



PAYDAY LOANS

MARKET TRENDS

OCTOBER 25, 2016

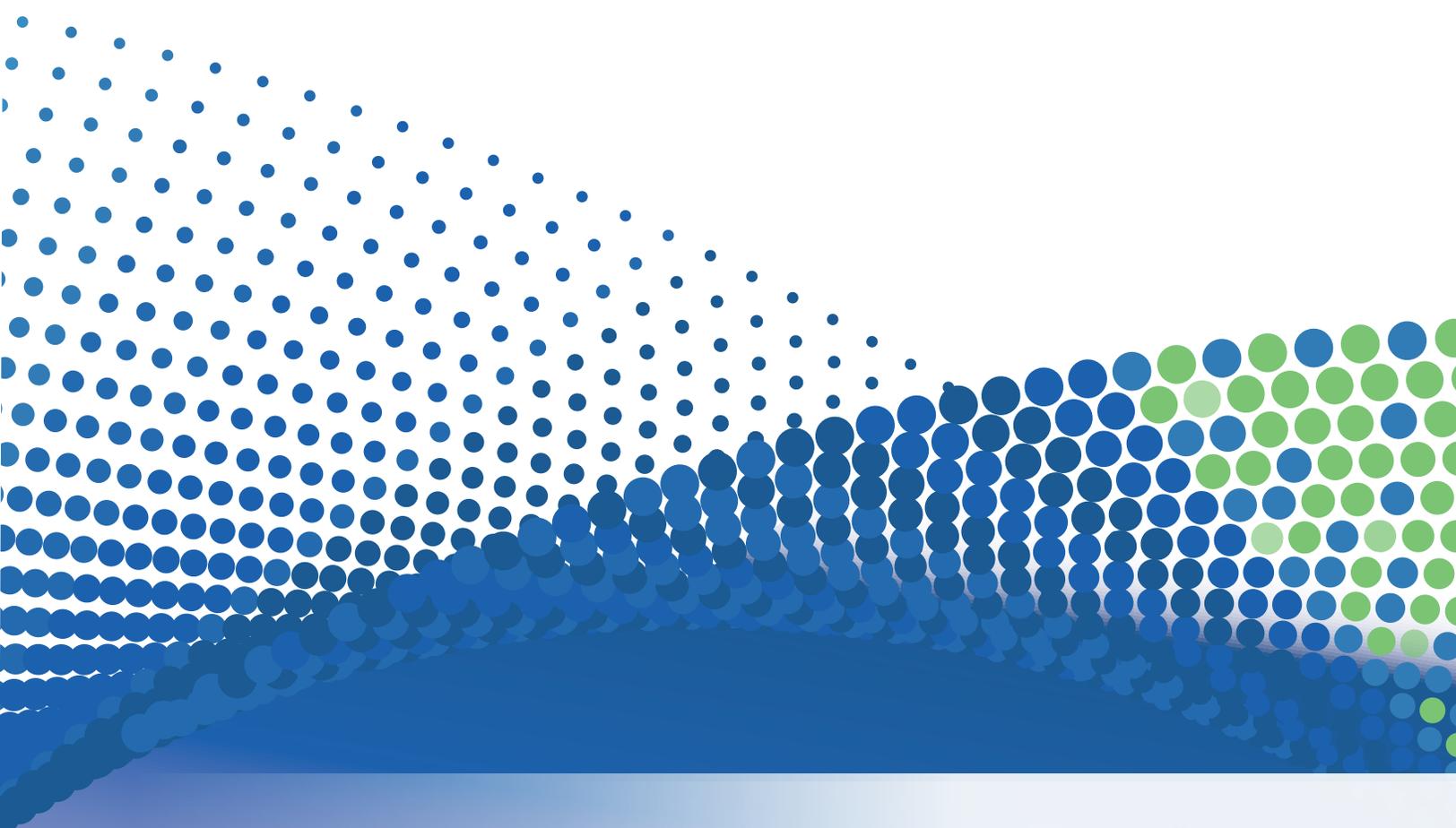


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Payday loans: Market trends

1. Purpose

Payday loans are an expensive way for consumers to borrow money. The use of these short-term, high-cost loans has more than doubled in Canada recently to four percent of Canadian households.¹ The Financial Consumer Agency of Canada (FCAC) has been tasked with raising public awareness about the costs of, and alternatives to, payday loans. FCAC conducted a national survey of 1,500 Canadian payday loan users to inform the Agency's approach to educating consumers. This report presents the survey's findings and FCAC's planned actions to foster consumer understanding of (1) payday loan costs, (2) skills and resources to reduce the need to access payday loans and (3) resources for paying down debts and exiting a debt cycle.

2. Highlights

Our survey findings offer a range of insights that will help inform the development and promotion of consumer educational resources. Three findings are of particular value in directing the focus of FCAC's interventions:

- **Many payday loan users were unaware of the high costs of payday loans compared to their alternatives.**

Fewer than half of respondents (43 percent) understood that a payday loan is more expensive than available alternatives. This suggests that many do not have sufficient knowledge to consistently make the borrowing decisions that best serve their financial well-being.

One of the reasons that payday loan users are unaware of the relative costs may be that many are not currently accessing alternatives. More than 60 percent of respondents said they did not have access to a credit card²—compared to 13 percent of Canadians generally—and 88 percent said they did not have access to a line of credit. This could be due to a combination of factors. While some borrowers may be unaware of options available at traditional financial institutions, others may have been ineligible for more credit.

These findings confirm the need to continue to raise consumer awareness about the costs of, and alternatives to, payday loans. FCAC will promote consumer education resources to assist consumers in understanding the alternatives and their relative costs. FCAC will also continue to work with provinces and territories to contribute to a coordinated, pan-Canadian approach to informing consumers about these topics.

1. In 2014, 4.3 percent of Canadians reported the use of a payday loan in their household in the previous year, in comparison with 1.9 percent in 2009. FCAC calculations of the 2009 and 2014 Canadian Financial Capability Survey data, available through Statistics Canada.

2. The survey asked, "Thinking back to the last time you used a payday loan, which of the following types of financial products did you have access to? [Select all that apply]" and provided a list of financial products. Interpretation of the word "access" may have varied between respondents.

- **Most payday loan users reported borrowing to cover necessary expenses.**

Roughly 45 percent of respondents reported typically using payday loans for **unexpected**, necessary expenses such as car repairs, while 41 percent used them for **expected**, necessary expenses such as utility bills. Compared to the general population, respondents were also substantially less likely to have savings. These findings highlight the need for consumers to increase levels of emergency savings, when feasible, that can be accessed when having difficulty making ends meet. FCAC will develop and promote consumer education material to assist consumers in understanding the importance of maintaining an emergency fund. FCAC will also promote resources to assist consumers to access professional advice when they need assistance to pay down debts.

- **Payday loan use was not restricted to low-income Canadians.**

Our survey shows that while payday loans are primarily used by those with low-to-moderate incomes (more than half lived in households with annual incomes under \$55,000) many higher-income Canadians also reported accessing these loans. Twenty percent of respondents reported household incomes exceeding \$80,000,³ with seven percent over \$120,000. While FCAC's payday loan resources will primarily target consumers with low-to-moderate levels of income, the Agency will also work to ensure that consumers at all income levels benefit from resources related to the costs of payday loans relative to alternatives, saving for emergencies and seeking professional advice when they need assistance choosing products and paying down debts.

3. Background

3.1. Payday lending

A payday loan is a short-term, small-dollar loan (up to \$1,500) offered by a non-traditional financial service provider. It is designed to bridge a borrower through a cash shortfall until their next payday, when generally the loan must be repaid in full.

Payday loans are an expensive way to borrow money. Their costs are typically based on a set dollar amount per \$100 borrowed—for instance, \$21 per \$100, which represents an annual percentage rate (APR) of 546 percent.⁴ The maximum allowable set-dollar amount varies among the provinces that regulate payday loans. Borrowers who cannot repay their loans in full

and on time may face additional fees—including penalties and non-sufficient-funds charges.

Despite the high costs, more Canadians are turning to payday loans. In 2014, four percent of Canadian adults reported that their household resorted to a payday loan in the previous year, up from two percent in 2009.⁵ The Canadian Payday Loan Association reports that nearly 2 million Canadians use payday loans each year.⁶

The *Criminal Code* makes it a criminal offence to charge more than 60 percent interest annually.⁷ However, it also provides for an exception, where provinces choose to regulate payday loans. Most

3. Statistics Canada reports that Canada's median family income was \$78,870 in 2014. See <http://www.statcan.gc.ca/tables-tableaux/sum-som/l01/cst01/famil107a-eng.htm>

4. APR is here calculated as fee charged (assumed at \$21) divided by amount borrowed (\$100), multiplied by number of payments this would represent over a year if rolled over consistently (26), multiplied by 100. For a two-week loan, this equates to an annual percentage rate (APR) of 546 percent (APR = 21/100 X 26 X 100 = 546).

5. FCAC calculations of the 2009 and 2014 Canadian Financial Capability Survey data, available through Statistics Canada.

6. See Canadian Payday Loan Association. History/Backgrounders: <http://www.cpla-acps.ca/english/mediabackgrounders2.php>

7. Annual Percentage Rate (APR), which includes interest and all fees, fines, penalties, commissions or other similar charges payable in exchange for the credit advanced.

provinces have adopted consumer protection measures such as:

- limiting rollovers and concurrent loans
- ensuring full and accurate disclosure of contract terms
- letting borrowers cancel new loans penalty-free within one business day
- requiring an independent complaint resolution mechanism
- adopting acceptable debt-collection practices

Provincial governments are continuing to adapt their regulatory frameworks as the marketplace evolves.

3.2. Survey methodology

In the spring of 2016, FCAC conducted a national survey of 1,500 payday loan borrowers.⁸ Respondents were 18 years of age or older and had used a payday loan within the previous three years. The 63-question survey was conducted online in both official languages. The full methodological report is available through Library and Archives Canada.⁹

Respondents were randomly selected from a broad pool of Canadians who volunteer to participate in online surveys. While these survey results cannot

be generalized to all payday loan users, meaningful conclusions can be drawn from this sample. Online surveys have become commonplace in Canada, and findings have been shown to generalize well.¹⁰ However, one of the drawbacks of having respondents report on their own behaviour in surveys is that their responses may not be perfectly accurate.

8. As a basis for this survey, FCAC adopted elements of a survey used by the Ontario Ministry of Government and Consumer Services. FCAC added additional questions from a recent OECD International Network on Financial Education (INFE) survey, and from the Canadian Financial Capability Survey.

9. See <http://www.bac-lac.gc.ca/eng/Pages/home.aspx>

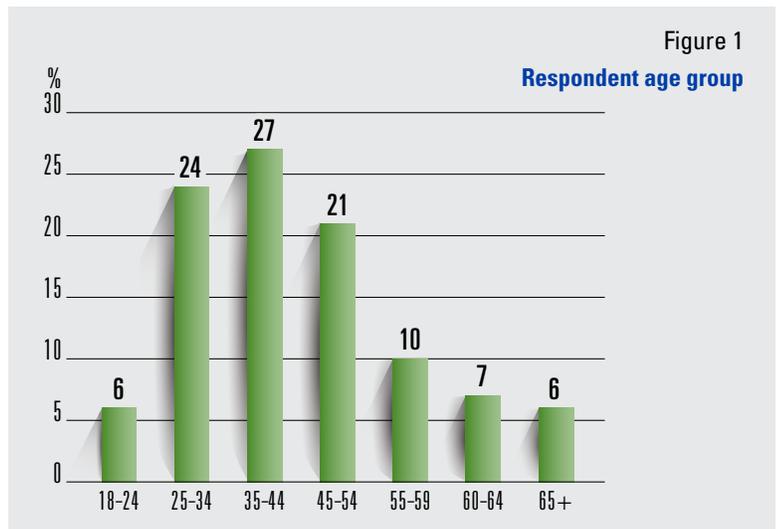
10. See Braunsberger, K., Wybenga, H., & Gates, R. (2007). "A comparison of reliability between telephone and web-based surveys." *Journal of Business Research*, 60, 758-764. It is possible that those individuals with higher literacy skills were more likely to choose to participate in an online survey. The Ontario survey that was used as a base for this survey was also conducted online.

4. Research findings

4.1. Demographics

Most borrowers in our sample were of working age.

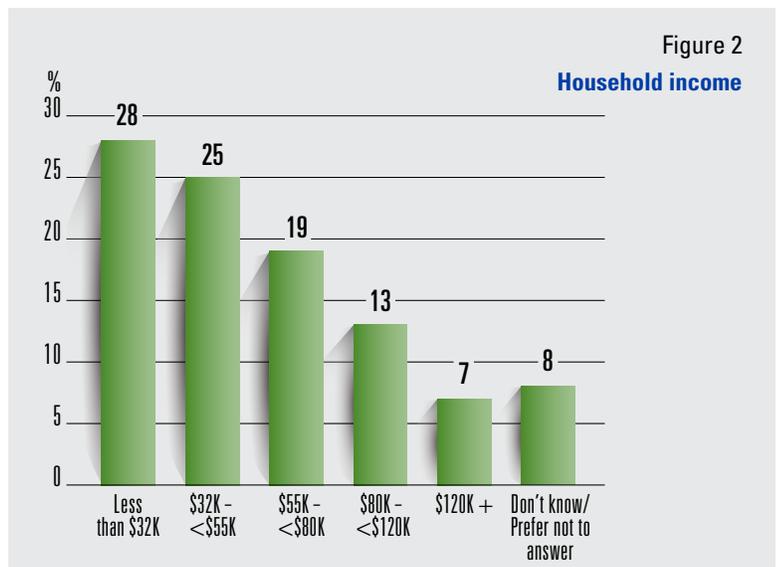
As shown in Figure 1, 72 percent of respondents were between 25 and 54 years of age. Eighty-three percent lived in an urban area, and 55 percent rented their home (while 32 percent owned a home with a mortgage and nine percent owned one without a mortgage.)



More respondents had low-to-moderate incomes.

As shown in Figure 2, over 50 percent lived in households with annual incomes under \$55,000, and over 70 percent lived in households with incomes under \$80,000. However, 20 percent reported household incomes exceeding \$80,000, with seven percent over \$120,000, demonstrating that payday loan use is not restricted to low-income Canadians.¹¹

This demographic information will help FCAC to tailor educational resources.



11. Canada's median family income was \$78,870 in 2014. See <http://www.statcan.gc.ca/tables-tableaux/sum-som/I01/cst01/famil107a-eng.htm>

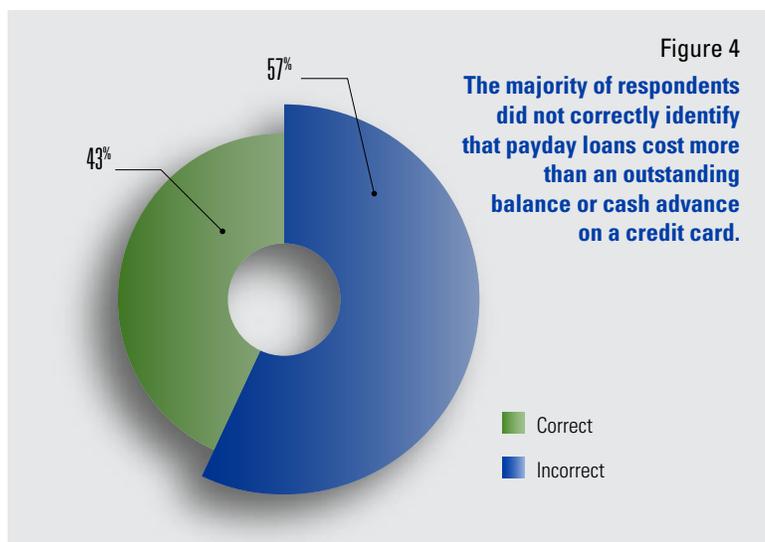
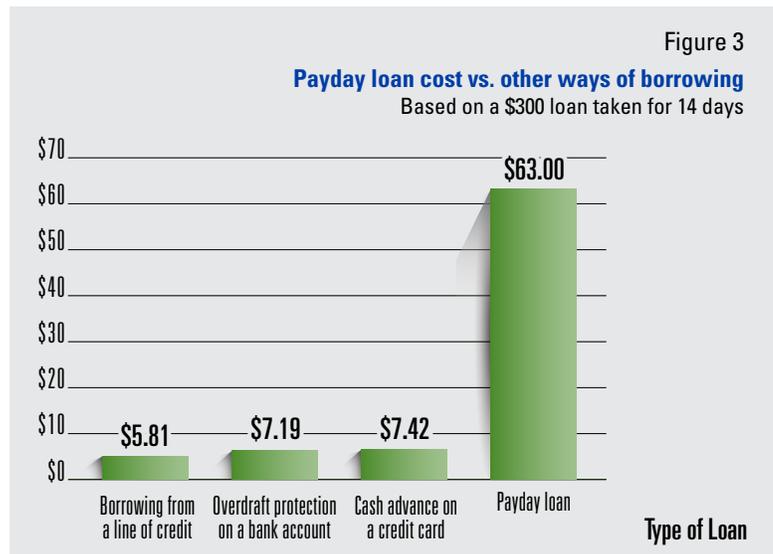
4.2. Understanding costs

Payday loans are an expensive way to borrow money. As shown in Figure 3,¹² they are significantly more expensive than other short-term credit options.

Despite this, **fewer than half of respondents understood that a payday loan is more expensive than an outstanding balance or cash advance on a credit card** (see Figure 4). This indicates that the majority of respondents were

not aware of the relative costs of all short-term credit options and may be using payday loans more often as a result.

This highlights the need to increase consumer awareness about the relative costs of various credit products.



12. See <http://www.fcac-acfc.gc.ca/Eng/forConsumers/topics/creditLoans/Pages/Paydaylo-Prtsurs.aspx>

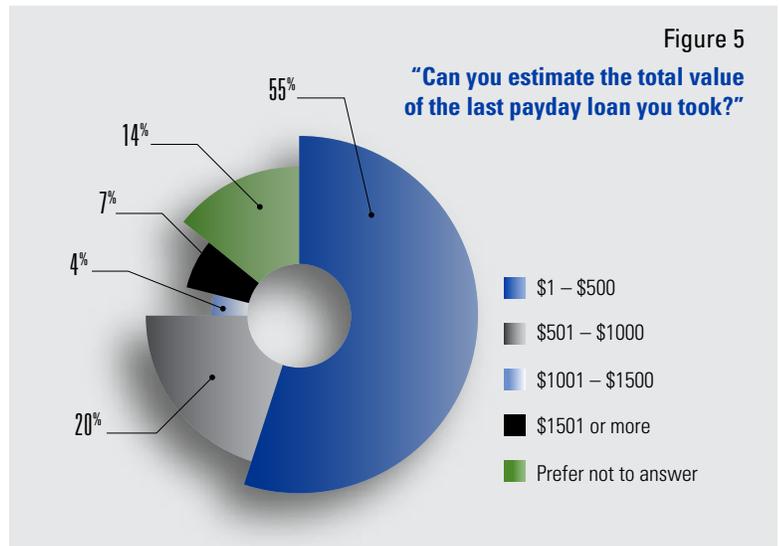
Costs shown are for illustration only and are based on these assumptions: payday loan costs \$21 per \$100; line of credit includes a \$5 administration fee plus seven percent annual interest; overdraft protection includes a \$5 fee plus 19 percent annual interest; credit-card cash advance includes a \$5 fee plus 21 percent annual interest.

4.3. Size of loans

Most payday loans taken out by respondents were relatively small in value.

As shown in Figure 5, three-quarters reported loans of \$1,000 or less, while more than half (55 percent) reported loans of \$500 or less. Twenty percent reported loans of \$500-\$1,000, while only four percent reported loans of \$1,001-\$1,500.

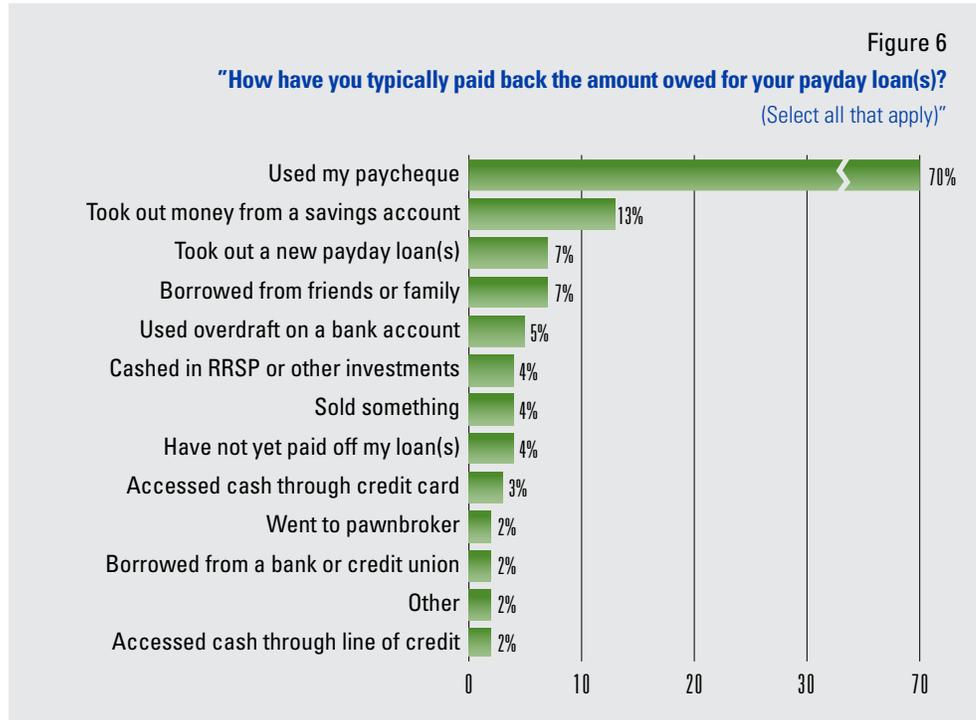
In Canada, a regulated payday loan cannot exceed \$1,500, yet seven percent said the value of their loan was over \$1,500. It is unclear whether these respondents were citing the total cost of borrowing (including interest and fees), were thinking of another type of borrowing, or were able to access larger payday-style loans from other lenders. Nearly half of those who accessed loans over \$1,500 accessed their loans online, which may indicate that larger loans are being accessed this way.



4.4. Repayment of loans

While payday loans are designed to bridge consumers to their next paycheque, one-third used sources other than their paycheque to repay their last loan.

Some respondents reported turning to savings accounts, taking out new payday loans from another lender, borrowing from friends or family or using bank account overdrafts to repay their outstanding payday loans (see Figure 6¹³). What remains unclear is why they did not access these sources of funds earlier—instead of taking out payday loans. This could be another indication that borrowers do not fully understand that payday loans cost more than other credit options and underlines the need for related consumer education resources.



13. Respondents were asked to select all that apply. Summing all options will therefore add up to more than 100 percent.

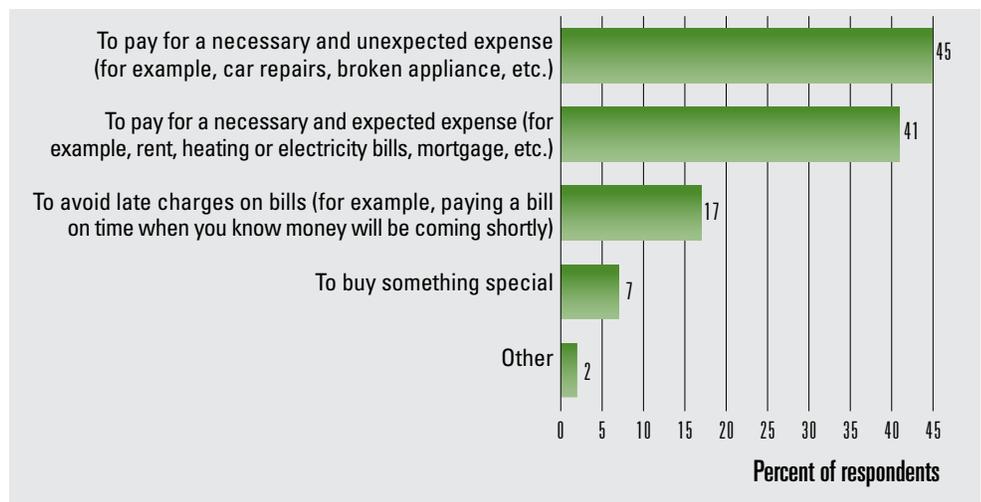
4.5. Reasons for loans

Most respondents reported taking out payday loans to cover necessary expenses.

As shown in Figure 7, almost half of respondents (45 percent) said they typically used payday loans for **unexpected** necessary expenses, such as car repairs. Nearly as many (41 percent) said they typically used payday loans for recurring and therefore **expected** necessary expenses, such as rent or utility bills.¹⁴

The data do not indicate what purchases may have preceded a cash shortfall. However, the vast majority of payday loan users indicated that their loans were taken out to pay for expenses they deemed necessary.¹⁵ This finding highlights the need for consumers to increase levels of emergency savings they can access when faced with

difficulties in making ends meet, rather than resorting to high-cost credit, such as a payday loan. While it is recognized that saving even very small amounts may be difficult for some Canadians, many could start by putting away as little as \$10 dollars per week. After a year, this would add up to \$520, which is equal to, or greater than the payday loans borrowed by most survey respondents.



14. Respondents were asked to select all that apply. Summing all options will therefore add up to more than 100 percent.

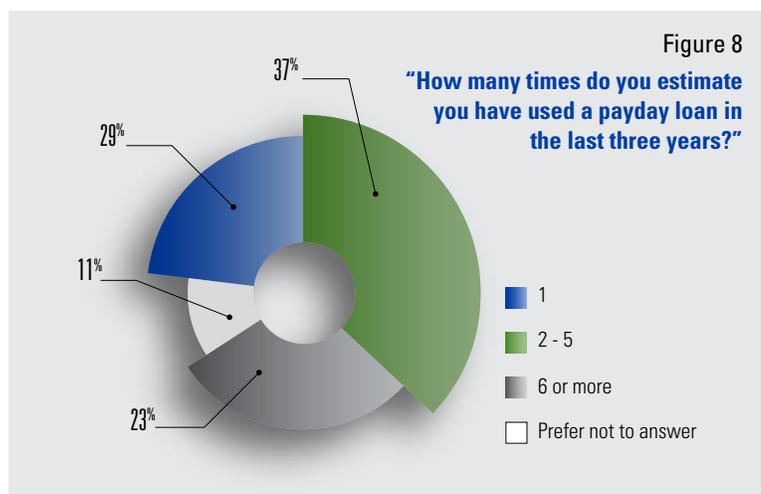
15. Eighty-nine percent of respondents selected at least one of the first three categories (i.e., necessary and unexpected, necessary and expected or to avoid late charges on bills).

4.6. Number of loans

Many borrowers in our sample reported returning to payday lenders regularly.

As shown in Figure 8, only 29 percent reported taking out just one payday loan in the previous three years. Nearly as many (23 percent) reported taking out six or more loans. Some 37 percent reported two to five payday loans, while a further 11 percent preferred not to specify.

In most provinces, direct rollovers are illegal, requiring borrowers to seek out new lenders. Only seven percent of respondents said they typically took out new payday loans to repay existing ones.¹⁶ These numbers contrast with those in the U.S., where as many as 80 percent of payday loans are either rolled over to another payday loan or followed by a new loan within 14 days.¹⁷



4.7. Household savings

Compared to the general population, respondents were substantially less able to use household savings to cover unexpected expenses.

As shown in Figure 9, 13 percent of respondents reported that their household could cover living expenses for at least six months if they lost their main source of income. Thirty-seven¹⁸ percent said they could not cover expenses for a month—and nearly 17 percent said they could not cover expenses for even a week—without borrowing money or moving house (green bars).

In comparison, a recent survey conducted by the Organisation for Economic Co-operation and Development's (OECD) International Network on Financial Education found that 44 percent of Canadians believed their household could cover living expenses for at least six months if they lost their main source of income (blue bars).

16. This seven percent rollover number is not clearly reflected in responses to the earlier question reported in subsection 4.5 ("Reasons for loans"). Those answers may reflect respondents' reports of why they sought a payday loan in the first place.

17. See Consumer Financial Protection Bureau (2014). *CFPB Data Point: Payday Lending*. http://files.consumerfinance.gov/f/201403_cfpb_report_payday-lending.pdf

18. Seventeen percent could continue less than a week and 20 percent could continue at least a week, but not more than one month.

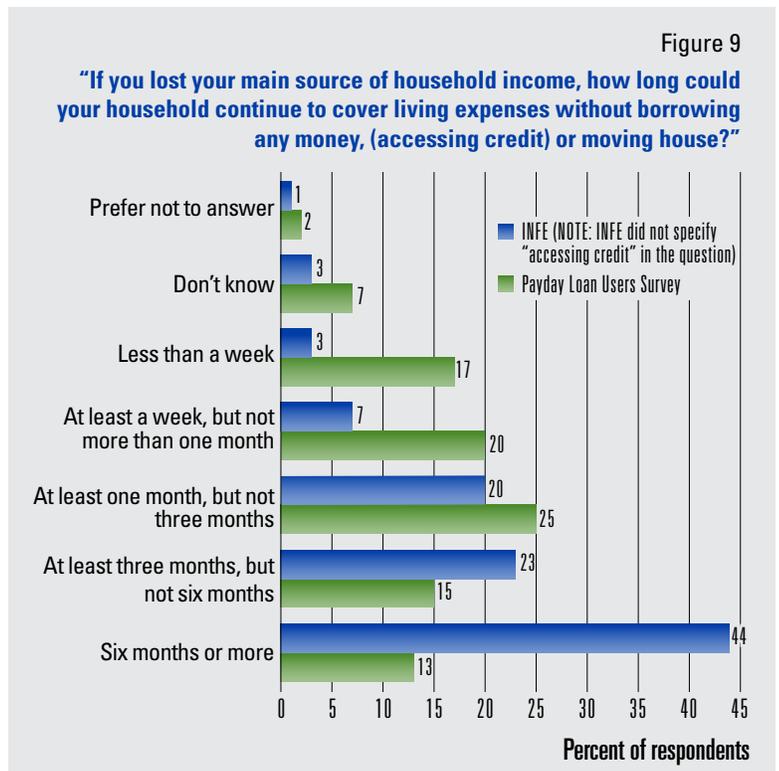
Only 24 percent of respondents reported household savings of at least \$1,500 (the maximum value of a payday loan) that they could access right away to cover unexpected expenses. Nearly half (47 percent) indicated they had no cash savings at all.

In a hypothetical scenario, only one quarter of respondents said they would draw on savings or emergency funds to cover an unexpected \$500 expense (see Figure 10). This is markedly lower than the 57 percent of Canadians in general who say they would do so.¹⁹

Even among respondents *with* savings, many said they would not use their saved funds for unexpected expenses. Among those with over \$500 saved, 46 percent said they would use their savings for an unexpected \$500 expense. This raises questions, particularly because the findings also show that of those with savings exceeding \$1,500, only 45 percent said they would use their saved funds in these circumstances. In both cases, close to one third said they would use a credit card instead.

It may be that these respondents may have planned to pay off the credit card with their savings. However, behavioural research shows that people with savings often turn to high-interest credit if their savings are earmarked for another use.²⁰

This highlights a need for consumer education resources on the value of *building* and *using* savings in a general emergency fund. Saving for a “rainy day” can minimize the need to resort to high-interest credit. A well-designed



emergency savings fund focuses on building savings with the intention of spending the money as necessary and then rebuilding the fund.²¹



19. FCAC calculations of the 2014 Canadian Financial Capability Survey data, available through Statistics Canada.

20. Sussman, A. B., & O'Brien, R. L. (in press). “Knowing when to spend: Unintended financial consequences of earmarking to encourage savings.” *Journal of Marketing Research*.

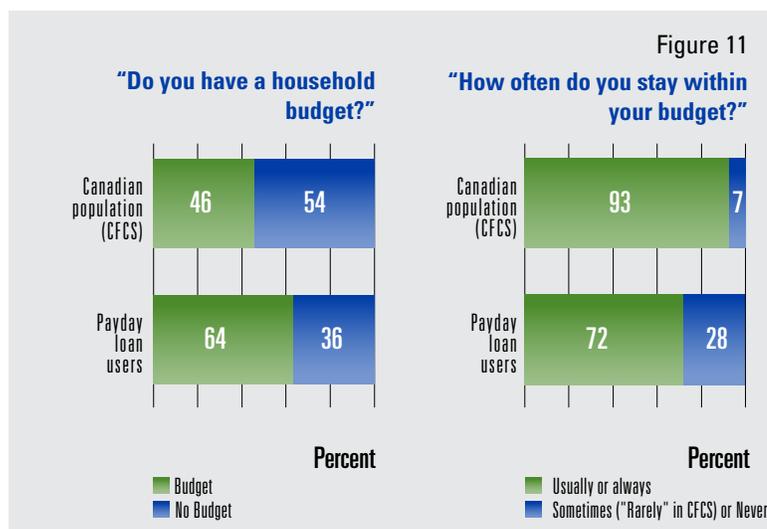
21. The Pew Charitable Trusts. (2016). *The Role of Emergency Savings in Family Financial Security: Barriers to Saving and Policy Opportunities*. Retrieved from <http://www.pewtrusts.org>

4.8. Household budgeting

Compared to the general population, respondents were more likely to have a household budget—yet less likely to successfully stay within it.

A budget is an effective mechanism to guide day-to-day planning. Sticking to a budget increases awareness with respect to spending habits.²² A written budget also helps identify emerging financial problems in time to address them.²³ Budgeting plays an important role in enabling households to build up emergency savings that can be used in situations of financial constraint.²⁴

As shown in Figure 11, 64 percent of respondents reported having a household budget, compared to just 46 percent of Canadians generally.²⁵ Among those with budgets, however, fewer successfully stay within them: 72 percent of respondents versus 93 percent of Canadians generally.²⁶ This finding highlights the need for consumer education material to help consumers budget effectively, and set up an emergency fund.



22. Kan, C., Lynch, J., & Fernbach, P. (2015). How budgeting helps consumers achieve financial goals. *Advances in Consumer Research*, 43, 74-79.

23. Fernbach, P. M., Kan, C., & Lynch, J. G. (2015). Squeezed: Coping with constraint through efficiency and prioritization. *Journal of Consumer Research*, 41, 1204-1227.

24. The Pew Charitable Trusts. (2016). The Role of Emergency Savings in Family Financial Security: Barriers to Saving and Policy Opportunities. Retrieved from <http://www.pewtrusts.org>

25. Those respondents who chose not to answer the question were excluded.

26. For general population figures, see Financial Consumer Agency of Canada. (2015). "Managing Money and Planning for the Future: Key Findings from the 2014 Canadian Financial Capability Survey." Ottawa. Retrieved from <http://www.fcac-acfc.gc.ca/Eng/resources/researchSurveys/Documents/managing-money-key-findings.pdf>. Note that the category labeled "Sometimes" in the payday loan survey was labeled "Rarely" in the CFCS.

4.9. Financial literacy levels

Our survey shows that more financially literate respondents used fewer payday loans.

Financial literacy means having the knowledge, skills and confidence to make responsible financial decisions. Respondents were asked to rate themselves in five areas: personal financial knowledge, keeping track of money, making ends meet, shopping around for the best financial product and staying informed about financial issues.

For each of the five areas, the higher respondents rated themselves, the fewer payday loans they had taken out.²⁷ Among those with household

budgets, ratings in each area of financial confidence also correlated with success at staying within their budget.²⁸

Self-reported financial literacy therefore correlated with both successful budgeting and less frequent payday loan use. Together with our findings that payday loan borrowers were unaware of the relative costs, this highlights the role financial literacy plays in reducing payday loan use and strengthening Canadians' financial well-being.

4.10. Seeking financial advice when it is needed

Many respondents did not consistently seek out financial advice even when they felt it was needed.

As shown in Figure 12,²⁹ only eight percent of respondents reported always seeking financial advice when they felt it was needed. Surprisingly, 27 percent never sought out advice even when they felt it was needed.

Getting advice on financial products and services is an important step in achieving financial well-being. For instance, FCAC research indicates that getting financial advice increases the likelihood of saving and financial planning.³⁰ The low rate of financial advice sought by respondents highlights the need to promote the availability of such advice to payday loan users.



27. Pearson *r*s ranged from -.096 to -.197, *p*s < .001.

28. Pearson *r*s ranged from .283 to -.431, *p*s < .001.

29. An additional one percent preferred not to answer the question.

30. Simhon, Y. (2016, June). *Financial Literacy and Retirement Well-Being in Canada: An Analysis of the 2014 Canadian Financial Capability Survey*. Paper presented at the 50th Annual Conference of the Canadian Economics Association, Ottawa, Canada. The logistic regression analyses controlled for age, gender, marital status, income quintile and highest level of education.

4.11. Use of financial institutions

Respondents reported lower access to traditional financial services than the typical Canadian.³¹

For instance, only 35 percent of respondents reported having access to a credit card, compared to 87 percent of Canadians generally.³² Only 12 percent

said they had a line of credit, compared to 40 percent of Canadians.³³

Respondents identified several reasons for not accessing credit from a bank or credit union:

- 27% said a **bank or credit union would not lend them money**
- 15% said they **did not have time to get a loan from a bank or credit union**
- 13% said they **did not want to get money from a bank or credit union**
- 55% said payday lending offered the **best customer service**
- 90% said payday lending was the **fastest or most convenient** option
- 74% said payday lending was the **best option available** to them

Notably, 35 percent said they did not have access to a bank account at the time of their last payday loan. This is striking, given that 99 percent of Canadians in 2014 reported having access to a bank account.³⁴ Further, payday lenders generally insist on pre-authorized access to a bank account before agreeing to lend to a consumer. It may be that some respondents excluded unused bank accounts, or interpreted “access to a bank account” as an account with money they could access. Some respondents may never have applied, while others may have applied and been denied. This finding highlights the

need for consumers to inform themselves and to seek assistance from professionals to understand the options available to them to meet their unique needs and circumstances.

31. As in footnote 2, the interpretation of the word “access” may have varied between respondents.

32. FCAC calculations of the 2015 OECD/INFE Survey on Measuring Financial Literacy and Financial Inclusion.

33. Environics Analytics Canadian Financial Monitor 2016.

34. FCAC calculations of the 2014 Canadian Financial Capability Survey data, available through Statistics Canada; World Bank. “Global Findex (Global Financial Inclusion Database).” Retrieved from <http://databank.worldbank.org/data/reports.aspx?source=1228#advancedDownloadOptions>

5. Conclusion

FCAC is working to inform consumers about the costs of, and alternatives to, payday loans. Through a survey of payday loan users, we found that many are not currently accessing available alternatives and do not understand the relative costs of payday loans. Although Canadians access payday loans for a variety of reasons, the lack of awareness and understanding of relative costs likely affect the decision to use these expensive products. FCAC encourages consumers to explore all of their credit options and ensure they understand their relative costs.

The payday loan users surveyed were more inclined than the average Canadian to budget, but many had difficulty covering necessary expenses. The demand for small-value, short-term loans illustrates the fact that many Canadians are not prepared for cash shortfalls, whether caused by unexpected expenses or income interruptions. FCAC recommends that all

consumers who are able build an emergency savings fund to avoid having to turn to high-cost credit to cover cash shortfalls.

Many of the payday loan users surveyed indicated that they rarely sought financial advice even when they felt it was necessary. As such, FCAC recommends that consumers seek the assistance of qualified professionals to explore options when choosing financial products and, for those having difficulty paying off a payday loan, to get help in developing a plan to repay what is owed.

6. Next steps

By choosing payday loans, many financial consumers are not serving their long-term best interests. Our research offers insight into who these borrowers are

and what drives their decisions. Building on these findings, FCAC will focus on the following initiatives to improve the financial well-being of Canadians.

6.1. Promoting consumer awareness through educational resources

FCAC will adapt its existing consumer education materials and develop new materials to address the gaps identified through this research. Our goal is to help Canadians make more informed borrowing decisions and to seek appropriate assistance as required.

FCAC's consumer education resources will focus on: (1) fostering consumer understanding of the costs of payday loans relative to existing alternatives, and (2) ways to reduce dependence on payday loans, particularly by paying down debts and ending recurrent debt cycles. FCAC resources will focus on the following themes:

- **Cost of credit:** Many payday loan users may not realize that payday loans are one of the most expensive ways to borrow money. Some may be confused when borrowing costs are not expressed in the same manner for all credit options. Others may be unaware about the costs of alternatives such as bank overdraft, lines of credit or cash advances on credit cards. Still others may have exhausted their credit elsewhere and feel they have no option other than payday lenders. Equipping consumers to make apples-to-apples comparisons between credit products available to them can empower them to make better credit choices.
- **Emergency savings:** Every year, a large proportion of Canadians face an unplanned emergency expense—and many need a loan to cover such costs. Their best protection is an emergency savings fund that they are willing to use. Some consumers may feel saving for a rainy day is impractical. Others may not be able to put aside even a minimal amount. Savings as low as \$5-\$10 per week can alleviate the need for a payday loan in the future. Many resources exist to assist consumers in establishing such a fund. FCAC resources, for example, include practical tools to get started with budgeting, and advice on how to develop an emergency fund such as starting small, making it a weekly habit or automating your savings.
- **Seeking advice:** FCAC recommends that consumers inform themselves and seek the assistance of qualified professionals to explore options when choosing financial products. For consumers having difficulty paying off high-cost loans, FCAC has extensive education material on debt management and budgeting. This includes tools and practical guidance on seeking the assistance of financial advisors, credit counselling services, licensed insolvency trustees and community resources that can help consumers who are struggling to make ends meet.

6.2. Working with provinces and territories

FCAC will continue to work with provinces and territories to contribute to a coordinated, pan-Canadian approach to informing consumers about the costs of, and alternatives to, payday loans.

This survey's findings may also help inform the work of provincial and territorial governments, researchers, etc.

Related FCAC web resources

[Payday loans](#)

[Emergency fund infographic](#)

[Budgeting](#)

[Debt management](#)

[Working with a financial planner or advisor](#)