repeat borrowing among households relying on social assistance.

## RATIONALE FOR QUESTION:

To understand reasons for changes or trends in borrowing since 2009.

## RESPONSE:

Our results are based exclusively on the reporting in the CFCS and we did not wish to speculate on the underlying behavioural trends. We could add, however, that provincial social assistance caseloads have been rising between 2008-9 and 2013-14 as reported for Ontario and Manitoba by the Canada Social Report (http://www.caledoninst.org/Publications/PDF/1062ENG.pdf), suggesting that social assistance is becoming a more important component of income for low-income households.

## RATIONALE FOR REFUSAL TO FULLY ANSWER THE QUESTION:

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|---|---|---|---|
| **Document:** | CAC Pre-Filed Evidence, Tab 4, *A Profile of Payday Loans Consumers Based on the 2014 CFCS* | **Page No.:** | 6 |
| **Topic:** | Payday Lending Consumers | | |
| **Subtopic:** | | | |
| **Issue:** | Demographics | | |

## PREAMBLE TO IR (IF ANY):

Dr. Simpson and Islam cite a trend of payday lending becoming more common among wealthier households.

## QUESTION:

Please provide any information Dr. Simpson and Khan have to explain this trend.

## RATIONALE FOR QUESTION:

To understand factors influencing changes in demographics of borrowers.

## RESPONSE:

Our results in Figures 1 and 2 reflect our inexact assessment of an increased proportion of payday loan borrowers in the highest (household and personal) income category compared to Simpson and Bazarkulova (2013). On reflection, this may simply be a consequence of natural growth in incomes during the period. We have no explanation for the seemingly high incidence of payday loan borrowing among persons and households with relatively high incomes, who we would expect to have access to mainstream financial services.

## RATIONALE FOR REFUSAL TO FULLY ANSWER THE QUESTION:

| | | | |
|---|---|---|---|
| **Document:** | CAC Pre-Filed Evidence, Tab 5, *Payday Loans Consumer Profile in Canada Based on the Survey of Financial Security* | **Page No.:** | |
| **Topic:** | Payday Lending Consumers | | |
| **Subtopic:** | | | |
| **Issue:** | Demographics | | |

## PREAMBLE TO IR (IF ANY):

## QUESTION:

Please produce 2012 Survey of Financial Security reviewed by authors.

## RATIONALE FOR QUESTION:

To enable review of source document.

## RESPONSE:

The Surveys of Financial Security are available under the Data Liberation Initiative of Statistics Canada (see http://www.statcan.gc.ca/eng/dli/dli) but they cannot be shared in the fashion requested according to Statistics Canada's procedures. That is, our understanding is that anyone wanting a copy of the data would have to make arrangements directly with Statistics Canada Information on the Surveys beyond what we provide in our report is available on the Statistics Canada website at http://www23.statcan.gc.ca/imdb/p2SV.pl?Function=getSurvey&SDDS=2620

## RATIONALE FOR REFUSAL TO FULLY ANSWER THE QUESTION:

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|---|---|---|---|
| **Document:** | CAC Pre-Filed Evidence, Tab 5, *Payday Loans Consumer Profile in Canada Based on the Survey of Financial Security* | **Page No.:** | 5 |
| **Topic:** | Payday Lending Consumers | | |
| **Subtopic:** | Demographics | | |
| **Issue:** | Manitoba Statistics | | |

## PREAMBLE TO IR (IF ANY):

Dr. Simpson and Islam note a finding that the gap between payday loan users and non-users is remarkably lower in Manitoba than in the rest of Canada.

## QUESTION:

Please advise as to whether Dr. Simpson and Islam have any information as to why the gap between payday loan user and non-users is lower in Manitoba than the rest of Canada.

## RATIONALE FOR QUESTION:

To understand demographic context of payday lending in Manitoba.

## RESPONSE:

The household income gap between payday loan users and non-users is lower in Manitoba primarily because the average income of non-users in smaller than the rest of Canada. Household incomes of payday loan users in Manitoba are similar, but slightly lower, than those in the rest of Canada. We have no further information to add to this comparison except to reiterate our caution that "the small Manitoba sample (33 borrowers out of 340 in total) limits the reliability of the results and comparison with rest of Canada (ROC)" (p.2 of our report) and to note that incomes in Manitoba are generally lower than the rest of Canada, e.g. http://careers.workopolis.com/advice/how-much-canadians-are-earning-by-province/

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| **Document:** | CAC Pre-Filed Evidence, Tab 5, *Payday Loans Consumer Profile in Canada Based on the Survey of Financial Security* | **Page No.:** | 6 |
| **Topic:** | Payday Loan Consumers | | |
| **Subtopic:** | | | |
| **Issue:** | Demographics | | |

## PREAMBLE TO IR (IF ANY):

Dr. Simpson and Islam cite information as to the average amount of household wealth among payday loan users.

## QUESTION:

Please explain how household wealth is determined.

## RATIONALE FOR QUESTION:

To understand context of information provided in report.

## RESPONSE:

"This survey provides information of the net worth (wealth) of Canadian families, that is, the value of their assets less their debts. . . The SFS provides a comprehensive picture of the net worth of Canadians. Information is collected on the value of all major financial and non-financial assets and on the money owing on mortgages, vehicles, credit cards, student loans and other debts. A family's net worth can be thought of as the amount of money they would be left with if they sold all of their assets and paid off all of their debts." (http://www23.statcan.gc.ca/imdb/p2SV.pl?Function=getSurvey&SDDS=2620#a1)

## RATIONALE FOR REFUSAL TO FULLY ANSWER THE QUESTION:

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|---|---|---|---|
| **Document:** | CAC Pre-Filed Evidence, Tab 5, *Payday Loans Consumer Profile in Canada Based on the Survey of Financial Security* | **Page No.:** | 10 |
| **Topic:** | Payday Lending Consumers | | |
| **Subtopic:** | Demographics | | |
| **Issue:** | Manitoba Statistics | | |

## PREAMBLE TO IR (IF ANY):

Dr. Simpson and Islam state that households in the Province of Manitoba are more likely to take a payday loan than those in the rest of Canada.

## QUESTION:

Please advise as to whether Dr. Simpson and Islam have any information as to why households in Manitoba are more likely to take payday loans.

## RATIONALE FOR QUESTION:

To understand particular circumstances of Manitoba borrowers.

## RESPONSE:

One might be tempted to suggest that factors such as the lower household and personal incomes in Manitoba relative to the rest of Canada could account for this result, but we would note that our regression results control for income and many other factors and still find that Manitobans are more likely to take out payday loans. Thus, it would appear that there are other, perhaps nonfinancial, factors not captured by the SFS that account for this result.

## RATIONALE FOR REFUSAL TO FULLY ANSWER THE QUESTION:

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|---|---|---|---|
| **Document:** | Pre-Filed Evidence of CAC, Appendix B, *Pew Charitable Trusts Report* | **Page No.:** | |
| **Topic:** | Payday Lending Consumers | | |
| **Subtopic:** | | | |
| **Issue:** | Demographics | | |

## PREAMBLE TO IR (IF ANY):

Dr. Buckland refers to the Pew Charitable Trusts research at various reports in his report, *Payday Lending: A Mature Industry with Chronic Challenges*.

## QUESTION:

(a) Please advise of any distinctions between Canadian and American consumers limiting the application of the findings in the study conducted by Pew Charitable Trusts;

(b) Please explain the basis upon which CAC states the findings in the study of the Pew Charitable Trusts are applicable in the Canadian and Manitoba context.

## RATIONALE FOR QUESTION:

To understand application of Pew's research in the Canadian and Manitoba context.

## RESPONSE:

(a) This is such an important question and challenging to respond to because there are so many factors to consider. I think there are important factors that are similar between Canada and the US and there are important factors that are dissimilar, including in terms of characteristics of consumers.

<u>Some factors in common</u>:

- Some similar demographic variables including.
    - Similar levels of average income per capita, being two of the world's richest countries
    - Similar trends in rising inequality over the past few decades

- Institutionally payday lending began around the same time and has become fairly common in both countries
- Regulations are largely held at the provincial/state level
- Payday loan consumers are relatively lower income as compared to non-payday loan consumers
- Canada's largest payday lender is owned by a US firm.

Some factors not in common:

- The US population is approximately ten times the size of Canada's population
- Mainstream consumer banking in the US is more decentralized than in Canada
- The US Consumer Financial Protection Bureau is proposing new major regulations on payday lending
- The US has a larger newcomer population and a larger share of its population is unbanked as compared with Canada.

(b) While the question is posed to CAC, we presume it was intended for Dr. Buckland.

Dr. Buckland Response:

Given the similarities, and noting the differences, on balance I think that the situation in the US is instructive to Canada, but of course, we must be careful not to assume results from the US apply directly to Canada.

## RATIONALE FOR REFUSAL TO FULLY ANSWER THE QUESTION:

| | | | |
|---|---|---|---|
| **Document:** | Pre-Filed Evidence of CAC, Tab 4, *A Profile of Payday Loans Consumers Based on the 2014 CFCS* | **Page No.:** | |
| **Topic:** | Payday Lending Consumers | | |
| **Subtopic:** | | | |
| **Issue:** | Demographics | | |

## PREAMBLE TO IR (IF ANY):

## QUESTION:

What application do the Canadian demographics have to Manitoba specifically?

## RATIONALE FOR QUESTION:

To assess applicability of data to the Manitoba context.

## RESPONSE:

Because the Manitoba sample in the SFS is so small, the Canada-wide results from the CFCS (and SFS) provide useful context to understand what is likely happening in Manitoba. For example, it would be very difficult to conclude anything about ethnic factors such as aboriginal or immigrant status from the small Manitoba sample, but the Canada-wide results suggest that borrowers "are more likely to be aboriginal and less likely to be immigrant: 15.02% of the borrower sample is immigrant and 7.22% is aboriginal, compared to 12.27% and 4.21%, respectively, for the non-borrower sample. The proportion of borrowers who are aboriginal decreased in 2014 comparing to 2009 when it was 11.7%." (p.10).

[Note that the small Manitoba sample restricts the comparisons we make with the rest of Canada in the SFS report. For example, we have compared average incomes between borrowers and nonborrowers in Manitoba and the rest of Canada in the SFS report, whereas we were able to look at the income distribution of borrowers and nonborrowers (in terms of quintiles) in the CFCS data where the larger sample can be sliced into finer classifications.]

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| **Document:** | CAC Pre-Filed Evidence, Tab 2, *Payday Lending: A Mature Industry with Chronic Challenges* | **Page No.:** | 6 |
| **Topic:** | Payday Lending Industry | | |
| **Subtopic:** | Demographics of Consumers | | |
| **Issue:** | Research by Packman | | |

## PREAMBLE TO IR (IF ANY):

Dr. Buckland cites research by Packman at page 6 of his report.

## QUESTION:

(a) Please provide any information with respect to the professional biography and/or expertise of Packman; and

(b) Please advise as to which countries Packman studied and whether they are demographically comparable to Canada.

## RATIONALE FOR QUESTION:

To understand applicability of Packman's findings in the Canadian context.

## RESPONSE:

(a) Mr. Packman is a researcher and journalist. According to his LinkIn page, Carl Packman is a "Professional researcher, writer and author working with various organisations." A fuller resume is found here: https://www.linkedin.com/in/carl-packman-00997b30. His book was published by Palgrave MacMillan and can be found here: http://www.palgrave.com/us/book/9781137372802; it can be found on Google books here:https://books.google.ca/booksid=0V2HBAAAQBAJ&printsec=frontcover&dq=carl+packman&hl=en&sa=X&redir_esc=y#v=onepage&q=carl%20packman&f=false. In the publisher website it is noted that "Carl Packman is a writer, researcher and broadcaster. He is the author of Loan Sharks: The Rise and Rise of Payday Lending (2012), a regular commentator on issues such as finance and personal debt, and has written for many household publications such as the Guardian in the UK and American Banker in the US." Here is a link to one of his Guardian articles: http://www.theguardian.com/commentisfree/2010/nov/14/loan-sharks-consumer-credit-bill.

(b) Packman provides a journalistic narrative of the beginning of modern payday lending and critique of it using pragmatic analysis. Packman argues that payday lending is a relative new product with older antecedents. In its current form it began in the US and is expanding into new countries including Canada, the UK, Europe, and Australia. He presents a critique of the industry and argues that it is heavily reliant on the repeat borrower and the repeat borrowing is harmful to consumers.

## RATIONALE FOR REFUSAL TO FULLY ANSWER THE QUESTION:

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|---|---|---|---|
| **Document:** | CAC Pre-Filed Evidence, Tab 2, *Payday Lending: A Mature Industry with Chronic Challenges* | **Page No.:** | 15 |
| **Topic:** | Payday Lending Consumers | | |
| **Subtopic:** | | | |
| **Issue:** | Demographics | | |

## PREAMBLE TO IR (IF ANY):

Dr. Buckland quotes a study conducted by Melzer (2014), and quotes the author as stating "there is evidence that this expansion of payday credit aggravates financial difficulties, *at least for a subset of borrowers*."

## QUESTION:

(a) Please provide any information with respect to the professional biography and/or expertise of Melzer;

(b) Please provide a summary of the demographics of the borrowers studied by the author; and

(c) Please advise as to the manner in which payday lending was found to aggravate the financial circumstances of certain borrowers and the demographics of those borrowers.

## RATIONALE FOR QUESTION:

To understand the applicability of findings in the Canadian and Manitoba context.

## RESPONSE:

(a) Dr. Melzer is Assistant Professor of Finance with the Kellogg School of Management, Northwestern University, US. According to his faculty member webpage, “Brian Melzer is an assistant professor in the Finance Department. His research interests include household finance, real estate, financial institutions and financial regulation. His recent research examines the impact of interest rate regulations on the automobile loan market. He has also studied the default and investment behavior of heavily indebted homeowners, the costs and benefits of retail financial advice and the impact of payday loans on household well-being. Professor Melzer received his PhD in economics from the University of Chicago Graduate School of Business in 2008. Prior to graduate study, he worked as a research analyst in the investment management business." His listed areas of expertise include: Banking and Financial Institutions; Corporate Finance; Personal Finance; Regulation of Financial Markets. A listing of his education, research, and teaching activities are available on this page, found here: http://www.kellogg.northwestern.edu/faculty/directory/melzer_brian.aspx#biography.

(b) One reference to his work relate to his summary of the literature ("Melzer (2014) summarizes the literature to date by stating 'there is evidence that the expansion of payday credit aggravates financial difficulties, *at least for a subset of borrowers* (italics added) (Melzer 2014, p.3).'") and one relates to this particular study ("Melzer, on the other hand found that payday loan clients were more likely to use food assistance and not make child support payments (Melzer 2014, p.21)."). Regarding his own study, the data that he uses is primarily from the US Census Bureau's Survey of Income and Program Participation (SIPP) (Mezler 2014, p.10). This is a panel survey that tracks housholds' income, expenses, employment, and transfer program participation for 32 to 48 months. The sample ranges from 14,000 to 43,000 households and "is designed to oversample low-income households for whom [social] program participation is most likely (Melzer 2014, p.10)." The analysis drew on data from 1991 through 2007.

The research design for this study is to segregate panel group participants in payday loan access areas and those who are outside payday loan access areas. A payday loan access area include counties less than 25 miles from a state that allows payday lending at that time.

Regarding the demographics of the panel group, I have directly copied that section from the report:

"III.C. Economic and Demographic Characteristics of Areas with Payday Loan Access
Table I displays sample statistics for a variety of economic and demographic variables, stratified by *Payday Access*. County-level data, summarized in Panel A, indicates that *Payday Access* areas are more prosperous, with lower rates of unemployment and slightly higher per capita income: 4.5% unemployment rate and $35,500 per capita income compared to 4.9% and $34,400 among nonaccess counties. *Payday Access* areas are also less populous and more rural: the average 2000 Census population in an access area is 152,000 with 50% urban population, compared to an average population of 251,000 in non-access areas, 61% of which is in an urban area.

Summary statistics for low- to moderate-income SIPP respondents (between $15,000 and $50,000 in annual income) are shown in Panel B. Households with *Payday Access* have slightly higher monthly income ($2,609 vs. $2,570), higher rates of home ownership (63% vs. 53%), and lower rates of being uninsured (19% vs. 21%), but they show no difference in employment status. Educational attainment is modestly higher in *Payday Access* areas, as a larger proportion of households obtain at least a high school diploma (92% vs. 89%). Disparities in racial/ethnic composition are more striking, with fewer minorities residing in *Payday Access* areas: the proportion of black households is

13%, compared to 16% in areas without access, and the proportion of Hispanic households is 3%, compared to 11% in areas without access. Heads of household, on average, are older in areas with loan access (53.3 years vs. 51.6 years). In other household characteristics, including number of children and household size there are only modest differences between access and non-access areas.

To summarize, areas with payday loan access appear to be more rural, less racially diverse and slightly more prosperous, which highlights the need for county-level and individual level controls in the regression analysis that follows. Beyond controlling for these variables in the main analysis, I will also estimate the effect of loan access within subsets of the main sample (for each racial category and for the subset of heavily urban areas) to ensure a closer match between the treatment and comparison groups. Finally, I will use falsification exercises – testing for the absence of a *Payday Access* effect before loans are available – to evaluate whether county-level omitted variables lead to bias in the estimated effects of loan access (Melzer 2014, p.11-12)."

(c) Melzer notes that studies have found that payday loan reliance can lead to difficulty making house and utility payments (Melzer 2011), increased risk of bankruptcy (Skiba and Tobacman 2011), and poorer performance at work (Carrell and Zinman 2014) (Melzer 2014, p.21)[1]. Melzer's study extends this analysis to examine if payday loan use effects child support payments and food stamp participation. His analysis finds that payday loan use does increase the likelihood of not providing child support payments and growing reliance on food stamps. He notes that these impacts fall outside the household —to the child living in another household or the state providing food stamps — and cause external or social costs: "These social costs should be weighed alongside the direct costs and benefits of credit access for borrowers when evaluating policies that impact the supply of short-term credit (Melzer 2014, p.21)."

## RATIONALE FOR REFUSAL TO FULLY ANSWER THE QUESTION:

[1] Carrell, Scott, Zinman, Jonathan. 2014. In Harm's Way? Payday Loan Access and Military Personnel Performance; Melzer, Brian T., 2011. The real costs of credit access: evidence from the payday lending market. Quart. J. Econ. 126 (1), 517–555; Skiba, Paige and Jeremy Tobacman. 2008. Do Payday Loans Cause Bankruptcy? Working Paper.

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|---|---|---|---|
| **Document:** | CAC Pre-Filed Evidence, Tab 2, *Payday Lending: A Mature Industry with Chronic Challenges* | **Page No.:** | 22 |
| **Topic:** | Payday Lending Consumers | | |
| **Subtopic:** | | | |
| **Issue:** | Financial Literacy and Education | | |

## PREAMBLE TO IR (IF ANY):

Dr. Buckland makes reference to financial literacy practices and studies.

## QUESTION:

Is Dr. Buckland aware of any studies that have been conducted with respect to financial literacy levels among payday lending consumers specifically? If so, please provide scope of research, methodology and summary of findings.

## RATIONALE FOR QUESTION:

To understand the interaction between financial literacy and use of payday loans.

## RESPONSE:

There are a limited number of studies that examine, to some extent, the relationship between financial literacy of payday loan borrowing (Wood 2013, Melzer 2014, Lusardi 2011; Lusardi and Scheresberg 2013)[2] and studies that examine the link between financial exclusion and financial literacy (e.g., Simpson and Buckland 2009)[3]. Using data from Virginia, US, Wood finds that payday loan borrowers' financial literacy is lower than non-borrowers but concludes that the literacy effect is weak (p.89).

This type of negative relationship between financial literacy and payday loan use was identified with Canadian data (Simpson and Buckland 2009). In his literature review Melzer (2014) notes "financial literacy is particularly low among payday [loan] borrowers…and simple information disclosures designed to lessen cognitive biases and limitations results in significant reductions in payday loan borrowing… (p.3)." There is also a growing literature that recognizes that there is not one appropriate financial literacy, but that there are different types of literacies and the appropriate literacy depends on many circumstances (Buckland 2011)[4]. These circumstances range from one's income and asset level, one's life goals, the social programs one has access to, and one's access to financial services.

## RATIONALE FOR REFUSAL TO FULLY ANSWER THE QUESTION:

[2] Lusardi, Annamaria. 2011. *Americans' Financial Capability.*National Bureau of Economic Research, Inc, NBER Working Papers: 17103; Lusardi, Annamaria, Schneider, Daniel J., and Tufano, Peter. 2011. *Financially Fragile Households: Evidence and Implications.*National Bureau of Economic Research, Inc, NBER Working Papers: 17072; Melzer, Brian T. 2014. *Spillovers From Costly Credit.*Center for Economic Studies, U.S. Census Bureau, Working Papers; Wood, William C. 2013. 'Payday Lending in Virginia: An Empirical Study of Customers.' *Virginia Economic Journal* 18, 83-90.

[3] Simpson, Wayne and Buckland, Jerry 2009. 'Examining Evidence of Financial and Credit Exclusion in Canada from 1999 to 2005.' *The Journal of Socio-Economics*, 38, p.966-976.

[4] Buckland, Jerry 2011. *Money Management on a Shoestring: A Critical Literature Review of Financial Literacy & Low-income People,* Research Paper Prepared for the Canadian Task Force on Financial Literacy, Ottawa.

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|---|---|---|---|
| **Document:** | Pre-Filed Evidence of CAC | **Page No.:** | |
| **Topic:** | Payday Lending Consumers | | |
| **Subtopic:** | | | |
| **Issue:** | Consumer Debt | | |

## PREAMBLE TO IR (IF ANY):

## QUESTION:

Please provide any data that the Coalition has regarding consumer debt as a percentage of disposable income for Canada and Manitoba.

## RATIONALE FOR QUESTION:

To understand current debt rates in the Canadian and Manitoba population.

## RESPONSE:

The CFCS and SFS do not measure "disposable income," i.e. income after taxes. The figure commonly quoted recently in the press is that household debt is now 165% of disposable income across Canada, although Manitoba's figure would be lower than that because of lower house prices and mortgage debt than Ontario, Alberta and British Columbia in particular.

## RATIONALE FOR REFUSAL TO FULLY ANSWER THE QUESTION:

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|---|---|---|---|
| **Document:** | Pre-Filed Evidence of CAC, Tab 9, *Small Loan Workshop: Summary of Proceedings and Recommendations* | **Page No.:** | 4-9 |
| **Topic:** | Payday Lending Consumers | | |
| **Subtopic:** | | | |
| **Issue:** | Alternatives to Payday Lending | | |

## PREAMBLE TO IR (IF ANY):

## QUESTION:

For each of the current alternatives to payday loans discussed in the Summary of Recommendations and Proceedings, are there any data or information indicating whether use of the alternatives by consumers led to a decrease in their use of payday loans? If so, please produce.

## RATIONALE FOR QUESTION:

To understand impact of alternatives to payday lending on borrower behaviour.

## RESPONSE:

We do not have data or information indicating whether the use of the alternatives by consumers led to a decrease in their use of payday loans. The financial institutions who attended the Small Loans Workshop did not provide information relating to whether they currently collect this information or whether they would be able to track the information requested. Additionally, even if the financial institutions attempted to track the information, the resulting data may not be reliable as consumers might have an incentive not to report payday loans to their financial institutions.

## RATIONALE FOR REFUSAL TO FULLY ANSWER THE QUESTION:

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|---|---|---|---|
| **Document:** | CAC Pre-Filed Evidence, Tab 3, *An Economic Analysis of the Payday Loan Industry and Recommendation for Regulation in Manitoba* | **Page No.:** | 1 |
| **Topic:** | Payday Lending Consumers | | |
| **Subtopic:** | | | |
| **Issue:** | Repeat Borrowing | | |

## PREAMBLE TO IR (IF ANY):

"The evidence shows that the great majority of payday borrowers are frequent repeat customers who face a chronic problem, and the business model of the payday loan industry depends on these repeat borrowers. Payday lenders now offer payday loan against a wide variety of non-employment cash flow sources such as pensions and disability payments, and many of the companies did not do that when Manitoba first regulated the industry in 2010."

## QUESTION:

a) Please provide detailed evidence of how many repeat customers and what percentage of revenue the repeat customers contribute to.

b) Please provide percentage of non-employment payday loan borrowers and discuss the impact if payday loan lenders stop offering loans to this group.

## RATIONALE FOR QUESTION:

To understand the payday loan industry in Manitoba.

## RESPONSE:

For part a) let us first restate the key finding, without specific numbers: a substantial percentage of the total payday borrower population borrow repeatedly within a year, as many as 15 loans per year. This evidence appears in Ernst & Young (2004), Montezemolo (2013), Pew Charitable Trusts (2103), Simpson and Islam (2016) and Appendix 1 (BC data) and Appendix 7 (NS data) of Dr. Robinson's report. The specific numbers and frequencies of borrowing are not measured using identical categories, but the message is the same. Dr. Robinson discusses this issue in Section 4 of his report. See Table 8 for analysis of the BC data. Repeat borrowers make up 75% of the total borrowing population, and they took out 94% of all loans in BC that year. The NS data in Table 7 use different categories, but the results would be similar. The Coalition has not seen any evidence that repeat borrowers are borrowing amounts materially different from the average (and since they do most of the borrowing, the average must be close to their loan size). The repeat borrowers are likely to have more defaults and so they might account for slightly less of the total revenue, but nonetheless the conclusion is the same: the industry is totally dependent upon repeat borrowers.

For part b), information about the percentage of non-employment loan borrowers is not within the Coalition's knowledge. The regulators do not appear to be collecting that data and we cannot be sure that the payday lenders retain that data in a form that they could recover it and provide a report.

In terms of Statistics Canada data, Simpson and Islam report based on the 2014 CFCS that there was an increase in payday loan usage by households on social assistance as compared to CFCS 2009. Again, based on the CFCS 2014, 48% of those taking on 3 or more loans annually relied on social assistance or retirement income (see Simpson and Islam, Tab 4, exec summary).

In terms of a general discussion of reduced access to payday loans, please see the Buckland literature review (Tab 2, Section 4.4).

We also note that one of the payday lenders intervening in this process does not lend on social assistance payments. An information request has been presented to that intervenor on the subject. The response may be of assistance to the PUB.

## RATIONALE FOR REFUSAL TO FULLY ANSWER THE QUESTION:

| | | | |
|---|---|---|---|
| **Document:** | CAC Pre-Filed Evidence, Tab 2, *Payday Lending: A Mature Industry with Chronic Challenges* | **Page No.:** | 15 |
| **Topic:** | Payday Lending Consumers | | |
| **Subtopic:** | | | |
| **Issue:** | Internet Payday Lending | | |

## PREAMBLE TO IR (IF ANY):

Dr. Buckland cites findings of the study of the Pew Charitable Trusts 2013, in which 81% of the respondents to the survey stated that if they were faced with a cash shortfall and payday loans were unavailable they would cut back on expenses.

## QUESTION:

Please advise as to whether Dr. Buckland has any information as to whether survey respondents were asked if they would be willing to borrow from an internet lender if payday loans were unavailable.

## RATIONALE FOR QUESTION:

To provide further context for findings made by the Pew Charitable Trusts study.

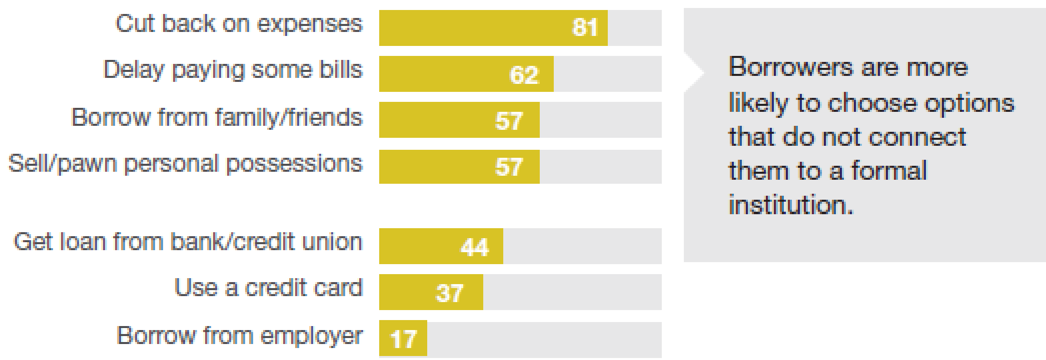
## RESPONSE:

The Pew Charitable Trusts research engages in this issue in a couple of ways. First, it asked respondents if there were not payday loans available, what you would do. For convenience I have pasted below, from Pew Charitable Trusts (2012), the responses to this question.

THIS IS COPIED AND PASTED FROM Pew Charitable Trusts (2012):

EXHIBIT 5:

**ALTERNATIVES IF PAYDAY LOANS WERE UNAVAILABLE**




NOTES: Data represent percentage of borrowers who would use each of these strategies if payday loans were unavailable, based on 451 interviews, December 2011 to March 2012.

Survey participants were asked: "I'm going to read you several options. For each, tell me whether you would use this option if you were short on cash and short-term loans of any kind no longer existed. How about (method)? Would you use this option or not?" The "borrow from employer" item was only asked of employed respondents.

SOURCE: Pew Safe Small-Dollar Loans Research Project, 2012.

The study also looked at the reported use of payday loans (storefront vs. online) in states with different regulatory regimes (Pew Charitable Trusts 2014). The regimes included permissive (i.e., very few if any restrictions), hybrid (some restrictions; akin to the types of restrictions found in Canada except for Quebec and Newfoundland/Labrador), and restrictive (regulations that essentially disallow payday lenders through rate cap at e.g., 36% APR). What they found was the uptake of online payday loans was lower in hybrid (1.28%) vs. permissive states (1.37%) and that uptake in restrictive states (1.58%) was only a little higher than in permissive states (1.37%). For convenience I have pasted below, from Pew Charitable Trusts (2014), the table associated with this point.

THIS IS COPIED AND PASTED FROM Pew Charitable Trusts (2014):

Table 5

## Method of Acquiring Payday Loans by State Law Type

Percentage of adults reporting payday loan usage in the past 5 years

| | Borrow from storefront only | Borrow from online or other | Number of interviews |
|---|---|---|---|
| National | 4.01% | 1.48% | 33,576 |
| Permissive states | 5.22% | 1.37% | 17,881 |
| Hybrid states | 5.06% | 1.28% | 5,565 |
| Restrictive states | 1.29% | 1.58% | 10,130 |

Note: Online or other represents all borrowers who have indicated online usage (including those who have borrowed both online and from a storefront), plus usage from other lenders that may include banks, credit unions, or employers, among others. Results are reported to two decimal places, but this reporting is not intended to imply such a detailed level of precision. Rather, two decimal places are used in order to avoid inaccurate calculations between groupings that could be caused by rounding. Because of sampling error, it is possible that the true level of usage in any of these groupings is slightly higher or lower. Restrictive states are those that have no payday loan storefronts. Permissive states allow single-repayment loans with APRs of 391 percent or higher. Hybrid states have payday loan storefronts, but maintain more exacting requirements, such as lower limits on fees or loan usage, or longer repayment periods. Data represent percentage of adults in each category who report having used a payday loan in the past five years. Results are based on 33,576 interviews conducted from August 2011 through December 2011.

Source: The Pew Charitable Trusts (2012)



Dr. Robinson was able to estimate the following payday loan revenue figures by using two tables on page 130 of the 2013 Dollar Financial 10K report. They show that at least at that time, Canadian and US borrowers from Dollar Financial were not very likely to be borrowing on the internet, while over 40% of loan revenue in the UK/Europe segment came from on-line borrowing.

Consumer Loan Revenue in MM

| | UK + Europe | Canada | US |
|---|---|---|---|
| Total revenue | $659.5 | $333.1 | $129.7 |
| Minus “Retail” | 371.1 | 322.9 | 122.5 |
| = Online lending in that region | $288.4 | $ 10.2 | $ 7.2 |

**RATIONALE FOR REFUSAL TO FULLY ANSWER THE QUESTION:**

| | | | |
|---|---|---|---|
| **Document:** | CAC Pre-Filed Evidence, Tab 1, Executive Summary | **Page No.:** | 10 |
| **Topic:** | Payday Lending Industry | | |
| **Subtopic:** | Manitoba Industry | | |
| **Issue:** | Availability of Payday Loans | | |

## PREAMBLE TO IR (IF ANY):

CAC indicates three largest payday lenders which are National Money Mart, Cash Money, Cash4You have grown substantially in the last three years.

## QUESTION:

What portion of revenue do these three payday lenders represent to the average industry in Manitoba?

## RATIONALE FOR QUESTION:

To understand the industry in Manitoba.

## RESPONSE:

The Coalition does not possess this information; it resides in the industry. Furthermore the industry provides no data on internet lending. We can draw some reasonable inferences. Cash4You does not operate in Manitoba. Money Mart has 22 stores and Cash Money has four, out of a total of 40, or 65% of the stores. They are concentrated in Winnipeg, whose larger population and population density make it likely these stores have higher volumes than those in small centres. Furthermore, Money Mart is by far the most recognised face of the industry. Both companies advertise widely. We can reasonably expect them to capture more volume than less well known competitors, although a lot of payday lending is also localised, and a well-established store in a smaller centre or a well-defined neighbourhood might capture as much volume as its national competitors. As far as the Coalition has been able to determine, all stores charge the full $17 per hundred and there is very little else to differentiate them. Price competition does not happen. With all that said, we believe a reasonable estimate is that Money Mart plus Cash Money account for 70 – 80% of the volume of payday lending in Manitoba.

## RATIONALE FOR REFUSAL TO FULLY ANSWER THE QUESTION:

| | | | |
|---|---|---|---|
| **Document:** | CAC Pre-Filed Evidence, Tab 3, *An Economic Analysis of the Payday Loan Industry and Recommendation for Regulation in Manitoba* | **Page No.:** | 6 |
| **Topic:** | Payday Lending Industry | | |
| **Subtopic:** | Number of Payday Lenders | | |
| **Issue:** | Non-Registered Payday Lenders | | |

## PREAMBLE TO IR (IF ANY):

"By 2006, the CPLA had succeeded the CACFSP, and it estimated there were 1,350 outlets, in conversation with Dr. Robinson, payday lenders did not have to be registered with anyone nor did they have to belong to the CPLA, which made its estimate by scouring the Yellow Pages in hard copy for all of Canada to find lenders who were not members."

## QUESTION:

Please provide information on payday lenders operating in Manitoba that either are not registered or do not belong to the CPLA.

## RATIONALE FOR QUESTION:

To understand the prevalence of payday loan operations in Manitoba.

## RESPONSE:

Aside from possible internet lenders, we are unaware of any unlicensed lender operating in Manitoba. Membership in the CPLA is more suitable for that organisation to answer. According to its website, Cash Money, Money Mart, Xtra Cash and The Fast Cash Company are the Manitoba payday lenders who belong to the CPLA.

## RATIONALE FOR REFUSAL TO FULLY ANSWER THE QUESTION:

| | | | |
|---|---|---|---|
| **Document:** | Pre-Filed Evidence of CAC | **Page No.:** | |
| **Topic:** | Payday Lending Consumers | | |
| **Subtopic:** | Internet Payday Lending | | |
| **Issue:** | Use of Internet Loans | | |

## PREAMBLE TO IR (IF ANY):

## QUESTION:

Does the Coalition have any data regarding the number of consumers in Manitoba who have used internet payday lenders?

## RATIONALE FOR QUESTION:

To understand trends in use of internet payday lending products.

## RESPONSE:

The CFCS and SFS do not distinguish internet payday loans from other payday loans. We do not have any other information directly relating to the number of consumers in Manitoba using internet payday lenders. Please see the answer to PUB/CAC 1-18.

It should be noted that in preparing its 2015 report for the Office of Consumer Affairs, CAC Manitoba explored the possibility of a general Canadian survey of internet payday loan users but was advised of substantial sampling challenges.

## RATIONALE FOR REFUSAL TO FULLY ANSWER THE QUESTION:

| | | | |
|---|---|---|---|
| **Document:** | CAC Pre-Filed Evidence, Tab 2, *Payday Lending: A Mature Industry with Chronic Challenges* | **Page No.:** | 12 |
| **Topic:** | Payday Lending Industry | | |
| **Subtopic:** | Internet Payday Lending | | |
| **Issue:** | Study Conducted by Denise Barret Consulting | | |

## PREAMBLE TO IR (IF ANY):

Dr. Buckland cites a study conducted by Denise Barret Consulting (2015) regarding online payday lending available to Canadians.

## QUESTION:

(a) Please provide any information with respect to the professional biography and/or expertise of Denise Barret Consulting;

(b) Please provide summary as to the scope of the research conducted by Denise Barret Consulting;

(c) Please advise as to the methodology employed by the author to locate payday lending websites; and

(d) Please advise as to who the "key informants" were with whom the author spoke.

## RATIONALE FOR QUESTION:

To understand the scope and applicability of the research in the Canadian and Manitoba context.

## RESPONSE:

(a) Denise Barrett Consulting has authored several projects for the Consumers Council of Canada in financial services, including: Tax-Free Savings Accounts (2010), Canada’s Banking Dispute Resolution System (2012), Canada’s Online Payday Loan Industry (2015) and the relationship between Loyalty/Rewards and Canada’s Payment System

(2015). A report on Canada's Rent-to-Own industry will be completed soon (spring 2016).

Principal Denise Barrett is a graduate of Ryerson University (B.A. Public Administration) and has an M.A. in Political Science from the University of Guelph. She has 30 years experience in public policy, and research for a variety of public and private sector clients. She serves as a public representative on two Advertising Standards Canada committees, has written for numerous publications and web sites.

(b) The scope of this research project was quite narrow as it involved collecting information from online payday lender websites regarding what information is disclosed *without* taking out a payday loan. The project examined if “what consumers see on a computer screen when they seek payday loans online” complies with payday loan regulations (Denise Barrett Consulting 2015, p.5).

(c) The method used by the researchers was what they called ‘online audits’ (p.5-6). This involved researchers in each province engaging in searches for ‘online payday loan’ using online search engines. Once online payday loan websites were identified then the researcher would audit or inspect the website for indicators including evidence of being licensed and 50 other observations “including the fees posted, rollover rules, cancellation notification, ownership and compliance with specific provincial rules (p.6).” Note that the researchers did not engage in telephone conversations and did not actually take out online payday loans. There are many limitations to this research and these are pointed out in the report on page 13, such as,

- Information is from the website not the loan agreement or the actual transaction
- Information may be from the lead generator (a company that advertises payday loans and directs prospective consumers to online payday loan websites) not the payday lender
- Results reflect online search results not consumer choice which may be affected by other factors such as word-of-mouth, referrals from store-front payday lender, etc.

(d) According to the report key informants included CPLA president and secretary, executives from Canada’s largest and licensed online payday loan firms, and executives from credit counselling agencies. The authors note that “Effort was made to interview unlicensed lenders, but *none* responded to requests (p.11).”

## RATIONALE FOR REFUSAL TO FULLY ANSWER THE QUESTION:

| | | | |
|---|---|---|---|
| **Document:** | CAC Pre-Filed Evidence, Tab 3, *An Economic Analysis of the Payday Loan Industry and Recommendation for Regulation in Manitoba* | **Page No.:** | 10 |
| **Topic:** | Payday Lending Industry | | |
| **Subtopic:** | | | |
| **Issue:** | Internet Payday Lenders | | |

## PREAMBLE TO IR (IF ANY):

In Dr. Robinson's report, there are two registered online operators in Manitoba. Consumers Council of Canada (2015) finds evidence that unregistered online payday lenders are less likely to adhere to Canadian law and regulation of payday lending.

## QUESTION:

a) Please confirm that the Consumers Council of Canada (2015) report is that which is found at Schedule F to the pre-filed evidence of CPLA.

b) If not, please file the Consumers Council of Canada (2015) report referenced by Dr. Robinson if available.

c) What impact has on-line borrowing had on storefront lending generally?

## RATIONALE FOR QUESTION:

To understand impact of internet payday lending on the industry.

## RESPONSE:

Yes it is the same report as Schedule F.

We do not have the data to say very much about the impact; the data is in the possession of the companies. Dollar Financial reports internet lending as a separate segment and it has grown very fast and become the largest single segment by volume, but is less profitable the segments operating out of stores. Internet lending is not shown separately by region and so we do not know how much is Canadian. Storefront lending has also grown rapidly in Dollar Financial and so internet lending is not reducing it, but undoubtedly storefront lending would have grown faster in the absence of the internet.

Money Mart and Cash Store require their internet borrowers to visit a storefront to complete the loan – the internet thus becomes just a convenient way to do most of the paperwork and avoid lineups. We theorise that requiring the borrower to come into the store reduces bad debts by improving the verification of identity.

Finally, please also consider the last paragraph of PUB/CAC 1-18 where I estimate online payday lending revenue for MoneyMart.

## RATIONALE FOR REFUSAL TO FULLY ANSWER THE QUESTION:

| | | | |
|---|---|---|---|
| **Document:** | CAC Pre-Filed Evidence, Tab 3, *An Economic Analysis of the Payday Loan Industry and Recommendations for Regulation in Manitoba* | **Page No.:** | 1 |
| **Topic:** | Payday Lending Industry | | |
| **Subtopic:** | | | |
| **Issue:** | Regulation | | |

## PREAMBLE TO IR (IF ANY):

Dr. Robinson references evidence that higher rates in provinces outside Manitoba are allowing large payday lending companies to earn excess profits.

## QUESTION:

(a) Please explain what Dr. Robinson considers to be "excess profits";

(b) Please explain why excess profit to the large payday lending companies is problematic.

## RATIONALE FOR QUESTION:

To understand rationale for Coalition's position on rate.

## RESPONSE:

I employ the premise of a just and fair (just and reasonable) rate which I believe is consistent with *Order 39/08* where the PUB referenced legislative debates indicating that the government's purpose for the amendments for licensing and regulating payday lenders

> ... was not to drive the companies out of business, because people are showing an interest in having this service, but to make sure that when they offer the

> service they do it in a way that's **just and reasonable**." (2008 PUB Order, p. 13) (emphasis added)

The PUB concluded that:

> "the maximum charges to be set for payday loans should be such as to reduce the cost of credit for consumers while promoting **increased efficiency** within the industry." (emphasis added). (2008 PUB Order p. 217) (See also 2008 PUB Order, p. 244 and 2013 PUB Order, p. 65)

In the economics of regulation that is the rate of return that compensates the capital providers fairly for their capital contribution, but does not pay them any more than that. The other factors of production -- land, labour and the natural environment – must also be paid their fair share for what they contribute to the joint product. The just and fair rate is the cost of capital in the language of finance.

The cost of capital has two components in most companies, including payday lenders: equity and debt. When we combine them to evaluate performance of the company as a whole, we calculate the weighted average cost of capital (WACC). The cost of each type of capital is what they would earn in a freely competitive market. The point of regulation is to allow the company to earn enough to pay each of the capital providers what they reasonably expect to earn. If they get paid more than that, then the regulation is not replicating or correcting the market, it is overcompensating them. Since equity holds the residual claim, the cost of equity is part of WACC that is usually controversial and difficult to estimate.

Let us look at the mechanics of this in the model in Dr. Robinson's report. A standard regulatory model determines to costs that are fairly attributed to labour and the natural environment, and to the government (income taxes). Suppliers of physical goods and places to work also must be compensated. The last piece is the capital. In a financial statement we treat the payments to debt and equity holders as cash flows: interest and dividends. These are not the correct economic values of what they expect to receive, and so we estimate the all-in cost of what they expect to receive, which will include the final repayment of a debt and an infinite stream of growing dividends, not just the current dividend. The methods for estimating the required cost of capital are well-established in the finance literature and Pinto et al. (2015) is just one of many references that could have been listed. In a regulation setting, once the cost of capital is determined, we treat the other costs as perpetuities, and apply the cost of capital as percentage of the capital that the company must have invested to run the business, and turn it into an expense just like the payments to labour and other factors. The remaining figure that is left to determine is the revenue, which is what we are trying to regulate. If we set rules around the revenue such that the net result is close to zero, we have paid off everyone who contributes to the firm without paying them too much or too little, and the rules we set are what we desire to be the regulated rules. For payday lenders, the principal rule in question is the maximum fee that can be charged, since we know that all lenders will gravitate toward charging the maximum fee. Dr. Robinson recommends that fee by $15 per hundred loan principal.

If the value left over after paying everyone is a significant positive, the equity holders will get all of it, because they hold the residual claim. The information request asks why we should care if the payday lenders get paid more than they have earned. Dr. Robinson advances two ethical arguments, which are also at the heart of most rate regulation.

The utilitarian philosphers, most notably John Stuart Mill, argued that the goal of an economy is to maximise the happiness or utility of its members. We cannot compare one person's utility to another person's utility, the way we can compare wealth or physical possessions. A pure utilitarian ethic therefore seeks to maximise the total utility in the system. We cannot measure personal utility directly, but we know that while it never decreases while you get more of something good, like money to buy food, the benefit increases at a slower rate as you get more of whatever it is that you want. In terms of payday lending regulation, extensive evidence the Coalition has presented shows that there is a relatively small part of society that borrows from payday lenders, but most of them borrow repeatedly and therefore the cost of the fees is significant for them. A higher fee thus translates into more disutility in total, because the utility loss to these people costs more in total than the utility gain to the few people who are one-time borrowers who will gain from higher fees, perhaps through having access to a payday lender on every corner and not having to walk far when they borrow once a year.

The weakness of pure utilitarian philosophy is underscored by the current day debates about the top 1% or top 0.1% of the world's population owning more wealth than the bottom 20% or bottom 50% of the population. John Rawls, *A Theory of Justice* is arguably the most influential philosophic work of the 20th century. His theory of justice can be summed up as "justice as fairness." One aspect of fairness he argues is that we have an obligation to help those who are most disadvantage in society, to give them fair access to the benefits that the majority enjoy. In the context of payday lending, we have seen extensive evidence that payday loan borrowers are more likely to be socially and economically disadvantaged,. In terms of regulation of payday lending, this ethical philosophy requires that we allow the equity owners of payday loan firms to charge fees that will compensate them for their capital, but no more than that, given the detrimental effect of higher fees on the disadvantaged persons who are borrowing.

## RATIONALE FOR REFUSAL TO FULLY ANSWER THE QUESTION:

| | | | |
|---|---|---|---|
| **Document:** | CAC Pre-Filed Evidence, Tab 3, *An Economic Analysis of the Payday Loan Industry and Recommendations for Regulation in Manitoba* | **Page No.:** | 36<br>Appendix 3 |
| **Topic:** | Payday Lending Industry | | |
| **Subtopic:** | Regulation | | |
| **Issue:** | Rate | | |

## PREAMBLE TO IR (IF ANY):

## QUESTION:

Please provide analysis as set out in Table 10 using the following variables:

(a) Fee is 15% of loan, loan limit is 25% of income;

(b) Fee is 15% of loan, loan limit is 30% of income;

(c) Fee is 17% of loan, loan limit is 25% of income; and

(d) Fee is 17% of loan, loan limit is 30% of income.

## RATIONALE FOR QUESTION:

To understand potential impacts of rate change and costs of borrowing.

## RESPONSE:

| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| fee rate | 0.15 | | | | | | | |
| loan limit | 0.25 | | | | | | | |
| % of max | 1 | | | | | | | |
| Loan value | 375 | | | | | | | |
| # of loans/yr | 1 | 2 | 3 | 4 | 5 | 6 | 7 | 8 |
| Loan fees | 56.25 | 112.5 | 168.75 | 225 | 281.25 | 337.5 | 393.75 | 450 |
| % of income | 0.1% | 0.3% | 0.4% | 0.6% | 0.7% | 0.9% | 1.0% | 1.2% |

| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| fee rate | 0.15 | | | | | | | |
| loan limit | 0.3 | | | | | | | |
| % of max | 1 | | | | | | | |
| Loan value | 450 | | | | | | | |
| # of loans/yr | 1 | 2 | 3 | 4 | 5 | 6 | 7 | 8 |
| Loan fees | 67.5 | 135 | 202.5 | 270 | 337.5 | 405 | 472.5 | 540 |
| % of income | 0.2% | 0.3% | 0.5% | 0.7% | 0.9% | 1.0% | 1.2% | 1.4% |

| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| fee rate | 0.17 | | | | | | | |
| loan limit | 0.25 | | | | | | | |
| % of max | 1 | | | | | | | |
| Loan value | 375 | | | | | | | |
| # of loans/yr | 1 | 2 | 3 | 4 | 5 | 6 | 7 | 8 |
| Loan fees | 63.75 | 127.5 | 191.25 | 255 | 318.75 | 382.5 | 446.25 | 510 |
| % of income | 0.2% | 0.3% | 0.5% | 0.7% | 0.8% | 1.0% | 1.1% | 1.3% |

| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| fee rate | 0.17 | | | | | | | |
| loan limit | 0.3 | | | | | | | |
| % of max | 1 | | | | | | | |
| Loan value | 450 | | | | | | | |
| # of loans/yr | 1 | 2 | 3 | 4 | 5 | 6 | 7 | 8 |
| Loan fees | 76.5 | 153 | 229.5 | 306 | 382.5 | 459 | 535.5 | 612 |
| % of income | 0.2% | 0.4% | 0.6% | 0.8% | 1.0% | 1.2% | 1.4% | 1.6% |

## RATIONALE FOR REFUSAL TO FULLY ANSWER THE QUESTION:

| | | | |
|---|---|---|---|
| **Document:** | CAC Pre-Filed Evidence, Tab 7, *Manitoba Consumers' Experiences with Payday Loans: Pricing and Practices of Licensed Payday Lenders in Manitoba* | **Page No.:** | 10 |
| **Topic:** | Payday Lending Industry | | |
| **Subtopic:** | Regulation | | |
| **Issue:** | Rate | | |

## PREAMBLE TO IR (IF ANY):

Sinclair notes that a number of payday lenders with whom he spoke expressed concern over the possibility of reducing the maximum amount loaned to 25% of the borrower's net monthly income.

## QUESTION:

Please provide any reasons for the concern given by lenders.

## RATIONALE FOR QUESTION:

To further understand industry perspective on rates.

## RESPONSE:

There were two reasons:

- The limitation on the loan size would mean the loan is not adequately large
- And if the loan ceiling is too low then people would be more likely to take out additional loans with another lender including online lenders

## RATIONALE FOR REFUSAL TO FULLY ANSWER THE QUESTION:

| | | | |
|---|---|---|---|
| **Document:** | CAC Pre-Filed Evidence, Tab 3, *An Economic Analysis of the Payday Loan Industry and Recommendations for Regulation in Manitoba* | **Page No.:** | 8 |
| **Topic:** | Payday Lending Industry | | |
| **Subtopic:** | US Regulations | | |
| **Issue:** | Rate | | |

## PREAMBLE TO IR (IF ANY):

Dr. Robinson states that a number of US States enacted rate caps that were too low for payday lenders to operate, causing lenders to exit those states.

## QUESTION:

(a) Please provide information as to which States enacted rate caps that were considered too low; and

(b) What rates were considered too low for payday lenders to operate.

## RATIONALE FOR QUESTION:

To understand application of US industry information in the Canadian context.

## RESPONSE:

Those states not listed in the Appendix are the ones that enacted rate caps that caused all payday lenders to exit the business. The rates used to close down the business varied somewhat, but the commonest one was an APR of 36%. Even an APR of 60%, the Criminal Code limit, would clearly be too low. It would equate, very roughly, to a fee of $2.50 per hundred loan principal. In an IR response to the CPLA, the Coalition advanced the opinion that at the very least, a fee cap could be no less than $10 per hundred to allow any lenders to operate, and very probably the cap needs to be closer to $15.

## RATIONALE FOR REFUSAL TO FULLY ANSWER THE QUESTION:

| | | | |
|---|---|---|---|
| **Document:** | CAC Pre-Filed Evidence, Tab 3, *An Economic Analysis of the Payday Loan Industry and Recommendations for Regulation in Manitoba* | **Page No.:** | 8<br>Appendix 3 |
| **Topic:** | Payday Lending Industry | | |
| **Subtopic:** | US Regulations | | |
| **Issue:** | Rate | | |

## PREAMBLE TO IR (IF ANY):

Dr. Robinson observes that most US States that still permit payday loans have rate caps substantially lower than Canadian rate caps.

## QUESTION:

Please provide any information available as to profitability of payday lending industry in any of the States with rate caps lower than Manitoba.

## RATIONALE FOR QUESTION:

To understand applicability of information regarding US industry in the Manitoba context.

## RESPONSE:

Most of the states listed in the Appendix have rate caps lower than Manitoba. The commonest cap is a flat $15 per hundred. Some states reduce the rate for loan principal above $500. The US companies do not provide state by state profitability. We can infer that they are at least earning their cost of capital on average:

- Grupo Elektra took over Advance America after most of the US and Canadian rate caps had been in place for a number of years;
- Lonestar Financial took over Dollar Financial after most of the US and Canadian rate caps had been in place for a number of years;

- All the states listed in the Appendix have rate caps, most of them are slightly lower than Manitoba's, and yet they continue to have significant numbers of payday loan stores. Many of the states shown in Appendix 3 have rate caps materially lower than Manitoba and yet have more payday loan stores per 100,000 population than Manitoba, and more than the other Canadian provinces which have much higher rate caps than Manitoba: California, Florida, Indiana, Iowa, Kansas, Michigan, Mississippi, New Mexico, Oklahoma, South Carolina and Wyoming.

## RATIONALE FOR REFUSAL TO FULLY ANSWER THE QUESTION:

| | | | |
|---|---|---|---|
| **Document:** | CAC Pre-Filed Evidence, Tab 3, *An Economic Analysis of the Payday Loan Industry and Recommendation for Regulation in Manitoba* | **Page No.:** | 11 |
| **Topic:** | Payday Lending Industry | | |
| **Subtopic:** | Cost of Issuing Payday Loans | | |
| **Issue:** | Financial Model | | |

## PREAMBLE TO IR (IF ANY):

Dr. Robinson states that "The financial model estimates a cost structure for an efficient payday lending store, including cost of capital, for a single store that can be either a sole proprietorship or one outlet in a chain of stores."

## QUESTION:

a) Please provide electronic version of regulatory financial model used to produce the evidence included in the filing in particular table 6.

b) Please provide a description of any changes to the model since 2007-08 hearing.

c) Please indicate the sensitivity of how the inputs (i.e. loan volume, fee charged, operating cost and bad debts expense) would change the output of the financial model.

## RATIONALE FOR QUESTION:

To understand the financial analysis.

## RESPONSE:

Dr. Robinson sent the electronic version to the Board and the intervenors on March 29, 2016 with permission to use it, and he invited questions if anyone needed help with using it. The Excel programming is very simple.

In 2007-08 the form of fee schedules was at issue. For example, Money Mart, charged a fee that was a fixed dollar amount plus a percentage of the final cheque (Money Mart called it a cheque cashing fee) plus 59% EAR (that is not an error, is was an EAR, not an APR). So the spreadsheet at that time had a number of extra lines to estimate the fees arising from fee structures of that sort, including an estimate of the distribution of loan sizes. The 2016 model dispenses with all that because everyone seems to have settled on a single rate cap regardless of loan size or time to maturity. Other than that, the model has not changed materially. The input numbers are very different because we have regulated rates now, and costs have naturally changed in the intervening years.

Table 6 Variations on the Base Case provides a series of different scenarios that incorporate different values of key variables. This table is intended to assist the Board in its determination of what effect a reduction in the rate cap would have. The Board or the other intervenors could use the Excel spreadsheet that Dr. Robinson provided to develop scenarios they wish to investigate. There are methods other than scenario analysis that are used to test the sensitivity of economic models, but they require a quantity and quality of statistical data that the industry has declined to provide. The scenario analysis of Table 6 is the only valid method, and the scenarios must be carefully considered. In particular, the different variable values used must be logically consistent as a set.

## RATIONALE FOR REFUSAL TO FULLY ANSWER THE QUESTION:

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| **Document:** | CAC Pre-Filed Evidence, Tab 3, *An Economic Analysis of the Payday Loan Industry and Recommendations for Regulation in Manitoba* | **Page No.:** | 16<br>Appendix 3 |
| **Topic:** | Payday Lending Industry | | |
| **Subtopic:** | Operations | | |
| **Issue:** | Financial Model | | |

## PREAMBLE TO IR (IF ANY):

Dr. Robinson states that his model is based on an efficient lender.

## QUESTION:

Please advise as to what is meant by efficient in this context and what factors influence efficiency.

## RATIONALE FOR QUESTION:

To understand assumptions in the model.

## RESPONSE:

An efficient lender uses all the inputs to the business at their highest and best use in economic terms. The office is busy all the time, the staff do not sit around doing nothing, there are customers coming and going all the time and there is no unused space. This is the basis of many challenges in utility rate regulation where utilities are expected to demonstrate that costs are "prudent and reasonable".. The companies are required to provide detailed evidence showing that they need all the assets they are claiming to apply the WACC against, that they need all the expenses that are listed, to produce the power or move the natural gas, or whatever the regulated industry does.

In the case of the payday loan industry, there is very little data and the companies are not asked to show their need for assets and expenses, or even to provide to the Board the financial statements showing that they are spending what they claimed in the seriously flawed and invalid studies like Ernst & Yong (2004) and Schedule D Deloitte Report in the CPLA evidence. The only evidence available to the Coalition is the published data of payday lenders whose shares are traded on an exchange and only the data from the Canadian segment of Dollar Financial is really relevant.

The Ernst & Young (2004) report, for all its flaws, did have some evidence that seems to be quite consistent and reliable. While the actual numbers are invalid, the relative cost structures of what it calls mono-line versus multi-line providers make perfect sense from an efficiency perspective. Dr. Robinson's evidence has mentioned the issue of efficiencies of scale and scope. For a retail business, which is a correct categorisation of a payday lender, the ability to push more products through a store and to carry a wider range of products, is essential to survival and success. One way to express it is that you want each customer to go through the cashier with a bigger ticket. The cost of the cashier's wages is not affected much by ringing in an extra item, though it is raised somewhat in the payday context. But more important, if you are selling more stuff and more variety of stuff, both the space and staff are more fully employed without raising costs very much. In terms of operating costs of payday lenders, the 10K report of Dollar Financial shows that occupancy costs and wages and salaries are by far the largest categories. An efficient lender will keep those resources occupied.

It is fortunate that Money Mart, the Canadian segment of Dollar Financial, seems to fit the efficiency criterion. It is a multi-line operator. Money Mart was early into both cheque cashing and payday lending, and it clearly has larger volumes than many lenders. It has added a number of other product lines, though none of them contributes a great deal to the revenue stream yet. Money Mart has many stores to share fixed costs like computer system development. Therefore, Dr. Robinson uses Money Mart's cost structure to exemplify an efficient lender, with one nagging concern that he did not identify in his original work in 2007-08.

Dollar Financial has an absolutely enormous amount of completely unidentified expenses, and Dr. Robinson has no way to determine what they are, nor has he been able to think of any reasonable business justification for them. The Coalition posed an information request relating to them. Dr. Robinson discussed this issue in his report and it relates also to CAC PUB IR 1-31. In particular, in the context of a regulated Canadian company, Dr. Robinson cannot conceive of an efficient Canadian operation needing its allocable share over $100 million in unidentified corporate expenses. As an expert financial statement analyst and expert in investment decisions, Dr. Robinson regards the financial statements of Dollar Financial as raising a significant red flag regarding the appropriateness of the expenses, even from the point of view of ordinary investors, let alone the Canadian borrowers who are paying far higher fees than American borrowers, to support costs incurred in the US.

## RATIONALE FOR REFUSAL TO FULLY ANSWER THE QUESTION:

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| **Document:** | CAC Pre-Filed Evidence, Tab 3, *An Economic Analysis of the Payday Loan Industry and Recommendation for Regulation in Manitoba* | **Page No.:** | 13, Table 1 |
| **Topic:** | Payday Lending Industry | | |
| **Subtopic:** | | | |
| **Issue:** | Operating Costs per Loan | | |

## PREAMBLE TO IR (IF ANY):

In Table 1, the operating cost per $100 loan (in Dr. Robinson's model) is $11. The table represents a single store. If it is part of a chain, then the operating cost line and the capital investment include costs that are not directly part of the store, but instead are administrative or head office costs.

In the Deloitte LLP report provided by CPLA, the operating cost per $100 loan is $12.84 in Alberta.

## QUESTION:

a) Please provide the quantitative analysis which supports the assertion that $11 per $100 in loans should be used in the base case.

b) Please comment on CPLA's estimate operating cost per store versus that used by Dr. Robinson.

c) If Table 1 changes to a chain store, what is the operating cost per $100 loan?

d) Please explain to what extent administrative costs should be included in the analysis if based on a chain store.

## RATIONALE FOR QUESTION:

To assess the reasonableness of operating costs for payday lenders.

## RESPONSE:

The Coalition response:

The Coalition notes that it has asked the CPLA a number of information requests relating to the Deloitte report. It has asked which witness of Deloitte will appear before the PUB to defend it as well as for confirmation of which four firms were surveyed.

The Coalition also has sought discovery on a number of questions posed by Deloitte to Alberta payday lenders which Deloitte does not report on. Responses to these questions should assist in understanding a number of puzzling aspects of the Deloitte report.

The Coalition reserves the right to provide further response upon reviewing the CPLA information responses.

Dr. Robinson responds:

First Dr. Robinson wishes to explain something that perhaps he did not make clear. Table 1 is a chain store in effect. A share of the chain's head office costs are allocated to each store so that the analysis focuses on this single table. Multiply the financial statement lines in the table by the number of stores and you get a whole company.

Please see again the discussion of how the Money Mart costs enter into Table 1 for an explanation and also see the response to IR 1 – 30. Money Mart is standing in as the efficient lender. These discussions should make it plain that there is no formal quantitative analysis possible to justify $11 specifically. The quantitative work gives a range of values depending on how much of the mysterious head office and "other" expenses are legitimately assigned to the Canadian Money Mart subsidiary. In market terms, if Money Mart were to be spun off as an independent company operating only in Canada, as it was prior to 1992, how much would it have to spend to replace the Dollar Financial Head Office.

In Dr. Robinson's wide experience of over 30 years of analysing financial statements of companies in every possible business, many of whom he has also invested in, others he has audited, he has not seen such a high proportion of expenses that are unidentifiable. In his opinion, allowing an $11 per hundred cost factor is more likely to be favouring the industry than to be favouring the consumer. Of course, he could be persuaded to change his mind if he had a complete set of audited financial statements for several years of all the payday loan firms in Manitoba.

Without the complete documentation that supports the Deloitte estimates, Dr. Robinson cannot say much about their validity. He notes that his estimate of the all-in cost of Money Mart, which forces Money Mart to absorb a large share of the head office costs solely because MoneyMart is more successful than other units, is $12.01 per hundred, which is at least in the same area as the Deloitte estimate. One of the problems of comparing with the Deloitte work is that there are internet loans mixed in, whereas Dr. Robinson is basing his recommendations on regulating storefronts only.

There is a broader issue with all the content of the Deloitte report and this is the sample selection bias. It appears that Deloitte did not ask all lenders, it asked only four. Since it got all four to respond, which is not what we usually expect, it is open to us to infer that the CPLA asked them to participate before Deloitte ever "selected" them, and therefore the sample is not independent at all, it represents exactly what the CPLA wanted to present. This is a total contrast with the sampling work of the Coalition's field researchers and the sampling procedures of Statistics Canada, whose surveys provide the data for Simpson and Islam (2016). The information provided in Appendix 1 and Appendix 7, from the regulators is not sample data, it is population data, and such data is ordinarily much more reliable.

The Alberta regulator is unable to provide a list of all payday lending locations in the province, which rather hampers our research, since we don't have the time and budget to search every possible company and every possible town in Alberta, and the large company websites are not designed to be helpful for such a search. However, we have the regulator's guess that there are 235 separate outlets, and Deloitte reports that its survey had 185 outlets. Dr. Robinson did enough searching to have some confidence that this means the survey must include Money Mart, Cash Money and Cash Canada, plus one more firm, in order to get that many outlets with only four firms. We also note that the report says only two of the firms have internet lending, but according to their websites, all three we named lend on-line. The issue of sample selection bias and reliability comes up again in IR 32.

## RATIONALE FOR REFUSAL TO FULLY ANSWER THE QUESTION:

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| **Document:** | CAC Pre-Filed Evidence, Tab 3, *An Economic Analysis of the Payday Loan Industry and Recommendation for Regulation in Manitoba* | **Page No.:** | Table 1 |
| **Topic:** | Payday Lending Industry | | |
| **Subtopic:** | Operating Costs | | |
| **Issue:** | Bad Debt Expense | | |

## PREAMBLE TO IR (IF ANY):

In Table 1, Dr. Robinson uses 2.2% for bad debt rate/loans. In the Deloitte LLP report provided by CPLA, the bad debt cost per $100 loan is $6.35 for Alberta.

## QUESTION:

a) Please explain the reasonableness of bad debt rates calculated in the economic analysis and comment on that provided in the Deloitte LLP report.

b) Please refile the analysis in Table 6 using a doubling of the bad debt expense ratio than that used in Dr. Robinson's economic analysis.

c) Please provide an updated financial run (table 6) based on the $6.35 per 100 used in the Deloitte LLP Report.

## RATIONALE FOR QUESTION:

To understand the impact of bad debt expense on payday lenders' profitability at different fee levels.

## RESPONSE:

<u>The Coalition Responds:</u>

We have advised Dr. Robinson that we will confer with PUB legal counsel before providing a response to PUB 1-32 c) given that the question as posed would not allow for an “apples to apples” comparison due to the definition of bad debt cost employed by Deloitte.

<u>Dr. Robinson responds:</u>

Dr. Robinson is of the view that there is substantial reason to question the bad debt rates calculated in the Deloitte report.

Dr. Robinson has reported the bad debt rates for Money Mart in 2013, Cash Store in 2013 before it failed, BC and NS. All these sources are far lower than the rates claimed for Alberta.

No independent evidence of the basis for the Alberta rates is provided. They appear to be calculated incorrectly in that they double count the loss of the fee. The loss is the principal loaned, not the principal plus the opportunity cost of the lost fee. This number could not in any case be entered into Dr. Robinson’s model, which is a cash flow model plus opportunity cost of capital. Even accountants, other than Deloitte, do not record the lost interest on loans as if it were lost cash flow. (Could you write this last sentence better)

## RATIONALE FOR REFUSAL TO FULLY ANSWER THE QUESTION:

Given the different definition of bad debt cost employed and the apparent double counting undertaken by Deloitte, PUB 1-32 c) would not provide an apple to apples comparison.

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| **Document:** | CAC Pre-Filed Evidence, Tab 3, *An Economic Analysis of the Payday Loan Industry and Recommendation for Regulation in Manitoba* | **Page No.:** | 23, Table 4 |
| **Topic:** | Payday Lending Industry | | |
| **Subtopic:** | Cost of Capital | | |
| **Issue:** | Weighted Average Cost of Capital | | |

## PREAMBLE TO IR (IF ANY):

Dr. Robinson comments that a 14% return on equity is very high.

## QUESTION:

a) Please provide the supporting analysis which indicates the Canadian and US Equity real return is 5-6%.

b) What would be a reasonable nominal equity ratio for a payday lender? Please explain.

c) Please provide the WACC based on that provided in (b).

d) Please discuss the appropriateness of using a notional 60/40 capital structure for the determination of WACC.

## RATIONALE FOR QUESTION:

To assess the reasonableness of WACC.

## RESPONSE:

First, the implicit assumption underlying all the work on revenues and cost structures is that they are expressed in real dollars. They have to be if they are treated as perpetuities. The discussion in both Ernst & Young (2004) and Deloitte (2015) makes it clear that they are unaware of this fundamental assumption underlying financial modelling. That fact alone makes 14% too high.

- Most investments and introductory finance textbooks include tables showing a history of annual rates of return. Kwok Ho and Chris Robinson, *Personal Financial Planning 5e*, 2012, Captus Press, includes such tables, with the data provided by PlanPlus Inc, a company that designs and sells financial planning software around the world. Appendix E shows the geometric mean return of a composite Canadian equity index and a composite US equity index as 5.23% and 5.26% respectively, for the period 1957 – 2010. Professor Aswath Damodaran of New York University is one of the world's most respected and cited finance researchers and teachers. He provides huge amounts of data and analysis, continuously updated, for free on his website, http://pages.stern.nyu.edu/~adamodar/. His current estimate for nominal cost of equity by industry average 9.06% and range from 5% for banks to 13% for oilfield services. If we assume an expected inflation rate of about 2%, that translates into cost of equity of just under 7% to just under 11%.

- Dr. Robinson is not sure what the question means. He assumes it means what is weighting of debt and equity, although that also seems to be part c. In classic finance, the weighting is done using market values, but the debt of these small companies is not traded on a market. Dr. Robinson looked at the weights of the four companies listed in IR 1 – 40 even though he has not had time to investigate them fully, and finds they have lower weights to debt on average. Let us suppose that an alternative weight would be 85% equity, 15% debt, for the next question.

- Dr. Robinson believes this IR was posed to get a better idea of a reasonable range of values for the WACC. The discussion in this IR and 1 – 34 shows that 10% is as high as you could possibly expect for a debt rate. Anything higher than that would be the yield of a company in financial distress. The possible variations to Dr. Robinson's values in the report lie in different equity rates and different weights of debt and equity. Let us introduce the Capital Asset Pricing Model as another way to estimate the cost of equity. Analysts use it more than any other model for estimating cost of equity.

  The beta for payday lenders can be estimated from the four companies listed in 1-40, though this is a regrettably small sample. Their betas, drawn from Yahoo Finance, range from .79 to 2.03, with an average of 1.4, which is quite high. The risk premium the difference between the risk free rate and the expected rate of return of the entire market, is often estimated as 5% - 6% by such authorities as

Damodaran. The current risk free rate for Canada, based on long Canada bonds, is about 2.1%. The CAPM yields as an equity cost estimate:

Cost of equity = 2.1% + 1.4(5.5%) = 9.8% nominal rate

Real cost of equity = 1.098/1.02 – 1 = 7.7%

Real cost of debt after tax – [1 + (10% X .75)]/1.02 = 5.4%

Using the alternative weighting of only 15% debt,

WACC = .85(7.7%) + .15(5.4%) = 7.4% real.

This alternative set of inputs yields a result slightly lower than the one Dr. Robinson used in his Report, section 2. The difference is not enough to affect his conclusions. The value plucked out of the air in the Deloitte report is seen to be much too high.

## RATIONALE FOR REFUSAL TO FULLY ANSWER THE QUESTION:

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| **Document:** | CAC Pre-Filed Evidence, Tab 3, *An Economic Analysis of the Payday Loan Industry and Recommendation for Regulation in Manitoba* | **Page No.:** | 22 |
| **Topic:** | Payday Lending Operations | | |
| **Subtopic:** | Cost of Capital | | |
| **Issue:** | Cost of Debt used in WACC | | |

## PREAMBLE TO IR (IF ANY):

Dr. Robinson states: "The average interest expense on the financials is 9.2% after deducting a large hedge expense. An interest rate of 10% is a reasonable estimate." The estimate is based on in part an analysis of Dollar Financial, a large payday lender.

## QUESTION:

a) Please discuss the reasonableness of using 10% for interest rate and whether this rate would be applicable for other, smaller payday lenders.

b) If there is a different rate for smaller payday lenders, please indicate the impact on the WACC.

## RATIONALE FOR QUESTION:

To assess the reasonableness of allowed rate of return for Manitoba payday lenders.

## RESPONSE:

The interest rate of 10% is very high in this era of low rates, when some governments are flirting with issuing zero rate bonds and the German government has already done so. It is reasonable to consider payday lenders as having a higher than average default risk, but 10% is really high. Damodaran (see PUB IR 33) shows a range of corporate debt rates from 3.5% for banks to 7.8% for precious metals and mining. In practice, smaller single store operations will pay much lower debt rates because no bank will lend money to them with the business as security, the banks will require the owner's house as collateral, and the rate will look more like a residential mortgage rate of 4 – 5%. Small businesses in general are accustomed to this practice, not just payday lenders.

## RATIONALE FOR REFUSAL TO FULLY ANSWER THE QUESTION:

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| **Document:** | CAC Pre-Filed Evidence, Tab 2, *Payday Lending: A Mature Industry with Chronic Challenges* | **Page No.:** | 24 |
| **Topic:** | Payday Lending Industry | | |
| **Subtopic:** | Colorado Regulations | | |
| **Issue:** | Installment Loans | | |

## PREAMBLE TO IR (IF ANY):

Dr. Buckland references the Payday Loan model implemented in the US State of Colorado in 2010, requiring payday lenders to transform their loans into longer term six month loans repaid with installments.

## QUESTION:

Please advise as to whether, and how, the regulations in Colorado pre-2010 were comparable to those in Manitoba.

## RATIONALE FOR QUESTION:

To assess the applicability of the Colorado regulations in the Manitoba context.

## RESPONSE:

Today payday loan regulations in Colorado require lenders to offer 6-month installment repayment loans. The Colorado payday loan industry prior to these regulations were similar to those in Canada in that they involved short-term single repayment loans but they were capped at $15/$100 loaned (Pew Charitable Trusts 2014, p.7-8). Concern mounted regarding the issue of repeat borrowing, “By 2008, consumer advocates and many state lawmakers in Colorado agreed that conventional payday loans were harmful to consumers, and that the market was not price competitive (Pew Charitable Trusts 2014, p.8).”

## RATIONALE FOR REFUSAL TO FULLY ANSWER THE QUESTION:

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| **Document:** | CAC Pre-Filed Evidence, Tab 3, *An Economic Analysis of the Payday Loan Industry and Recommendation for Regulation in Manitoba* | **Page No.:** | 33 |
| **Topic:** | Payday Lending Industry | | |
| **Subtopic:** | Alternatives to Payday Loans | | |
| **Issue:** | Installment Loans | | |

## PREAMBLE TO IR (IF ANY):

Dr. Robinson states: "Usually payday loans are a single repayment of principal and interest. Installment loans with equal periodic payments have entered the payday world in two different forms. One is a longer-term, very high interest rate loan, offered as a product by a lender. The other form is an option to convert a payday loan to an installment loan if the borrower is unable to repay it on the due date."

## QUESTION:

a) Please provide the preferred scheme the Board should be using for “installment loan”.

b) Please describe the regulatory changes that would be required to allow for such loans as part of payday lending practices.

## RATIONALE FOR QUESTION:

To understand how installment loans could be introduced in payday lending operations.

## RESPONSE:

This is a very interesting question. I am unable to give it the attention it requires given data, time and budget limitations

In terms of potential regulatory changes, I have referred that question to legal counsel who may be able to provide further comment as the hearing proceeds.

## RATIONALE FOR REFUSAL TO FULLY ANSWER THE QUESTION:

This question and IR 1-37 require very challenging analyses and are beyond the budget and the short time frame allowed for the information requests. They require data that the industry has declined to provide and therefore Dr. Robinson would have to develop new models with the data sources he has used for his analysis, rather than with the data he really needs. Furthermore, Dr. Robinson does not believe that regulations for an installment plan that borrowers opt into at or before the first due date could be developed successfully without consultation with the industry. Dr. Robinson has offered to participate in such an effort, which would be relevant to all eight provinces that allow payday lending.

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| **Document:** | CAC Pre-Filed Evidence, Tab 3, *An Economic Analysis of the Payday Loan Industry and Recommendation for Regulation in Manitoba* | **Page No.:** | 39, Table 6 |
| **Topic:** | Payday Lending Industry | | |
| **Subtopic:** | Alternatives to Payday Loans | | |
| **Issue:** | Profitability of Payday Lenders with Installment Loans | | |

## PREAMBLE TO IR (IF ANY):

## QUESTION:

a) Please provide the impact on the profitability of payday lenders (Table 6) assuming the following scenarios:

I. 10% of the loan volume written is converted to an installment loan over 6 months or 12 months;

II. 30% of the loan volume written is converted to an installment loan over a 6 month or 12 month term.

b) Please provide your assumptions and commentary on the impact of the introduction of the installment loans on the payday lenders profitability.

## RATIONALE FOR QUESTION:

To understand the impact of installment loans on payday lending in Manitoba.

## RESPONSE:

Please see the response to PUB/CAC 1-36.

## RATIONALE FOR REFUSAL TO FULLY ANSWER THE QUESTION:

| **Document:** | CAC Pre-Filed Evidence, Tab 2, *Payday Lending: A Mature Industry with Chronic Challenges* | **Page No.:** | 24 |
|---|---|---|---|
| **Topic:** | Payday Lending Industry | | |
| **Subtopic:** | | | |
| **Issue:** | Ontario Study | | |

## PREAMBLE TO IR (IF ANY):

Dr. Buckland references report of a panel appointed by the Ontario Government.

## QUESTION:

Please produce report if available.

## RATIONALE FOR QUESTION:

To provide further detail regarding the issues examined in Ontario review.

## RESPONSE:

Please see PUB Appendix 1, Deloitte Payday Lending Report.

## RATIONALE FOR REFUSAL TO FULLY ANSWER THE QUESTION:

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| **Document:** | CAC Pre-Filed Evidence, Tab 3, *An Economic Analysis of the Payday Loan Industry and Recommendations for Regulation in Manitoba* | **Page No.:** | 5 |
| **Topic:** | Payday Lending Industry | | |
| **Subtopic:** | | | |
| **Issue:** | Financial Information | | |

## PREAMBLE TO IR (IF ANY):

Dr. Robinson references affidavit evidence in the CashStore bankruptcy filing indicating an average loan size of $449.00 in 2014 for the Province of British Columbia.

## QUESTION:

a) Please provide basis for assumption that the loan size of $449.00 would be a reasonable average size for Canada.

b) Please advise as to whether this would be an assumed reasonable average size for Manitoba.

## RATIONALE FOR QUESTION:

To understand assumptions made by Dr. Robinson and application to the Manitoba context.

## RESPONSE:

Please see Appendix 7 for Nova Scotia data and Schedule G Deloitte Report of the CPLA evidence. The average loan sizes for the most recent reports we have are thus: BC, $449; Alberta, $528; and, Nova Scotia, $433. The regulator data is complete, covering all lenders, and therefore more reliable. The respondents to the Alberta study are primarily the largest firms. Inflation also raises the loan size every year and all the data suffers from an unavoidable reporting lag. Manitoba is perhaps a bit less wealthy than the Canadian average, but that does not necessarily mean that loans would be smaller, particularly given the evidence from the CPLA that 68% of borrowers did not borrow the maximum amount they qualified for.  Dr. Robinson judges that an average loan size of $450 for Canada and Manitoba is appropriate for this report.

## RATIONALE FOR REFUSAL TO FULLY ANSWER THE QUESTION:

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| **Document:** | Pre-Filed Evidence of CAC, Appendix B, *Pew Charitable Trusts Report* | **Page No.:** | |
| **Topic:** | Payday Lending Industry | | |
| **Subtopic:** | | | |
| **Issue:** | Operating Costs | | |

## PREAMBLE TO IR (IF ANY):

## QUESTION:

Does the Coalition or any of its experts have any information comparing operating costs of payday lenders in the US to those in Canada? If so, please provide.

## RATIONALE FOR QUESTION:

To assess applicability of findings in Pew's research in the Canadian context.

## RESPONSE:

It is possible to work on this problem using public data from four US payday lending firms that still have their shares listed on a stock exchange: Cash America, QC Holdings, EZ Corp and First Cash Financial. There are many complications in the details, because the analyst has to understand each company's business thoroughly before doing any calculations. Time and budget do not permit that work to be completed within the information request time span. In addition, it is quite possible that factors unique to each business such as whatever other businesses each one operates will make the results of limited use for a Canadian comparison.

No-one in the Coalition has seen analysis of costs and a regulatory model of the sort that Dr. Robinson has performed, which is somewhat surprising since it is simply an application of widely-used utility regulation principles.

## RATIONALE FOR REFUSAL TO FULLY ANSWER THE QUESTION:

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|---|---|---|---|
| **Document:** | CAC Pre-Filed Evidence, Tab 7, *Manitoba Consumers' Experiences with Payday Loans: Pricing and Practices of Licensed Payday Lenders in Manitoba* | **Page No.:** | |
| **Topic:** | Payday Lending Industry | | |
| **Subtopic:** | Manitoba Practices | | |
| **Issue:** | Lending Practices | | |

## PREAMBLE TO IR (IF ANY):

## QUESTION:

Did Sinclair obtain any information from lenders as to the proportion of consumers who have open loans at two or more lenders at a given time? If so, please provide that information.

## RATIONALE FOR QUESTION:

To obtain information as to frequency or likelihood of multiple payday loans.

## RESPONSE:

We did not ask that question and we were not provided that information.

## RATIONALE FOR REFUSAL TO FULLY ANSWER THE QUESTION:

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|---|---|---|---|
| **Document:** | CAC Pre-Filed Evidence, Tab 8, *Inner City and Suburban Payday Lenders in Winnipeg from 1994 to 2015* | **Page No.:** | |
| **Topic:** | Payday Lending Industry | | |
| **Subtopic:** | | | |
| **Issue:** | Market Conditions | | |

## PREAMBLE TO IR (IF ANY):

## QUESTION:

Please provide any information explaining decline of number of lenders in inner city and suburban Winnipeg from 2012 to 2013.

## RATIONALE FOR QUESTION:

To understand factors influencing payday lending market in Winnipeg.

## RESPONSE:

The Coalition's understanding is that the decline between 2012 and 2013 is largely related to changes in the CashStore business model. In particular, please see the press release of Manitoba from October 2012 indicating that CashStore was no longer licensed to provide payday loans in the province.

http://news.gov.mb.ca/news/index.html?archive=&item=15504&utm_source=F2610&utm_medium=F2610&utm_campaign=F2610

In addition, please see the CBC news story raising concerns that the CashStore was offering lines of credit that strongly resembled payday loans.

http://www.cbc.ca/news/canada/manitoba/payday-lenders-lines-of-credit-questioned-in-manitoba-1.1397013

As the Coalition identified in 2007/08, the CashStore had a problematic business model including fewer economies of scope than MoneyMart (which had cheque cashing as an additional line of business) and higher risk tolerance as reflected in a higher default rate among their borrowers. The Coalition also raised concerns about the transparency of the CashStore financial arrangements with borrowers.

During the 2012/2013 period, the CashStore ceased to be licensed as a payday lender and began to offer a product that had many similarities to a payday loan but no longer fit the statutory description. This left a product in the marketplace that looked like a payday loan in many respects and acted like a payday loan in many respects but was not regulated like a payday loan. This concern was brought to the PUB's attention in 2013.

The PUB may wish to refer to the evidence of the Coalition in 2007/08 and 2013 for a better understanding of these issues. It also may wish to review the evidence and IR responses of the CPLA from 2013 for greater insight.

## RATIONALE FOR REFUSAL TO FULLY ANSWER THE QUESTION: