

**Networking on the Margins:
The Regulation of Payday Lending in Canada**

By

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Abstract

The contemporary emergence of payday lending as a major source of high-cost short-term credit for credit-constrained populations has prompted debates among government officials, business representatives, advocacy groups and academics over how best to regulate the industry. Such debates typically focus on the prevailing lending practices and interest charges in the industry. While critics associate these with usury, supporters of payday lenders defend them as appropriately priced responses to market demand. This dissertation seeks to contextualize, and contribute to a deeper understanding of, the terms of these debates through an exploration of the recently concluded political exercise in Canada where responsibility for the governance of payday lending has been shifted from the federal government, with its criminal law power over usury, to provincial governments with their various regulatory powers over licensing and consumer protection. The dissertation begins with the observation that there are competing moral discourses about money and interest simultaneously embedded in the financial policy-making process in Canada, a fact that has complicated regulatory efforts aimed at payday lending. While these efforts have largely been informed by varying assessments of the transparency and competitiveness of the payday lending market, this dissertation contends that a conceptually

more useful way of understanding this market is to study the organizational and marketing strategies employed by payday lenders to indentify and retain a stable customer base, and the reciprocal moves on the part of customers to improve upon their terms of trade. In detailing the political process which culminated in a new regulatory regime for payday lending, this dissertation draws on the “regulation through networks” literature to help explain its progress. A major contribution this dissertation makes to this explanatory approach is in its emphasis on the dual legitimation imperatives with which the network actors had to contend as they negotiated their way to a consensus on a politically acceptable regulatory structure for payday lending. This consensus has proved to be politically vulnerable because of the continuing normative conflicts embedded in official financial policy discourse, and *inter alia*, in the legitimation imperatives which have permeated the policy-making process.

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Introduction

In the lead article in a recent issue of the journal *Criminology and Public Policy* devoted to investigating the social ecology of payday lending, Charis E. Kubrin, Gregory D. Squires, Steven M. Graves and Graham C. Ousey argue on the basis of an empirical study conducted in the city of Seattle, Washington that a high concentration of payday lending leads to higher violent and property crime rates (2011, 437-66). In that same issue, Eric Davis contends that the findings of Kubrin et al confirm what many other scholars have noted as a tendency for problem-producing institutions to proliferate in poor neighbourhoods, reinforcing inequality and crime by contributing to the kinds of alienation from broader society that erode public trust, order and a sense of social inclusion (2011, 469). Finally, in their response to the Kubrin et al essay, Pamela Wilcox and John Eck express their doubts about the purported empirical linkage between payday lending and criminality, in the process inviting a critical re-examination of the “criminology of the unpopular.” Wilcox and Eck suggest that when looking for a place-based explanatory variable to account for crime rates, the appropriate indicator is not the type of activity that occurs in a facility but the volume of traffic a facility helps generate. On this hypothesis, both “good” and “bad” social resources might be equally responsible for higher crime rates if they contribute to a high volume of human traffic (2011, 473-82). All the authors in this debate, including the skeptical Wilcox and Eck, conclude their articles by urging a more closely regulated payday lending industry.

The debate among these several authors is characteristic of much of the burgeoning literature on payday lending. That literature typically is framed by normative concerns over the

social costs and benefits of payday lending, and almost invariably is policy-oriented. That the current iteration of payday lending should attract such considerable academic and particularly policy-making interest should not be altogether surprising given how significant a feature of the modern economy it has become.

The contemporary significance of payday lending contrasts with what on first sight seems to be its relatively humble origins. These origins are routinely attributed to the entrepreneurial vision of W. Allen Jones of Cleveland, Tennessee who borrowed a business concept pioneered by fellow Tennessean James Easton to found a national payday advance chain called Check into Cash in 1993. Jones and Easton both had previous experience in local credit bureau businesses which kept track of credit risks for department stores and served as collection agencies in markets that were mostly small and local. When Easton founded a cheque-cashing venture that offered small short-term loans secured by future paycheques, the financially more established Jones was able to expand on the business model to create what eventually would become one of the three largest payday loan companies in the United States (Brook, 2009). The financial prescience of this founder of payday lending, as one chronicler of the emergent industry has noted, is easily explainable in retrospect by the observation that 47% of Americans now report living from paycheque to paycheque (Brook, 2009, 41).

That payday modern lending should first appear and proliferate in the southern United States is likewise understandable given that Tennessee along with Mississippi, Arkansas, West Virginia, Louisiana, Alabama, and South Carolina ranked amongst the quarter of U.S. states reporting the lowest per capita income in 1990 (U.S. Department of Commerce, 2011). By contrast, payday lending in Canada started in Alberta, a province with one of the highest per

capita income levels in the country, albeit with a sizeable transient labour population both in the city of Edmonton where Money Mart launched the business of cash advances in 1996, and especially in the surrounding oilfields. Just as was the case with their U.S. counterparts, the founders of payday lending in Canada had considerable prior experience with credit-constrained populations. Money Mart, for instance, started out as a cheque-cashing business a decade and half before it ventured into payday loans. And another Edmonton-based entrepreneur, Gordon Reykdal, who would go on to establish Cash Store Financial Services which would become the main competitor to Money Mart in the Canadian payday lending business, had his start in the rent-to-own business, supplying furniture and appliances to people with poor or no credit.

Whatever the local exigencies propelling these new business undertakings, payday lending has quickly become an enormous financial industry. The staggering growth of this industry has been widely documented. In the United States, for example, by 2005 it was reported that there were more payday lenders (22,000) than there were McDonald's, Burger King, Sears, J.C. Penney, and Target stores combined (Karger, 2005). Between 1999 and 2004, industry sources in the U.S. estimated that the volume of payday advances grew from \$8 billion to \$40-50 billion, with roughly \$6 billion dollars in finance charges being generated in 2004 (Stegman, 2007, 169-70). In Canada a similar pattern obtains. For example, in Toronto, according to research done by *The Toronto Star* in 2004, cheque-cashing and payday lending stores, which were non-existent as recently as fifteen years ago, rose to 235 outlets spread out primarily throughout low- to middle-income neighbourhoods (*Toronto Star* 2004a). Nationwide, reports indicate that by 2004 there were at least 1350 independent and chains stores specializing in cheque-cashing and payday loans, and that payday lending in Canada was worth an estimated \$1.7 billion (Hemsworth 2006)

This phenomenon, it should be noted, is not confined to North America. Britain experienced a comparable rapid increase in payday lending during this same period, as evidenced, for example, by the growth of The Money Shop, a subsidiary of one of the U.S. market leaders, Dollar Financial. The Money Shop expanded from one location in 1992 to 273 stores and 64 franchises across the U.K. in 2009 (Gibbons et al 2010). In that country it has been estimated that the industry as a whole made about £1.2 billion worth of loans in 2009, generating gross revenues of £242 million worth more than 20% of the total lent (Burton 2010).

Enormous as these revenues and profit levels are, it must be kept in mind that payday lending is only one part of a larger subprime financial market that includes everything from check cashing, prepaid credit cards, automobile title loans, leaseback loans, injury loans, and, of course, the infamous mortgages which contributed to the recent liquidity breakdown in U.S. banks. This subprime credit market has not only become a significant component of the financial services market, but it increasingly is a sector to which mainstream financial institutions are drawn. This is true not only of U.S. subprime mortgages but also of the outlier segments of this market such as payday lending, which, as recent studies have shown, depend more and more on traditional banks for capital. Gary Rivlin, for instance, reports that the largest U.S. payday loan company, Advance America, relied on \$40-50 million dollars of financing from a series of banks including Wells Fargo, Wachovia and NationsBank before it even had begun its operations (Rivlin 2010, 120). Aside from providing start-up capital, these same banks, together with other major lenders like JP Morgan, US Bank and Credit Suisse, have offered credit facilities estimated to be in the range of \$2.5-3 billion to the payday lending industry in the United States for the period 2006-2010 (Connor and Skomarovsky 2010, 10). And many of these same financial institutions have themselves become investors in publicly traded payday loan

companies. For example, as of 2010 Bank of America and Wells Fargo between them owned over 20% of the stock of Dollar Financial, while Goldman Sachs held a significant stake in Advance America (*Ibid.* 17).

Canadian banks have not been averse to exposing themselves to this market. A 2007 report by ACORN Canada, a national community-based organization advocating on behalf of low-income families, reveals that Toronto Dominion Bank and Royal Bank of Canada have become shareholders in some of the larger American and Canadian payday loan companies such as Advance American and Dollar Financial (ACORN Canada 2007, 6). Other similar investments include Toronto Dominion's purchase in 2006 of VCF Inc. which is one of Canada's largest finance companies specializing in subprime automobile loans, and the Bank of Nova Scotia's acquisition that same year of Maple Financial Group, whose main business is subprime mortgages (SHARE 2007, 3). The appetite of mainstream Canadian financial institutions for these ostensibly more risky segments of the consumer credit market was explained by one business reporter at the time as a matter of a surplus of capital chasing higher returns: "Brimming with cash, but bereft of places to spend it, acquisition hungry Canadian banks are descending on one of the last apparent markets for growth in domestic retail banking: the higher risk or 'sub-prime' consumer" (Stewart 2006, B1). Darko Mihelic, a bank analyst with Blackmount Capital in Toronto cited in Stewart's article, excitedly predicted that the 'sub-prime' lending market in this country would soon be occupied by the established Canadian banks: "It's the last frontier, so to speak, of retail lending in Canada. I think banks are going to steamroll this [market] in the next five years. It's only a matter of time before they become the source of all this stuff" (*Ibid.*).

Sentiments such as these doubtless accelerated the entrance of conventional banks into the subprime market. The resulting extensive interlacing of mainstream and subprime financial markets represented a novel development in modern capitalism. The purveyors of credit to that segment of the population that is credit-challenged were no longer, as in the nineteenth century, minor figures in the world of finance, eventually to be swept away by regulation and a rising affluence. They had now become so central to modern economies that just prior to the financial crisis which originated in the U.S. banking sector in 2008, it was estimated that in countries like Britain and the U.S. the subprime financial market comprised 30% of the overall retail lending market (*Ibid*).

The sheer size and profitability of the payday lending industry is one reason for the scrutiny it increasingly has received from academics, consumer advocacy groups, and policy-makers. But even more important is the nature of its business. What makes payday loans so potentially profitable are the number of charges that firms characteristically throw into the mix. The typical structure of a payday loan, which usually is quite small—in the \$200-\$300 range—and of short duration (on average two weeks), consists of a set-up fee, a percentage rate, and a cheque-cashing fee. A borrower, who usually finds herself short of money for necessities in the week or so before payday, will contract to borrow a sum, and in payment write a personal cheque to the payday lender exceeding the cost of the loan. The cheque is post-dated to the actual day the borrower is to receive her pay, and it exceeds the loan by a factor determined by various charges. For instance, there might be a set-up charge for the loan, a fee based on the face value of the loan, and finally a charge for cashing the cheque on the payday (this latter charge can be avoided if the cheque is redeemed by the borrower prior to its due date.) As well, the payday lender usually extracts a significant penalty from the borrower for NSF cheques. Depending

upon how exactly the loan is structured, the effective interest rate can vary considerably. For instance, in a study for the Office of Consumer Affairs in Canada, Iain Ramsay (2000) discovered that the annualized interest rates for small seven day loans ranged from 670% to 1300%, and for the same loans spread out over fourteen days, 335% to 650%.

With an APR (annual percentage rate) so high, small wonder payday loan companies are frequently accused of engaging in usury. Even more damning is the allegation that payday loan companies specifically target the poor, trapping them in endless cycles of debt that further immiserate them (see, for example, MacDonnell 2007; Babe 2006; Mayer 2004; Berry 2007). A sign of how large and profitable the payday lending industry has become in so short a period has been the establishment of relatively refined industry associations complete with websites dedicated to burnishing their public image in light of such criticisms. On sites such as <http://www.cfa-uk.co.uk/>, <http://www.cfsa.net/> or <http://www.cpla-acps.ca/>, this image-making strategy is carried out with varying degrees of sophistication. For instance, to counter the popular impression that payday lenders prey on the poor, the U.K. association website features a picture of a car with a flat-tire, signifying an unexpected expense, underneath which is an unattributed statement saying that “Nurses, teachers, and others of the middle-class are the most likely to use payday loans” (CFA-UKa). In stressing its commitment to promote responsible lending and borrowing, the British association website goes on to imply that traditional lending sources are to blame for the current credit crisis while payday lenders offer a constructive remedy:

The way we borrow has changed since the credit crunch. Previously, people used ongoing credit sources like credit and store cards or bank overdrafts, or long term repayment loans for higher value goods. But this led to quite high levels of debt for some, which many consumers today wish to avoid. Instead, many people want to borrow small amounts over short periods to smooth out the peaks and troughs of their income and expenditure, but not to run up long term debt. (CFA-UKb, 1)

And in an effort to forestall political demands for interest rate caps, the CFA-UK provides figures meant to show how calculations of an Annual Percentage Rate (APR) are unreliable indicators of “actual interest costs”. In this deconstruction of the standard rule for interest formulation, the CFA-UK presents several notionally comparable loans including a month-long £200 payday loan costing £250, a £100,000 twenty-five year mortgage whose cost over the entire term is £202,563, and a one week £25 pub loan at a cost of a drink worth another £2. The point of the comparison is to show that the nominal APR for payday loans, and presumably their close conceptual relative—pub loans—might appear high (1,355.2% for payday loans; 5370.6 for pub loans), relative to that of a mortgage (6.5%), but that this measure does not capture the true costs of each loan. Hence, on the CFA-UK calculation, the true cost of a loan is total interest paid as a percentage of the original sum borrowed. This means that while the actual interest rate on a payday and pub loan would amount to 25% and 8% respectively, that of a twenty-five year mortgage would be in excess of 100%.

While the British association website remains relatively unassuming in its portrayal of a conscientious and consumer-friendly payday industry, its U.S counterpart takes a comparatively more assertive approach to critics of payday lending by exploiting arguments from authority. For example, it makes use of an ostensibly sophisticated and credible empirical study (Elliehausen and Lawrence, 2001) to declare that the majority of those who use payday lending services are “middle-incomed”, “middle-educated” and from “stable working-class” families. And a banner headline on this same website offers a rejoinder to the “myth” that payday loans trap borrowers in a never-ending cycle of debt by highlighting the conclusion of an undocumented study from Clemson University

baldly stating that: “There is no statistical evidence to support the ‘cycle of debt’ argument often used in passing legislation against payday lending” (CFFSA 2011).

Finally, the website of the Canadian Payday Loan Association is almost entirely devoted to the proposition that it is not a “typical industry association” because “it works to promote laws and regulations that balance strong consumer protections while preserving access to short-term credit for millions of Canadians” (CPLA 2012b). In stressing this self-defined mandate to help governments fashion a national regulatory framework for payday lending, the CPLA gives pride of place to its Code of Best Business Practices, a self-regulating code whose provisions regarding such controversial measures as loan rollovers, multiple loans, and default and post-maturity interest charges, are meant to demonstrate just how determined association members are to not exploit their customers (CPLA 2011c).

Such efforts to normalize and legitimize payday lending mark one pole in the ongoing debate over its merits. Virtually all academic, advocacy and government-sponsored literature engage this debate directly. While this dissertation joins in the normative debate over payday lending to some extent, its main interest lies elsewhere. There are three main foci of the dissertation which depart from the usual themes found in other studies of the subject. First, this dissertation attempts to situate the normative debate in the context of evolving attitudes towards usury. But rather than simply relate the historical development of cultural norms, this dissertation identifies the ways in which competing moral discourses about money and interest have co-existed for much of the modern history of capitalism, and are simultaneously embedded in the financial policy-making process in Canada, something that has complicated regulatory efforts

aimed at payday lending. A second focus has to do with the construction of the payday lending market. Almost all the economically-oriented literature on payday lending assumes either perfect or imperfect markets and proceeds to analyze transactions between lenders and borrowers accordingly. Very little work has been done, however, on the sociological processes by which markets are constituted. In this dissertation rather more attention is paid to this latter phenomenon, especially as evidenced by the organizational and marketing strategies of payday loan companies.

The third focus is the regulatory process as it has played itself out in Canada with respect to payday lending. While existing studies of payday lending are quick to offer regulatory prescriptions, none have attempted to detail the political intricacies of the regulatory process, and in consequence, have failed to grasp the dual legitimation imperatives involved in this political exercise. What is meant by dual legitimation imperatives here is that the participants in the regulatory process find themselves in a position where they have both to defend payday loans as a socially acceptable form of credit while providing reassurances that the public interest is being protected in the rules being devised for the regulation of this industry. This dissertation traces the complex legislative and bureaucratic decision-making processes that gave rise to a new regulatory regime for payday lending, with special attention paid to how these dual legitimation imperatives affected the policy deliberations of the parties involved.

Because this dissertation is organized around these three separate focal points, no effort will be made to provide a preliminary literature review. Rather, literature pertinent to each focal point will be reviewed as the themes they represent are introduced. The three focal points of this dissertation are developed in the following six chapters. Chapter one introduces the idea of

competing moral discourses embedded in financial policy-making in Canada. Specifically, I argue that a tension between remnants of an older vision of a moral economy and the precepts of liberal political economy informs legal approaches to institutional lending in ways that often undermine the coherence of laws on interest. To support this claim I focus on an historical trajectory frequently discussed though not adequately analyzed in the literature on lending and interest, that is, the gradual though always it seems guarded moral acceptance of interest charges as a legitimate economic activity (see, for example, Gelpi and Julien-Labruyere 2000, Homer and Sylla 1996, Calder 1999). While proscriptions against usury, whether of the Aristotelian, medieval theological or early modern humanist variety, eventually gave way to a contractual view of economic transactions, including the free trade in money and credit, a powerful vestige of these older disapproving attitudes to money-lending survived in those anti-usury laws still to be found in contemporary jurisdictions. Thus it is that even the most dedicated of neo-liberal governments find it difficult to embrace the idea of entirely unregulated credit markets, yet at the same time are reluctant to defer to non-market judgments about appropriate rates of interest. The result is that state policy towards consumer lending in general and lending to financially distressed borrowers in particular vacillates markedly between admonitions of *caveat emptor* and laws protective of borrowers.

The second chapter broaches the idea of the constructed consumer by challenging the neo-classical economic conception of imperfect markets. In the neo-classical view, imperfect markets are characterized by information asymmetries which disadvantage one of the contracting parties in an economic transaction. Prescriptions for mitigating the effects of imperfect markets that flow from this neo-classical perspective generally revolve around ways of repairing an information asymmetry. By contrast, following upon the insights of Geertz (1978), I argue in

this dissertation that the appropriate unit of analysis for studying how information is gathered and evaluated for purposes of commercial transactions is not the isolated utility-maximizing individual of neo-classical theory but rather the relatively stable “clientships” that emerge among buyers and sellers for socially and economically complex reasons. In terms of the payday loan market, I contend that clientship implies a calculated search on the part of payday lenders for a pool of repeat customers and a reciprocal movement on the part of potential borrowers to find a suitable transactional partner. This reciprocal movement, it must be emphasized, is always a socially and institutionally situated pursuit which means that there are multiple mediations through which clientships emerge. Chapter two focuses on the first part of this dynamic by exploring how payday lending firms, through their organizational and marketing strategies, try to secure these durable clientships.

The third chapter traverses a ground made familiar by numerous Canadian and U.S. empirical studies—the world of the payday borrower. In this chapter, existing studies of the social and economic characteristics of payday loan takers will be subjected to critical analysis in an effort to try to answer the fundamental questions of who typically resorts to payday loans and why. This review will be augmented by data gathered from interviews with payday loan borrowers in one neighborhood in Toronto, and from a location analysis I conducted of Money Mart outlets in the Greater Toronto Area. In addition to looking at the demographic characteristic of payday loan customers, the research carried out for this chapter is meant to illuminate further that reciprocal dynamic by which stable clientships between lenders and borrowers are fashioned. The chapter ends by addressing what John Caskey (2010, 1), a long time student of the payday loan phenomenon in the U.S., recently called the “big question”: “Do payday lenders, on net, exacerbate or relieve customers’ financial difficulties?” It is some variant of this question

that policy-makers have had to contend with as pressures have mounted in both the U.S. and Canada to have payday lenders subjected to stricter regulatory controls.

How Canadian governments have responded to these contradictory pressures is the subject matter of the remainder of the dissertation. Chapters four to seven contain an extended analysis of the political process which led to the passage in 2007 of Bill C-26, which exempted payday loan companies from criminal code provisions against usury in an arrangement that required the devolution to the provinces of regulatory authority over payday lending. Bill C-26, it will be shown, was the culmination of a protracted consultative exercise among federal and provincial policy-makers, industry representatives and select consumer advocacy groups. In Chapter four I introduce the major players in this consultative undertaking and propose that the concept of network governance is useful in helping to explain the process itself. Key to that process was a preliminary agreement amongst the network actors on what I call a master narrative. The master narrative, to which all parties to the policy process initially seemed to have subscribed, proposed that payday lenders provide a necessary and desirable service in the form of short-term credit that is not readily available from conventional financial institutions. Furthermore, it was held that any prohibitive regulatory scheme would only compel those in need of this service to seek it from criminal loan sharks. In these real-world circumstances, the best policy option would be to find a practicable way of controlling those unscrupulous lending practices indulged in by some companies while ensuring the survival of the industry as a whole. Consensus over this master narrative implicitly meant that the actors who were party to the governance network had to contend with a dual legitimation problem: how to legitimize an industry whose lending procedures often ran afoul of existing law, and how to legitimize the

political process by which a regulatory regime was being fashioned. Chapter four focuses on this twin legitimization predicament in the early stages of the governance network formation.

In chapter five a confounding factor is introduced. No mention is made in the existing literature on payday lending regulation of the role courts have played in the political process that has guided decisions about appropriate governance measures. In this chapter I contend that courts in Canada ended up playing a significant role in prompting the payday lending industry to accede to the necessity of state regulation. As a result of what some writers call “regulation through litigation” (e.g. Viscusi 2002), otherwise fierce rivals in the payday lending industry were compelled to find ways of co-operating in search of a political solution to the issue of industry governance. The litigation which drew courts into this regulatory debate included both the law of contract and tort law. In the case of the former, by the mid 2000 a growing number of minor law suits initiated by payday lenders to collect on defaulted loans began to earn them stern judicial rebukes. There was, at the same time, a rise in the number of successful certifications of class action law suits in which payday loan companies were accused of causing their customers harm. This judicial assault on payday loan companies that gathered momentum by the middle of the decade became one of the factors which the parties to the governance network had to calculate as they tried to negotiate their way to a preferred regulatory regime. Chapter five summarizes trends in the disposition of court cases involving payday lenders, thereby illustrating the judicial pressures that increasingly were coming to complicate the network deliberations.

Chapter six concludes the story of the regulation of payday lending in Canada by examining in some detail the final compromise leading to the devolution of authority over the industry to the provinces. In chapter six I argue that the political compromise that Bill C-26

represented was subject to still further political machinations as the regulatory drama shifted to the provinces. In this chapter the regulatory schemes introduced by the governments of Manitoba, Ontario and Nova Scotia are inspected closely because they contain discernable differences in their underlying policy goals, and this variation testifies vividly to some of the contradictory forces and values that afflicted the negotiations undertaken by the various parties involved in this governance network. Various developments at the provincial level are raised to show that the goal of depoliticizing the regulatory process through a system of network consultations has never been entirely successful, with the result that the legitimation objectives this exercise was meant to accomplish remains an unfinished task.

The concluding chapter draws together the three foci sketched above. The effects of the contradictory normative discourses that have permeated policy discussions on payday lending are analyzed one last time with an eye to clarifying the terms of the contemporary debate over the moral status and legal prospects of this industry. The closing analysis of these opposing normative discourses will also include a discussion of the contributions this study makes to the fields of criminology and public policy. These contributions are linked to the basic observation which motivated the dissertation in the first place. That observation consists of the fact that since 1980 Canada has had a prohibition against usury in the form of S. 347 of the Criminal Code which makes it illegal to charge interest at a rate in excess of 60% per annum. Given that payday loan companies regularly charge their customers significantly more than 60% for their lending services, why had they not been prosecuted, save for one exception, for a breach of the criminal code prior to the 2007 amendment to S. 347? And why eventually did federal and provincial governments agree to exempt payday loan companies entirely from the application of the usury law in 2007 when a new regulatory framework was introduced for their governance? The answer

most commonly given to these questions is that the legal tolerance of payday lending companies, and more recently the sanctioning of their lending practices under provincially devised regulatory schemes, have been driven by a pragmatic acknowledgment that the alternative to these financial services is the illegal world of loan sharks (Kitching et al, 2006, 11). But this response begs a very important question. What is the difference between legally endorsed payday lending and classic loan sharking? This question is especially acute in light of an observation made by two U.S. students of payday lending who compared the representative rates charged by contemporary payday lenders in that country and by old-style mafia loan sharking syndicates, finding that typical payday lending rates of 450% were far more excessive than the latter's average rate of 250% (Graves & Peterson, 2008, 638). Why is the larger rate deemed to be legally acceptable while the lesser rate is designated as criminal?

This question points both to the enduring debate in criminal law about the difference between *malum in se* and *malum prohibitum*, and to the ongoing political and conceptual controversies over how to identify and respond to so-called white-collar and corporate crimes. The first distinction is meant express the difference between acts regarded as evil in themselves and those that are thought to be wrong only because they are prohibited by law. Said to convey the varying degrees of moral approbation associated with more serious and lesser types of criminal offences, the dividing line between *malum in se* and *malum prohibitum* is notoriously difficult to draw, not least because such differing moral evaluations will always remain culturally and politically contested concepts (Green, 1997, 1614). The continued use of this distinction in criminological discourse is therefore more instructive for what it reveals about the politics of naming, i.e. how certain acts or behaviours come to be criminalized or decriminalized, than for the conceptual contrast it is designed to highlight.

The effective decriminalization of payday lending in Canada and its transformation into a provincially regulated industry represents just such a discursive move in the politics of naming. In order to replace the idea of usury embedded in Sec. 347 of the Criminal Code with the idea of a “fair and reasonable rate” for payday loans there had to be a moral and legal re-evaluation of what constituted economic harm. There are at least two ways of explaining the grounds for, and process behind, such a re-evaluation. One of these is found in the abundant advocacy literature arguing that there has been an over-criminalization of morally neutral behaviours in the modern era, especially in the area of white collar and corporate crime. Proponents of the over-criminalization of corporate crime thesis tend to gravitate either to a neo-liberal or a neo-regulatory position. Neo-liberals typically argue that an excessive criminalization of allegedly harmful business practices is both wrong and self-defeating because it undermines the very risk-taking behavior that permits capitalism to flourish. Their prescriptive view accordingly is that criminal law should be retained only for offences that impede the normal functioning of a competitive marketplace, leaving all other business practices to be governed by tort law or non-criminal regulations (see, for example, Thornburgh, 2007; Terwilliger, 2007). Those who adopt the neo-regulatory approach, on the other hand, contend that political reality is much more complex than imagined in neo-liberal worldview, a fact revealed in the comparative growth of business regulation even as neo-liberalism came to dominate political discourse in much of the advanced capitalist world. While criticizing their descriptive claims and some of their normative conclusions, adherents of the neo-regulatory perspective nonetheless have in common with neo-liberals serious misgivings about the efficacy of criminal law in achieving its intended effects in the world of commerce. Neo-regulators thus emphasize the superiority of non-criminal

regulatory innovations including market mechanisms designed to elicit desired economic behaviours (see for example Levi-Faur, 2005; Braithwaite, 2008).

While these variants of the over-criminalization thesis call for less, or at least different kinds of, business regulation, and hence would doubtless approve of the recent decriminalization of payday lending in Canada, a second approach to understanding this policy development can be found in the literature in critical criminology which attempts to relate epistemic changes in public policy discourses to the varying structures of power in society. Laureen Snider's (2000) argument about the relative disappearance of corporate crime as a form of state regulation of business exemplifies this critical approach. According to Snider, the conspicuous withdrawal of the state from the overall field of white collar crime has been an integral part of the deregulatory drive of neo-liberalism, a political program she calls a corporate counter-revolution that tries to "legitimize virtually every acquisitive, profit-generating act of the corporate world" (Snider, 169). Crucial to this counter-revolution, in Snider's account, has been the successful penetration of neo-liberal knowledge claims into public policy discourse made possible by their compatibility with hegemonic economic interests.

In this dissertation I shall argue that the master narrative that informed the policy discussions over payday lending in Canada corresponds to what Snider has described as a neo-liberal knowledge claim about what constitutes criminogenic activity in commerce. A consideration of the actors who prevailed in transforming this knowledge claim into official public policy, and the circumstances in which this transformation was accomplished, however, reveals a much more complex political and discursive dynamic at work than that suggested by Snider's notion of ideological compatibility. That dynamic involved what Braithwaite (2008) and

others have called network governance which, with its multiplicity of parties in the decision-making process, would seem to imply a more consensual regulatory approach than one might expect to obtain in the top-down ideological model proposed by Snider. But that consensual process of network governance supposedly in evidence in the case of payday lending turns out upon closer inspection to be weighed down by continuing normative conflicts never fully displaced by the master narrative that was supposed to unite network members. In detailing these discursive fractures this dissertation aims to refine Snider's observations about how knowledge claims about criminality are asserted and normalized in the public policy process by stressing their essentially contingent and contested nature—that is to say, their irremediably political character.

Chapter 1

The Moral and the Market Economy

1:1 Introduction

In an unorthodox but highly imaginative interpretation of Shakespeare's *Merchant of Venice*, the political theorist Edward Andrew compared the character of Shylock, portrayed in the play as the quintessential Elizabethan figure of the usurious money-lender, with the seventeenth century English theorists of liberalism, Hobbes and Locke. Andrew tried to make several points with the aid of this comparison. One of his points is that the forthright Hobbes was a more dependable and honest exponent of a liberal world view than was Locke, who duplicitously tried to sugar-coat the former's thoroughly self-interested and starkly contractual understanding of social relations with a comforting layer of Christian natural law teachings. By the same token, Andrew argues that Shylock, the representative of an all out commercial world view, should be seen, at least at the psychological level, to be a more sympathetic character than Antonio, the ostensible representative of Christian charity, whose act of compelling Shylock's conversion to Christianity at the end of the play betrays a less than charitable attitude to the alien Jew. Shylock's fidelity to the agreed-upon terms of a contract, like Hobbes' allegiance to the logic of rational self-interest, exemplify, according to Andrew, the governing ethic of the emerging liberal-capitalist order. While Andrew is critical of this economic order and its individualistic ethic, he nonetheless hoped to illustrate in his philosophical reading of Shakespeare's play how it was dependent upon a conceptual separation of justice and charity, the former now collapsed into a discourse of rights seen as properties possessed by individuals. Thus it is the case, argues Andrew, "that rights are born precisely from this separation of charity and

justice, that rights emerge with the expansion of commerce, are contemporaneous with the dissolution of Thomistic strictures against usury and with the triumph of property right over the Christian idea of possession as a trust for the common good” (Andrew, 1988, 8).

What is interesting about this theoretical discussion of the birth of modern liberalism is that the contrast it describes between pre-liberal conceptions of justice and charity, on the one hand, and a liberal conception of rights, on the other, has never been entirely resolved or transcended. This is particularly evident in current controversies over the expansion of fringe banks or alternative financial service providers and what many regard as the usurious interest rates they charge. These institutions have proliferated in urban centres throughout North America in recent years, and have attracted increasing criticism and calls for regulation because they are seen by many to be nothing more than loan-sharks that routinely break existing laws against usury. Industry defenders, on the other hand, both challenge the conception of usury underlying criminal code and common law prohibitions, or at least challenge the way interest is to be calculated when charges of usury are raised, and insist that their lending practices are perfectly valid contractual arrangements between rational self-interested agents. Hence the debate that Andrew featured as essential to an understanding of early liberalism and capitalism has proved not to have disappeared in a society where liberal capitalism appears now to reign supreme.

This chapter will examine how pre-liberal conceptions of economic justice have survived into the modern age of rights-based liberalism and free-market capitalism by first exploring changing attitudes to usury in the western world. This brief excursion into intellectual history will be followed by an account of how the problem of small consumer loans was initially posed as a public policy issue in Britain, the United States, and Canada in the early twentieth century,

and how the Canadian government chose to liberalize its interest rate policy in 1980 with Bill C-44. Finally the chapter concludes with a preliminary consideration of some of the implications which the federal government's affinity for financial deregulation, together with jurisdictional vagaries over who has responsibility for consumer protection, have had for the nascent payday loan industry in Canada.

1:2 A Short History of Usury and its Regulation

The lending of money at interest is by all accounts a very old practice. So too has been the impulse to set limits on interest charges, as evidenced by the earliest known set of written laws, the Code of Hammurabi, which contained detailed regulations on the relationship between debtor and creditor including restrictions on rates for different types of loans (Homer and Sylla 2005, 26-31). In the ancient world the moral unease over the charging of interest on loans was famously expressed by Aristotle (1998, 1528b) in his musings on the ignoble art of money-making:

The most hated sort of money-making, and with the greatest reason, is usury, which makes a gain out of money itself and not from the natural use of it-for money was intended merely for exchange, not for increase at interest. And this term interest, which implies the birth of money from money, is applied to the breeding of money, because the offspring resembles the parent. Wherefore of all modes of money-making, this is the most unnatural.

Aristotle's depiction of money as an artificial and for that reason sterile medium of exchange, and his conclusion that that the charging of interest was an unnatural act, came to influence the medieval Catholic Church, which had also relied on biblical scriptures to condemn

usury. Thomas Aquinas (1989, Q. 78, Art. 1) for one made use of Aristotle's doctrine of money, supplementing it with an argument that charging interest on a loan amounts to double-charging:

To take usury for money lent is unjust in itself, because this is to sell what does not exist, and this evidently leads to inequality which is contrary to justice. In order to make this evident, we must observe that there are certain things the use of which consists in their consumption: thus we consume wine when we use it for drink and we consume wheat when we use it for food. Wherefore in such like things the use of the thing must not be reckoned apart from the thing itself, and whoever is granted the use of the thing, is granted the thing itself and for this reason, to lend things of this kin is to transfer the ownership. Accordingly if a man wanted to sell wine separately from the use of the wine, he would be selling the same thing twice, or he would be selling what does not exist, wherefore he would evidently commit a sin of injustice. On like manner he commits an injustice who lends wine or wheat, and asks for double payment, viz. one, the return of the thing in equal measure, the other, the price of the use, which is called usury.

While views like those expressed by Aquinas dominated Church teachings and informed both canon and civil law, historical evidence suggests that usury was never fully proscribed in medieval Europe. For instance, aside from "manifest usurers" like Jews and Lombards who were allowed to lend money at interest in certain protected places, there also emerged in the late Middle Ages church-sanctioned public pawnshops financed by charitable donations to service the poor (Homer and Sylla 2005, 72-79). It was, however, the growing credit demands arising both from expanding trade and commerce and the financing of wars that paved the way for an eventual change in church doctrines concerning the lending of money. This change was already prefigured by a distinction generally accepted by medieval theologians between usury and interest. The former referred to the illicit profit derived from the use of money while the latter was meant to signify loss in the sense of expense incurred to the lender as a consequence of extending a loan (Homer and Sylla 2005, 73-74). Such a definition of interest bears close resemblance to the modern economic concept of the "opportunity cost of money", and was

deemed an acceptable financial charge for a loan by ecclesiastical authorities if appropriate limits were observed.

A wholesale change in attitudes to lending money for profit would occur only after the Protestant Reformation introduced a new conception of the virtue of wealth accumulation. Perhaps nowhere was this new conception more evident than in the teachings of John Calvin who directly challenged the Aristotelian and Scholastic view of money as a barren medium of exchange. According to Calvin, money is not an unproductive symbol of value but rather a potentially fruitful wealth-producing commodity no different in kind from other commodities such as land or buildings. And since the creation of wealth is positively endorsed in Calvin's theology, the intrinsic taint associated with money-lending in the Christian tradition is diminished if not transcended. Significantly, in this bid to redeem money-lending Calvin (1854, 131) found it necessary to repudiate conventional biblical teachings on usury, a feat he accomplished first by historicizing the biblical injunctions, and then by insisting that the principle of equity alone should determine whether and to what degree profiting from the lending of money is legitimate:

Only those unjust exactions are condemned whereby the creditor, losing sight of equity, burdens and oppresses his debtor. I should, indeed, be unwilling to take usury under my wing, and I would prefer the name itself to be banished from the world. But I do not dare to pronounce upon so important a point more than God's words convey. It is abundantly clear that the ancient people [the Hebrews] were prohibited from usury. But we must admit that this was because it was a part of their political constitution. Hence it follows, that usury is not now unlawful, except in so far as it contravenes equity and brotherly union.

While never completely and unreservedly approving of money-lending for profit, Calvin and his fellow religious reformers nonetheless contributed to a fundamental change in the terms of the debate on its social merit. Henceforth the question of lending money tended no longer to

revolve around the issue of its moral permissibility but rather on the amount of interest that could be justly charged. And not surprisingly, it was in European Protestant countries where civil authorities first began to repeal prohibitions on usury and enact maximum rates of interest for loans (Gelpi and Julien-Labruyere 2000,71-72). Yet even as interest-bearing credit became a widespread phenomenon in the era of commercial capitalism, its apologists continued to hold certain reservations about its practice and retained the word “usury” to denote and condemn excessive rates of interest. No less a person than Adam Smith, for instance, argued for the preservation of laws against usury. Although Smith entertained a modern economic conception of money as a medium of exchange and investment, he nonetheless contended that some restrictions on interest charges were needed in order to ensure that investments would be directed towards productive uses rather than allowed idly to earn high rates of return (Levy, 1987). This distinction between productive and unproductive lending was itself subject to criticism on utilitarian lines by Jeremy Bentham (1788, I-3) in his tract, *Defence of Usury*, where he urged a simple contractual view of the creditor-debtor relationship:

In a word, the proposition I have been accustomed to lay down to myself on this subject is the following one, viz. that no man of ripe years and of sound mind, acting freely, and with his eyes open, ought to be hindered, with a view to his advantage, from making such bargain, in the way of obtaining money, as he thinks fit: nor, (what is a necessary consequence) any body hindered from supplying him, upon any terms he thinks proper to accede to.

In detaching the credit nexus from all moral inhibitions, proponents of a pure market view of monetary transactions like Bentham ushered in new economic vocabulary seemingly devoid of any normative content except for the acclaim placed on individual choice. But without a more structured normative anchor, there arose the puzzle of how to conceive of the value of money, and by extension, the value of credit.

There have been two strands of thought in the economic field which have come to dominate discussions of the place of money, credit and interest rates in a market economy. One is the commodity theory of money, which holds that money is a special neutral form of commodity (or kind of capital) used to facilitate the exchange of other commodities by virtue of being a store of value, and whose exchange (as opposed to nominal) value is measured by the interest charged for its use. The latter in turn is supposedly determined at any given moment by the forces of supply and demand. Variations of this argument can be found in classical and neo-classical economic thought. Adam Smith, for instance, depicted money and interest in this fashion, and argued that as the stock of capital increased in a nation, the price for its use, or interest rates, would decline as lenders competed to find borrowers (Smith 1999, II.4.8). Curiously, in this argument about the long-tendency for interest rates to decline, Smith employed what was for all intents and purposes a closed model of economic production. For it seemed to assume that there could only be a finite number of producers in need of the growing stock of investment capital generated by past production, thus driving down its cost in the long run. Not only did such a theoretical outlook foreclose the possibility of continuous growth in production and a concomitant high demand for money, but it did not recognize consumers as a source of demand for credit. This latter omission reflected Smith's lingering moral misgivings about activities that amounted to an unproductive deployment of capital.

In neo-classical economic thought Smith's supposition about declining interest rates is abandoned while the element of "time preference" is used to help explain the market determination of interest rates. A useful way of understanding this neo-classical innovation is to recall another conceptual puzzle that had exercised classical economists. For economists like Smith and Ricardo, no less than for their famous critic, Karl Marx, the value of a commodity was

said to be linked to the quantity of labour necessary to produce it. While these several economists may have offered different ways of accounting for the socially necessary labour time involved in production, the basic principle behind the labour theory of value remained the same. If there is to be an objective way of comparing the values of different commodities, then there must be something common to all commodities. That common element for the classical economists is the quantity of labour employed in the production of commodities, something that should be reflected in their relative prices over the long run.

Adam Smith's insistence that interest rates will decline in the long run can be seen to rest on assumptions similar to that which inspired his labour theory of value. In the case of interest, Smith had tried to link its value to something objective—in this instance, the capacity of money to make useful production possible. By proscribing as usurious money lent out for purposes that did not increase such production, Smith ended up suggesting that the value of money as measured by the interest charged for its use could be determined over the long run by its tangible contribution to productivity. What neo-classical economists accomplished was to change the terms of reference for the fundamental economic questions their classical counterparts had typically asked. Thus, while Adam Smith and David Ricardo focused on finding objective determinants of different economic values, and principally from the perspective of producers, neoclassical economists like Jevons, Menger and Walras took a subjective turn and sought to model economic behavior of both producers and consumers on the basis of their aggregated preferences. This shift of attention to subjective preferences gave theoretical pride of place to the idea of marginal utility, that is, the notion that one either gains or loses utilities as a result of an increase or decrease in the consumption of a good or service. Armed with demand and supply curves derived from assumptions about utility functions for different goods and services, neo-

classical economists abandoned not only the classical labour theory of value but other similar objectively oriented measures of economic activity.

The neo-classical time-preference explanation of interest rates is a case in point. On this view, the market determination of interest rates reflects the aggregation of the subjective relative preferences of holders of capital for either present or future consumption. Simply put, this means that holders of capital in the form of money are always confronted with the choice of using their capital for present-day consumption or making that money available as loan capital for others in exchange for a price. That price (or interest rate), neo-classical economists typically argue, is the estimated value of substituting future considerations for present consumption (as well as inflationary costs involved in such transactions), a calculation which lenders make when deciding on whether and at what rate to offer a loan (Fisher 1974; Bohm-Bawerk 1959). For contemporary neo-classical economic theorists, the time-preference function in turn helps in solving, at least on the theoretical level, the “economic calculation problem”, a term used to refer to the problem of finding a method for individual producers to be able to decide how to employ the productive factors they own so as to maximize returns. Thus it is assumed that market-derived interest rates, themselves a reflection of the time-preferences of individual owners of investment capital, become one of the price signals that enables others to decide on their own production and consumption plans in ways that would maximize each and every person’s utilities (Hayek 1945).

The rational economic calculations which classical and neo-classical economists built into their economic theories, it bears emphasizing, have unmistakable normative dimensions to them. While the normative foundations of Adam Smith’s science of economics is underscored in

his recurring contrast of productive versus idle capital, that of neo-classical economics draws both on the Benthamite celebration of contractual relations and the utilitarian belief that all values are reducible to individual utilities. These two ideas have given rise to a powerful prescriptive ideal. The contractual view proclaims that individual liberty must be the presiding principle in economic transactions. Thus whatever is accepted as money, and all loan agreements freely entered into, must be regarded as the preferred outcomes of individual decision-making (Friedman 1982). The combination of this normative affirmation of the primary value of economic liberty, and the neo-classical stress on the importance of pricing information for consumption and production decisions, has provided what is perhaps the most familiar contemporary justification of market-based interest rates. That justification works by way of a market rationality assumption which states that once everyone has the opportunity to rationally calculate the relative costs and benefits of their consumption and production choices, then investments, including those involving money capital, will be judiciously put to their most efficient use.

While the neo-classical view of money and interest rates has enjoyed something like a hegemonic status in recent years, it has never been free from controversy. John Maynard Keynes, for one, had disputed the model of economic rationality upon which neo-classical economics relied on for its theorems. In the case of interest rates, Keynes postulated that economic actors rely on differing convictions about the future direction of interest rates, and it is these differing convictions which govern their preference for money or interest-bearing assets, something that can be modeled in a “liquidity-preference” curve but that can never be predicted independently of investment behaviors displayed in real existing markets (Ciocca and Nardozi 1996, 38-41). What is important about Keynes’s depiction of a liquidity preference function is that it tries to

contextualize economic rationality, and for that reason invites an analysis of interest rates that takes into account the multiplicity of expectations that real economic agents entertain.

In a similar vein, doubts have been expressed about the usefulness of the market-pricing mechanism so cherished by neo-classical economists in markets where information is uncertain. According to the so-called adverse selection problem, consumers who cannot predict with any degree of certainty the quality of the product brought to the market are likely to bid down the price of the product with the result that high-quality-high-price sellers will ultimately be driven out of the market. The ensuing domination of the market by low-quality-lower-price sellers may then lead to two eventualities: either the collapse of the market altogether, or the exploitation of that segment of consumers without access to adequate information about quality and price who remain to be served by the low-quality sellers (Akerlof 1970; Stiglitz and Weiss 1981) This problem of asymmetrical information, it has been pointed out, has a particular relevance to the market for credit where sellers have an informational advantage over buyers, a fact that is glossed over in neo-classical theories of money and interest.

Although the insights of Keynes and theorists of asymmetrical information cast doubt on the efficacy of the pure market explanations of money and interest, their theories nonetheless continue to portray money primarily as a commodity with an associated opportunity cost expressed in terms of interest rates, albeit rates that are derived arguably in a more realistic fashion than what neo-classical theory proposes. There are, however, alternative sociological and political conceptions that challenge even more fundamentally the classical, neo-classical and Keynesian understanding of money. This second strand of economic thought dispenses with many of the working assumptions that inform earlier commodity theories of money. A notable

example of this second approach is the “credit theory of money” which questions the conventional distinction between money and credit to which classical and neo-classical and, for the most part, Keynesian economists subscribe. In “credit theories of money”, the attempt to ground money in the real economy of commodity production which is characteristic of classical and neo-classical economics is rejected in favour of an explanation that stresses its social construction out of an institutionalized credit-creation system. Thus rather than looking at the way in which money facilitates production, or at the relative preferences for future considerations over present consumption, credit theorists instead focus on the role that banks and related financial institutions play in the creation of money by the expedient of extending credit. In an influential modern sociological version of the credit theory of money, Geoffrey Ingham (2004) reiterates the point that money, since it has no stable intrinsic value of its own, is to be seen as a form of credit in the sense that its bearer holds not a good itself but a claim to goods. But more importantly from his sociological and historical perspective, the particular form of “credit-money” upon which the capitalist market depends is itself the product of a specific historical conjuncture and a specific constellation of social relations. Ingham’s point is that with the advent of private credit-producing institutions like banks, not only were the investment needs of capitalism more easily facilitated, but there developed in the process a complex hierarchy of financial institutions and credit-debtor relationships that together make up a national money-system:

The capitalist monetary system’s distinctiveness is that it contains a social mechanism by which privately contracted debtor-creditor relations—for example, bank loans, credit card contracts—are routinely monetized. Private debt in its various forms (cheques, credit cards, promissory notes and so on) are converted into the most sought-after ‘promise to pay’ at the top of the hierarchy of promises. This is the state’s issue of money that is accepted in payment of taxes and final settlements. (135-36.)

Ingham's argument about the complex institutionalized nature of credit-money is made more pointed by his observation that "both the supply and demand for money are controlled and regulated according to criteria of creditworthiness—that is, they are socially constructed" (Ingham 2004, 137). This latter assertion refers in the first instance to the well-known practice of institutional lenders gauging the hazards involved in different kinds of loans:

Within this constraint [of central banks setting base rates of interest] access to the credit money that fuels the capitalist economy is determined by an assessment of credit-worthiness, by what is considered an appropriate rate of interest, and by as much exploitation as the level of competition in the credit market allows. Loans by the banking system are priced in accordance with a profit-maximizing strategy that includes a calculation of the degree of risk of default. First, risk is taken to increase with the length of the term of the loan; second, it is considered to vary with the purpose of the loan—investment, especially if collateral is provided is less risky for loans than consumption; and third, the borrowers' ability to repay—creditworthiness—is assessed (137).

While this process of credit analysis which aims to stratify orders of risk might seem a neutral exercise in financial prudence, Ingham insists that it is structurally implicated in the continued reproduction of income inequalities. That is to say, credit risk analysis does not simply quantify risk in accordance to income strata, but also contributes to the perpetuation and deepening of income differentials by establishing the criteria which lenders use to justify higher rates for those most in need of their facilities.

Ingham's sociological account of money, interest and credit has the virtue of locating these abstract economic concepts in concrete social and historical processes, and hence offers an understanding of their workings that do not reduce to simple demand and supply functions. But his treatment of the social construction of credit demand remains underdeveloped. To help give substance to the various theoretical debates about the nature of money and interest rates, and

especially the idea of the social construction of credit, the remainder of this chapter details how the credit demands of the working poor were met in the modern marketplace, and how these market products aroused regulatory responses animated in part by precepts drawn from the very moral economy the modern market had supposedly displaced.

1:3 The Small Loans Problem

The pure market conception of interest championed so candidly by Jeremy Bentham and his heirs in economic theory had an uneven history when it came to its operationalization in public policy in the western industrialized world in the nineteenth and early twentieth centuries. That concept came to prevail in the leading capitalist nation of the nineteenth century, the United Kingdom, when it introduced the *Bill of Sales Act* of 1854, which, among other things, effectively abolished all restrictions on interest rates (Finlay 2005, 21).¹ But in continental Europe, by contrast, most countries retained legal limits on interest rates, while in the United States, local authority over banking meant that policies on usury were a state prerogative. While most states had laws against usury, the content and effectiveness of these laws varied considerably. The Canadian approach to interest rate regulation tended to follow British precedents in the nineteenth century, but moved closer to American practices in the early twentieth century.

There was a host of reasons why the regulation of interest rates attracted conflicting policy responses. The cost of money, for example, was a crucial factor in capitalist investment

¹ Britain did reintroduce a 48% interest rate ceiling for a period between 1927-1974 (Finlay 2005, 21, fn 3).

decisions and these in turn were regarded as transparent measures of economic development. But the cost of money also became an issue for that growing army of industrial workers whose wages were often insufficient to meet their regular needs and who in consequence had to find ready sources of credit. For this reason the business of lending to the working poor, often intertwined with other commercial activities directed at this same class, became relatively common in the late nineteenth century in both the U.S. and Britain. In the U.S., for example, a widespread practice developed during the Civil War of merchants called “sutlers” following Union army regiments as they moved from battlefield to battlefield, offering to advance funds or necessities to ill-provided soldiers in exchange for claims on their wages (Graves and Peterson 2005.)

Roughly at the same time there arose in major cities in the eastern United States a category of lender called “salary lenders” who typically sought out the relatively more secure workers in large industries and government institutions as customers for high-interest short-term loans at rates often in excess of 500% per annum (Haller and Alviti 1977). Similar predatory lending practices materialized in Britain as tallymen and check traders transformed themselves into money lenders for the working poor by the late nineteenth century (O'Connell 2009.) And throughout the period in both countries a host of related enterprises such as pawnshops and hire purchase schemes proliferated with the same purpose of supplying high interest loans to those who had no alternative sources of credit. The rise of these various forms of questionable credit facilities at the turn of the nineteenth century was matched by the emergence of progressive reformers to seek ways of curbing predatory lending to the working poor.

Unscrupulous as credit providers to the working poor may have been in the nineteenth century, it is worth noting that civic reform responses to their perceived depredations were motivated by a modern liberal governance project that had a particular type of moral and social

regulation as its goal.² The contours of that goal can be glimpsed from the activities of one of the key philanthropic agents in the U.S. promoting the cause of small loan reform: the Russell Sage Foundation. Created in 1907 by the widow of Russell Sage, a wealthy New York financier who controlled, among other assets, the fabled Western Union Company, the foundation almost from its inception focused its efforts on finding solutions to the problem of credit for the working poor by helping sponsor the creation of low-cost loan funds capitalized by philanthropically-minded financiers, and by advocating for legislative curbs on what were conventionally seen as usurious money lenders. The foundation had some success with the latter when different iterations of a model piece of legislation it had crafted in 1916, the Uniform Small Loans Law, were adopted by most state legislatures during the interwar years. In broad outline, the Uniform Small Loans Law aimed at controlling usurious lending by regulating small loan providers through a combination of licensing and disclosure requirements while at the same time authorizing such providers to charge interest at rates higher than those allowed for commercial banks so that they might realize reasonable profits on their outlays of capital. As more than one commentator has pointed out, one of the effects of the Uniform Small Loans Act, aside from affording borrowers a more transparent and capped rate structure for small loans, was to help provide a stable state-sanctioned regulatory environment for small loan providers, thus helping both to legitimate their enterprise and ensure their profit levels (Nugent 1941).

Not only were the Small Loans Acts (and the variations on them which early twentieth century British and Canadian governments introduced in the form of Moneylenders Acts) a benefit to mainstream lenders who wished to penetrate the working-class credit market, but their

² For detailed analyses of the modern liberal governance project aimed at the working poor, see Dean, 1991; Neocleous 2000; Corrigan and Leonard 1978; and Dickinson and Russell 1986.

underlying rationale was consistent with the self-responsibilization assignment envisaged by liberal governance. For intrinsic to these efforts to normalize credit facilities for the working poor was the objective of instilling in them habits of thrift, financial prudence and self-reliance, an aspiration succinctly affirmed by Mary Ellen Richmond, director of the charity department of the Russell Sage Foundation and a founder of modern American professional social work, when she related what she regarded as a well-known truism. Observing there were two classes of workers, one that was aspiring to middle class comforts and capable of financial self-discipline, and another that was self-indulgent and financially imprudent, Richmond (1907, 111-112) saw the task of social work as one of inculcating habits of self-reliance:

The second class [of workers] includes those who are willing to work when work is plentiful, but who have little persistence or resourcefulness in procuring work. In the busy season they spend lavishly on cheap pleasures and soon become applicants for relief in troubled times....It is with the second class that the charitable may work lasting harm or lasting good. To let them feel that no responsibility rests with them during the busy season, and that all the responsibility rests with us to relieve their needs when the busy season is over, rapidly pushes them into [pauperism]. To teach them, on the other hand, the power and cumulative value of the saving habit, and so get them beforehand with the world, is to place them in the first class and soon render them independent of our material help.

While the efforts of social reformers eventually succeeded in curtailing much of the barely licit trade in predatory lending to the poor by the mid-twentieth century, it must be pointed out that at first this did not do much to change the financial position of the working-class, a majority of whom continued to remain at near subsistence wage levels in the early twentieth century (Stricker 1983). Rather, it was ultimately the welfare state, itself predicated in important ways on the growth of a productivist regime geared to mass consumption, that led to the relative decline of predatory lenders by midcentury. For example, A.L Minkes (1953, 21), a British student of the phenomenon of pawnbroking, explained its comparative decline in post-

war Britain as largely determined by that country's commitment to a full-employment economy: "The broad explanations of the decreased importance of pawnbroking are, on the demand side, the great extension of the scope of social policy, the maintenance of continued full employment, and changes in the opportunities and attitudes of consumers, and on the supply side, the declining relative attractiveness of pawnbroking as an occupation."

Post-war prosperity, particularly in the U.S., gave rise to new types of credit facilities aimed at domestic consumption. The proliferation of these different types of credit provisioning created new regulatory dilemmas for American legislators, not the least of which was the problem of accurately determining their true price. The growth in pressures for more robust consumer protection legislation eventually led the federal Congress to enact the *Consumer Credit Protection Act* (better known as the *Truth-in-Lending Act*) in 1968 despite spirited resistance from the financial and business community. Among other things, lenders objected that the Act's requirement that all credit costs be disclosed in terms of an annual interest rate (APR) would only serve to distort consumer perceptions about those costs. As one spokesman for the National Retail Merchants Association rather airily testified in Congressional Hearings considering an early version of the bill, its annual interest rate reporting obligation:

propagates fear, doubt and distrust through junking...the well understood monthly terms for monthly transactions and substitutes new and little understood simple annual rates for monthly transactions—requiring in turn a radical readjustment of the consumer mind—particularly the female mind. (Brooks Schumaker quoted in Nadel 1971, 131).

While the Truth-in-Lending Act survived such self-serving and paternalistic opposition, its credit disclosure requirements aimed at producing a level competitive market in credit did not lead to any national efforts at capping credit costs, these latter for the most part remaining the

responsibility of state governments. Effective state jurisdiction over lending rates was undercut, however, when the U.S. Supreme Court ruled in *Marquette National Bank of Minnesota v. First of Omaha Service Corp et al* that national lenders could charge common interest rates in all states (U.S. Supreme Court 1978). The practical consequence of this ruling has been that lending institutions with a national presence that are intent on escaping stringent state laws on interest charges can simply choose the expedient of incorporating in a state with high or no interest rate ceilings.³ Alternatively, local lenders can affiliate with federally-regulated banks, thereby circumventing their own state laws on lending rates. In either case the result in the United States has been a de facto deregulation of interest rates similar to what presently obtains in the United Kingdom.

Canadian policy on interest rate regulation was influenced both by British and American developments. Thus just as in Britain, the Canadian colonies repealed usury laws in the mid nineteenth century, only to re-impose different versions of them in the early twentieth century in the form of a federal Money-Lender's Act (1906) and various pieces of federal and provincial legislation governing the activities of pawnbrokers and more generally those aimed at curbing "unconscionable transactions" (Ziegel 1981). Difficulties in applying the Money-Lenders Act, which lacked a clear statutory definition of what constitutes interest, in an economy that was becoming more and more dependent on credit, particularly consumer credit, led the federal government to replace it with the *Small Loans Act* in 1939. Modeled after the American Uniform

³ The advantages of locating in states with no or extremely high interest rate ceilings was not lost on the U.S. credit card companies after the Marquette decision as witnessed by the current location of the top ten credit card issuers: Citibank (South Dakota, no interest rate ceiling); American Express (Utah, no interest rate ceiling); Bank of America (Arizona, 36% interest rate ceiling); Provident (New Hampshire, no interest rate ceiling); JP Morgan Chase, MBNA, Morgan Stanley, HSBC (Delaware, no interest rate ceiling); and Capital One (Virginia, no interest rate ceiling). Information gathered from "Secret History of the Credit Card." *PBS Frontline*.

Small Loans Law, the Canadian Act established a graduated set of limits on interest rates that could be charged on small loans up to a maximum of \$500. The Act also required all moneylenders who charged more than 1% per month to be licensed, and it regulated certain conditions of loans including refinancings. (Waldron 1992, 15) Significantly, the Small Loans Act at the time of its enactment was seen, as was its counterpart in the U.S., to be as much about ensuring the profitability of finance companies which served this market as it was about protecting borrowers from exorbitant interest rates.

With periodic readjustments of its interest rate ceilings and loan maximums, the Small Loans Act continued to be the principal legislative vehicle for regulating loans aimed at low income high risk consumers for the next four decades. But in response to pressures from financial institutions in the 1970s, especially credit unions, many of which were experiencing losses on their small loans portfolios because of rate limitations in an era of ever more expensive money, the federal government replaced the Small Loans Act with Bill C-44. This introduced into the Criminal Code a new Section 347 containing a new definition of a criminal interest rate of 60%, but otherwise effectively deregulated interest rates below that level.

1:4 Bill C-44: Solution or Problem?

Many observers have characterized Bill C-44 as a triumph of the market economy approach to interest rates, albeit a triumph compromised by the retention of a criminal penalty for rates above a proscribed ceiling (Ziegel 1981; Antle 1994; Waldron 1994). This particular legislation, it is worth noting, came on the heels of a failed bill, the 1976 *Borrowers and Depositors Protection Bill*, which had been sponsored by the Department of Consumer Affairs, and which, during its long period of gestation, had evolved into an omnibus bill that would apply

to virtually all lenders. The ill-fated Borrowers and Depositors Protection Act would have created a regulatory environment that in key respects mirrored the Truth-in Lending innovations in the U.S., premised on the idea that suitably informed consumers are best able to determine and protect their own interests. Central to this legislation was a disclosure proposal that would have required a uniform reporting of all credit costs, a measure which the then Director of the Consumer Research Branch, John Evans, saw as the principal means of effective consumer protection:

Any consumer protection legislation may be thought to have one or both of the following functions: to inform and to protect. In a free and competitive market environment, adequate consumer protection could be achieved through complete and accurate information alone. Consumer's action in the marketplace would then ensure they receive optimal treatment. However, markets are not fully competitive and consumers are not capable of obtaining or digesting the mass of information that is required to make wise decisions on the myriad of products which they purchase...In situations such as this, it is appropriate for the government to respond by establishing "rules of the game" to facilitate consumer decision-making. In the field of consumer credit, this entails specification of that provision, regulation of the nature and content of standard agreements and provision of a means of ensuring compliance by providing effective penalties and remedies in situations where violations occur (Evans cited in Burns 1983, 95).

The final version of the *Borrowers and Depositors Protection Act* that made it to Parliament was designed to replace the *Small Loans Act*, as well as the existing federal *Interest Act* and the *Pawnbrokers Act*. The *Interest Act*, initially passed in a piecemeal fashion in the last decade of the nineteenth century, established what would become the basic laissez-faire framework for money-lending in Canada by stipulating that any rate of interest can be charged for a loan provided the contracting parties agree to it. The Act did establish a default rate of 5% if a loan agreement had failed to specify an interest charge, or if the terms of the loan were not otherwise regulated by law, though this latter provision was hardly ever enforced by courts (Telfer 2007, 4). The *Small Loans Act* of 1939 served to modify the *Interest Act*, but only for

small consumer loans. Likewise, the *Pawnbroker's Act*, originally passed in 1866, placed certain limits on redemption charges for pawned items, thus also departing from the general market regime for interest rates prescribed by the *Interest Act* (Veitch 1992-93, 57). In place of the interest rate ceilings incorporated in these latter two Acts, the *Borrowers and Depositors Protection Act* would have left it up to contracting parties to determine an acceptable rate of interest, but at the same time it would have permitted borrowers to appeal to civil courts to nullify unwarranted interest rates, thus leaving it up to the judiciary to determine what constituted unconscionable financial transactions. While this remedy, together with extensive and standardized disclosure requirements, were designed to shift the burden of consumer protection to individual borrowers themselves, the Act also contained a criminal proscription for interest rates deemed usurious (at a rate to be set by regulation but at the time projected to be somewhere in the vicinity of 70%). Interestingly, the impetus for including a Criminal Code sanction against usury in the Act came about because of requests from police in Montreal for legislative assistance in their efforts to control loan sharking by organized crime; this partly explains why the rate was set so high (Burns 1983, 91; Ziegel 1981, 192).

Opposition to the *Borrowers and Depositors Protection Act* by the banking community (which objected to the uniform reporting requirements), by certain provincial governments concerned about jurisdictional integrity, and by a number of consumer advocates alarmed at the loss of the interest rate ceilings that hitherto had been contained in the *Small Loans Act*, together with inter-departmental discord at the bureaucratic level, all conspired to derail the legislation at committee stage. Subsequent changes in government and a general change in regulatory beliefs meant that when finally the issue of credit reform returned to Parliament in 1980 in the form of Bill C-44, all that remained of the broad goals of the *Borrowers and Depositors Protection Act*

was the aspiration to deregulate the realm of small loans to ease the burden on those credit providers willing to serve this market, while still retaining a nominal prohibition of usury ostensibly aimed at deterring the criminal practice of loan-sharking (Burns 1983).

Whether this conjunction of a market economy in interest rates with a residual criminal prohibition of usury has made for coherent public policy has been a topic that has attracted its fair share of debate. Among academic legal commentators there has been a tendency to view the retention of a criminal prohibition against usury in a regulatory regime dedicated to a free market in credit as an anomaly that complicates commercial financial transactions while failing to provide any genuine consumer protection. The problem with the legislation, as many have noted, is not so much the substantive criminal law provision which, after all requires the consent of a provincial Attorney-General for its prosecution, a fact that one might reasonably expect would deter frivolous indictments. But its presence in the legislation nonetheless invites appeals for civil remedies for commercial financial transactions that include quite legitimate practices, but which might be in notional breach of the 60% threshold. The emergence of several such court cases involving commercial loans over the years, where borrowers have sought release from their financial obligations on grounds that these obligations breached Sec. 347, has led commentators like Ziegel and Waldron to question the wisdom of retaining a criminal interest rate (Ziegel 1986; Waldron 2003). This especially is the case, Ziegel argues, in light of the fact that Sec. 347 has never been used for its stated purpose of prosecuting criminal loan-sharks, while causing difficulties for lawful commercial lenders (Ziegel 1986, 397).

The discussion of policy efficacy raised by commentators like Waldron and Ziegel repays a close examination because the terms they employ and the distinctions they try to make

inadvertently reveal something of that lingering tension between a moral and a market approach to interest rate setting which I suggest underlies virtually all policy proposals in this field. That tension is best exemplified in Waldron's 2002 address to the Uniform Law Conference and Ziegel's response to that address, both of which were offered at a time when the federal government once again began the process of looking at consumer credit reform with an eye to regulating the newly arrived payday lending firms. In her address Waldron repeats the assorted criticisms of how Sec. 347 unfairly burdens legitimate commercial financial transactions, adding that if overzealously applied to the contemporary payday loan industry, this provision in the Criminal Code might have the perverse effect of forcing out an industry which does after all serve a market not met by other suppliers of credit, with the result that at least some prospective borrowers might be driven into the arms of criminal loan-sharks (Waldron 2003, 377).⁴

But Waldron is not prepared to accept the market economy argument entirely, noting that the criminal law prohibition on usurious interest rates serves a valid public purpose other than promoting market conditions in the credit industry. That purpose, she seems to accept, is to combat loan-sharking by criminal elements. Asking whether this purpose might still be better served by other legal expedients, Waldron reviews only to reject a number of alternatives to the criminalization of usury. For example, she acknowledges that criminal loan-sharking, if identified by the issuing of threats of violence rather than simply excessive interest rates, might be controlled by utilizing existing criminal sanctions against extortion. But such a remedy, she quickly adds, is also not likely to be of much use to victims of criminal loan-sharks who often

⁴ This particular argument is part of the more general contention that any attempt to set limits on interest rates will end up distorting market rates with deleterious consequences for consumers of credit. For a representative version of this market economy argument, see Cayne and Trebilcock (1973).

are fearful of giving evidence of extortion. In like measure, resorting to provincial statutes limiting unfair trade practices may also be ineffective because they require injured borrowers to make use of the civil court system, something that the indigent or uneducated might be reluctant to do in general, and certainly reluctant if their adversary is from the criminal underworld. Instead of recommending the repeal of Sec. 347, therefore, Waldron asks whether it might be revised in such a way as to restrict its reach to authentic loan sharks by, for example, defining interest in a more narrow fashion so as to exclude all those fees and ancillary costs which legitimate commercial lenders might charge, thereby protecting them from untoward charges of usury. Alternatively, a usurious interest rate could be set at a much higher level, such as 500% per annum, which would capture the lending practices of organized crime but otherwise leave out conventional corporate and commercial lending which conceivably would never reach such levels.

In addition to contemplating adjustments to the details of Sec. 347, Waldron also considers ways of exempting business loans entirely or for the most part from the application of the criminal prohibition on usury. For example, sec. 347 could possibly be amended to apply only to consumer loans, leaving commercial loans entirely to market forces. Curiously, Waldron resists this solution on grounds that an exorbitant commercial loan can be just as usurious as an exorbitant consumer loan, insisting that “the commercial character of the transaction does not necessarily affect the criminal character of the act” (Waldron 2003, 382). Finally, Waldron reflects on another way of protecting legitimate commercial lenders from sec. 347 by prohibiting its use in civil courts (as borrowers now sometimes do in an effort to seek release from loan obligations) unless the lender has been formally prosecuted in criminal court with the authorization of a provincial Attorney-General.

In his response to Waldron's various suggestions of an amended Sec. 347, Ziegel makes it plain that he does not think it worth the effort to rehabilitate this criminal law provision. For example, he observes that it is unlikely any Parliament would willingly legitimate an interest rate of 500%, a figure, he implies, that would be politically offensive. As for the device of redefining interest rates so as to exclude from the calculation those costs that legitimate commercial lenders typically add on their loans, Ziegel points out that past experience proves that any legislative exclusions would quickly be exploited by all lenders thus defeating the purpose of refining Sec. 347 so that it would apply only to a specific class of unsavory money lenders. Ziegel is likewise dismissive of Waldron's proposals to narrow the application of Sec. 347, stating, for example, that her suggestion that civil remedies for usurious loans be prohibited unless prior criminal proceedings were initiated would "turn public policy on its head [showing] how little confidence we have in our ability to craft a revised s. 347 that can credibly distinguish legitimate from illegitimate loan transactions" (Ziegel 2003, 396).

Worth noting in this exchange between Waldron and Ziegel is the way in which a moral economy perspective on interest rates is never quite abandoned by either analyst, even as they both condemn the market distorting effects arising from the wholesale application of Sec. 347 to all forms of credit provisioning. The moral economy perspective reveals itself in Waldron's repeated attempts to find a way of preserving a criminal code sanction against usury though presumably one directed only at so-called criminal loan-sharking. The distinction Waldron seeks, however, is obscured once she concedes that commercial borrowers can suffer from the depredations of usury just as much as those who borrow for consumption. This concession implies that what Waldron objects to is not so much a particular **method** of exacting extortionate interest rates but rather an unconscionable rate level itself.

As for Ziegel, his longstanding antipathy to Sec. 347 notwithstanding, his prescriptions for its repeal are never offered in the spirit of a pure market economy devotee. Rather, Ziegel has always lamented the abandonment of the *Small Loans Act* which he thought could have been revised to reflect a more reasonable interest rate structure for firms willing to engage this particular market (Ziegel, 1981). His more recent views have been that given the perverse consequences for normal business and consumer loans occasioned by Sec. 347, it would be preferable to do away entirely with the criminal code provision while protecting the most vulnerable consumers of credit, specifically, payday loan customers, with new legislation designed for the industry. That, coupled with existing civil relief remedies available under provincial consumer protection acts and common law doctrine, as well as existing criminal law protections against violence and illegal collection practices, would, he concludes, not be a perfect alternative, but would nonetheless be “more realistic than the illusory protection of s. 347” (Ziegel 2003, 399). What is missing in this nod to legislative realism is any indication of what criteria Ziegel would rely upon to distinguish the “vulnerable” credit-seeker in need of protection, nor what levels of interest rate would be acceptable in a regulatory scheme aimed at safeguarding this constituency from predatory lenders. It turns out in the end that Ziegel, no less than Waldron, must revert to an undefined normative intuition about unacceptable rates of interest to supplement his market economy arguments.

What this extended commentary on legal critics of the usury provisions in the Criminal Code was meant to illustrate is that however guided their arguments are by precepts drawn from the market economy, it is difficult to relinquish completely surviving normative judgments drawn from the moral economy. Whether those judgments continue to have any purchase in actual policy-making remains to be discussed in the final three chapters of the dissertation which

focus on efforts to regulate the burgeoning payday loan industry. Before turning to the subject of the regulation of payday lending, however, it is necessary first to gain some understanding of who the lenders and borrowers are in this new commercial field of small, short-term cash advances.

Chapter 2

Payday Lending in Canada

A payday loan is an unsecured short-term loan to meet unexpected cash needs. When used for short-term cash needs, a payday loan is convenient and economical, but it is inappropriate to use for long-term or continuing cash needs. (CPLA 2009)

“The survival of payday loan operators depends on establishing and maintaining a substantial repeat customer base.” (Ernst and Young 2004, 46)

2:1 Introduction

The story typically told by the payday loan industry is that the services they provide fill a need not met by traditional financial providers. On the webpage of the Canadian Payday Loan Association, for example, care is taken to portray payday loans as forms of credit designed to meet occasional unanticipated cash requirements. That same webpage features an industry sponsored study by the polling firm *Environics* ostensibly demonstrating that those who take out payday loans in the main are drawn to this service because procedures for processing loans are “quick and easy” and because the location and hours of operation of payday loan providers make this a convenient source of credit (Environics 2005, 4.) To reinforce the view that these lending arrangements are purely voluntary transactions, it was further stressed in this same *Environics* study that payday loan users do have other financial options available to them such as bank accounts, credit cards, and lines of credit--although this assertion hardly masked the fact that over a fifth of the respondents in the study reported that they had no alternative source of borrowing. And as further evidence of the providential nature of the business of payday lending,

the Canadian Payday Loan Association webpage gives pride of place to its voluntary *Code of Best Business Practices* which, among other things, requires its member firms to refrain from extending new loans to customers to allow them to pay back existing loans (so-called loan rollovers) unless allowed by provincial legislation, nor grant multiple loans in excess what the customer has initially been approved to borrow (CPLA 2011c).

Although generating some controversy among payday lending firms in Canada (see the discussion of the division between Money Mart and Cash Store Financial in ch. 5), the clear intent of adopting a Code of Best Business Practices has been to help legitimize an industry often criticized for exploiting a financially vulnerable segment of society. The promise not to engage in the practices of loan rollovers and multiple loans is part of a strategic campaign on the part of payday loan companies to create the public perception that they are financial providers *responding* to a market not well-served by traditional financial institutions. In this representation, comparative advantages are stressed (e.g., ease of transactions, convenience of location and hours of operation) to suggest that the growth of the payday loan industry can be explained by pure market mechanisms of supply and demand in a milieu where both competition and the self-restraint of a business code of ethics ensures the provision of needed financial services at a fair market-determined price.

To drive home this benign, competitive-market picture of the payday loan industry, the CPLA had also commissioned a study by the accounting firm of *Ernst and Young* to try to dispel the notion that these firms enjoy excessive profits from their lending charges which seem, at least nominally, to routinely exceed the 60% APR prohibited under Canada's usury law (Ernst and Young 2004). The Ernst and Young study dutifully proceeded to offer a conventional analysis of

the marginal costs of providing payday loans, relying on the information furnished by participating payday loan companies for its data on the segregated costs associated with payday loans. The study concluded with the observation that the payday industry as a whole is “earning returns on equity that are somewhat comparable in other segments of the financial service sector” (Ernst and Young 2004, 46).

But significantly, the Ernst and Young study contained an almost parenthetical observation that arguably undermines the entire legitimization strategy pursued by the CPLA. Central to that strategy is the emphatic assertion that payday lenders do not attempt to ensnare economically susceptible individuals in a continuous cycle of debt but rather are in the business of providing occasional credit to those who experience unplanned albeit minor financial shortfalls. This contention becomes less persuasive when the very accounting firm charged with justifying the typical cost structure of payday loans allows that, given the average size of these loans and their marginal returns, the very survival of this industry “depends on establishing and maintaining a substantial repeat customer base.” (*Ibid.*) This admission speaks volumes about the actual practice of payday lending. In particular, by pointing out the need to *establish* and *maintain* a substantial repeat customer base, the Ernst and Young study more or less demolishes the pure market image that payday lenders have tried to convey of their business as one where supply conveniently emerges to satisfy demand. Instead, Ernst and Young inadvertently suggest that the industry is opportunistically involved in creating and recreating over time the very demand it seeks to fulfill with its financial products. While this is not exactly a novel observation in the field of the sociology of economics, or in the literature on marketing, for that matter, its normative no less than descriptive implications directly undercut the justifications upon which

the payday lending firms have been building their case for a minimally or weakly regulated industry.

This chapter will be devoted to studying precisely how payday lending firms in Canada have tried to accomplish, both by way of organizational structure and business strategy, the market-building mandate Ernst and Young have suggested is essential to the industry. Three firms have been selected for close examination based in part on the size of their market share in Canada, but also based on their distinctive business models. Certain theoretical insights drawn from the fields of institutional economics, economic sociology and marketing studies will be employed to help clarify what is involved in the measures these payday firms use to target and capture that particular segment of the market for credit that is the bedrock of their business. Further, the chapter will discuss some of the implications their organizational and business strategies have for the ongoing efforts to regulate payday lending in Canada.

2.2 Some Preliminary Theoretical Observations

In conventional neo-classical economic theory an elementary distinction is drawn between perfect and imperfect markets. The former is meant to describe a condition with multiple sellers offering wholly commensurate products in an arena where there are no barriers to entry or exit either of buyers or sellers, and where transactions costs (including the cost of acquiring reliable information) are zero. In such an abstractly conceived world, prices and volumes are determined by the intersection of supply and demand and the resulting equilibriums, by definition, represent seamlessly efficient markets. Real world economies, it is usually acknowledged, do not necessarily reflect these ideal conditions, hence the concept of imperfect markets. When discussing imperfect markets, neo-classical economists tend to stress barriers to

entry that undermine competitive equilibriums, as for example when there are monopolistic or duopolistic sellers. In the circumstances, the corrective policies that are usually advocated revolve around measures that might alleviate such entry restrictions (e.g. anti-monopoly laws.) But there have also been significant theoretical discussions of imperfect markets that highlight transaction costs. One of the more well-known of these derives from George Akerlof's (1970) reflection on market distortions caused by information asymmetries when the seller knows more about the product than the buyer. Policies to prevent market distortions that might flow from information asymmetries generally emphasize transparency requirements (e.g. full pricing disclosure). The governing assumption behind such a remedial course of action is that if consumers are properly apprised of the true characteristics of a product (including its pricing structure), they would be better placed to make the kinds of decisions that would maximize their own utilities, a situation that theoretically obtains in perfect markets.

Not surprisingly, in their continuing campaigns to legitimize their own industry practices, payday lending firms would like to situate all regulatory discussions in the conceptual terrain of neo-classical economics (as evidenced, for instance, by their commissioned Ernst and Young study designed to show that the marginal costs of providing payday loans justifies their nominally high pricing structure). The burden of submissions by payday lending firms to regulatory hearings held in those provinces which have been adopting regulatory mechanisms for the industry (to be discussed more fully in chapter 5) is that theirs is a competitive environment where consumers have genuine choice. And as for information asymmetries, these same firms, while often disagreeing with regulators over what counts as genuine transparency (for example, the long-standing arguments of industry officials against reporting fees for payday loans in terms of an annual percentage rate—see chapter 5), do nonetheless stress their commitment to full

disclosure of credit costs and to credit counseling. In short, if taken at face value, the debate about the regulation of payday lending among and between government officials, payday lending firms, and many public interest groups that have taken up the cause of reform can be reduced to the neo-classical economic description of, and prescriptions for mitigating the effects of, imperfect markets. These prescriptions typically involve measures to improve truth-in-lending and financial education. For example, in its preliminary dialogue with parties interested in the issue of payday lending regulation, the Consumers Measures Committee (CMC) Working Group on the Alternative Consumer Credit Market—a consortium of Industry Canada and provincial territorial departments responsible for consumer affairs—offered a series of policy proposals for discussion. Featured among those were suggestions such as: a) requiring that contracts for payday loans include a plain language warning of their high cost as well as contact information for making a complaint; b) requiring that contracts for payday loans include contact information for credit counseling services, and requiring that such credit counseling information be prominently posted within outlets offering such loans; c) requiring small-short lenders to provide borrowers with copies of contract documentation, receipts for payments, and statements of account for installment payments (Kitching and Starkey 2006, 12-13).

Proposals such as these, meant to acquaint consumers with the true costs of payday loans and provide information about credit alternatives, are entirely conventional neo-classical economic policy responses for the problem of information asymmetries. But as will be contended in this chapter, a neo-classical economic comprehension of imperfect markets hardly captures the real workings of payday lenders in their efforts to establish and maintain a repeat customer base. Rather, it will be argued, traditional institutional economists, economic sociologists and anthropologists, and marketing theorists can contribute infinitely more useful

concepts to understand just what is involved in the business of payday loans. For example, in the matter of information asymmetries, Clifford Geertz's (1978) seminal anthropological study of a bazaar economy suggests that the appropriate unit of analysis for studying how information is gathered and evaluated for vending and consumption decisions in that economic environment is not the isolated utility-maximizing individual of neo-classical theory but rather the stable "clientships" that emerge among buyers and sellers for reasons that are socially and economically complex but which have the effect of normalizing commercial transactions. Geertz's insights into the formation of clientships in bazaar economies have implications that go beyond these particular localized settings. Acquiring reliable information, Geertz tells us, is the essential element in economic transactions in the bazaar: "Every aspect of the bazaar economy reflects the fact that the primary problem facing its participants (that is, "bazaaris") is not balancing options but finding out what they are" (Geertz, 1978, 30). Establishing clientship relations is a response to this problem because it "reduces [the search for information] to manageable proportions and transforms a diffuse mob into a stable collection of familiar antagonists" (*Ibid.*, 31). Geertz insists on calling market vendors and their customers "antagonists" because they remain competitors seeking out their own best advantages. In this perpetual competition, knowledge itself becomes the key to realizing an advantage: "The central paradox of bazaar exchange is that advantage stems from surrounding oneself with relatively superior communication links, links themselves forged in sharply antagonistic interaction in which information imbalances are the driving force and their exploitation the end" (*Ibid.*).

Geertz's proposition that the creation of stable transactional relationships is an endemic feature of bazaars is something worth exploring in markets for payday loans. So too is his suggestion that informational asymmetries both lead to the quest for reliable transactional

partners and become the basis for individual advantages in the terms of trade these relationships make possible. In terms of the payday loan market, clientship implies the active pursuit on the part of payday lenders of a predictable pool of repeat customers, a pursuit that will be detailed in this chapter. It also implies a reciprocal movement on the part of potential borrowers to find a suitable transactional partner. This latter pursuit will be examined in detail in chapter 3.

In using the concept of clientship to suggest that commercial transactions in bazaar economies are profoundly mediated by extra-economic social ties and networks which confer predictability on these exchanges, Geertz is content to say that the relationships thus formed should not be characterized as dependency relations but rather are relations of reciprocal convenience. This assertion of reciprocity is offered on the conceptually obvious grounds that sellers and buyers are in need of each other. But such an observation is less persuasive in markets where demand for goods or services is systematically constructed by their suppliers. Contemporary marketing literature on capturing market segments no less than studies in critical political economy underscore the role firms play not simply in identifying but in important ways fashioning the demand that gives rise to transactional networks. That is to say, sellers are frequently engaged in non-trivial efforts at constituting individuals as buyers (see, for instance, Fligstein 2002; Biggart and Beamish 2003; Sen 1977).

Once it is acknowledged that economic transactions are not simply a case of supply somehow effortlessly meeting demand, the utility-maximizing supposition of neo-classical economic theory is open to question, as is its standard prescription for information asymmetries focused on transparency laws. Among those who question this precept and prescription is a growing school of economic thought influenced by recent work in cognitive psychology which

explores the ways in which “bounded rationality” causes individuals to make sup-optimal economic decisions. Bounded rationality refers to the idea that individual decision-making is powerfully constrained not only by the choices and information available, but also by iterative cognitive patterns and by the finite amount of time in which a decision has to be made. An early proponent of the notion of bounded rationality, Herbert Simon (1957), suggested that the various cognitive biases individuals exhibit and the practical constraints they encounter means that in economic terms they are best construed not as utility-maximizers but as “satisficers” whose aim is to make economic choices which are acceptable under the circumstances they face rather than abstractly optimal. While offering this notion of satisficer as a more realistic conceptual alternative to the utility-maximizer of neo-classical economic theory, Simon nonetheless maintained that satisficing decisions tended in the direction of utility optimization and as such could be integrated into neo-classical theory. The subsequent development of behavioral economics has attempted to extend Simon’s insights into satisficing behavior by exploring the myriad ways in which social, cognitive and emotional factors impact on economic decision-making while still retaining the foundations of neo-classical economic theory (e.g. Kahneman and Tversky 1979; Jols, Sunstein & Thaler 1998).

There are, however, relatively more critical theorists who are unwilling to treat the less-than-rational cognitive patterns described by behavioral economists as accidental anomalies that distort but do not fundamentally undermine the neo-classical model of economic decision-making. For example, in their authoritative review of the extant findings of behavioral economics, Hanson and Kysar (1999) have drawn attention to the ways in which businesses exploit known cognitive biases to influence consumer behavior. In particular, these authors claim that disclosure laws meant to provide consumers with the necessary information to make rational

decisions about the risks associated with particular products in the marketplace might not fulfill their purpose because sellers are known to utilize a variety of devices to alter those perceptions of risk: “Advertising, promotion, and price setting all become means of altering consumer risk perceptions, regardless of mandated hazard warnings” (Hanson and Kysar 1999, 637). Chief among the cognitive biases which firms try to make use of to manipulate market perceptions is what is known as “framing effects”, that is, the ways in which decisions of individuals are influenced by the framing of the choices they confront. These cognitive effects are of special interest to business firms, according to Hanson and Kyser, because they are “perhaps the most obviously exploitable of the biases, capable, for instance, of causing dramatic preference reversals based on an entirely nonsubstantive shift in terminology” (*Ibid.*, 684-85).

What these observations about bounded rationality and the methods business use to take advantage of cognitive biases suggest at the very least is that the market in payday loans might be a place where demand is assiduously constructed by manipulative measures. If it can be shown that these kinds of deliberate efforts aimed at the formation of reliable repeat consumers of short-term credit are commonplace, the concept of clientship as networks of mutual accommodation will require modification. The remainder of this chapter accordingly focuses on the question of just how involved payday loan companies are in creating the market segment they purport to service.

2.3 The Players

While a host of payday lending firms have appeared over the past decade, leading to approximately 1500 storefronts as of 2009 in Canada, this chapter will focus on three firms: Money Mart, Cash Store Financial (formerly known as Rentcash) which operates Instalozans and

the Cash Store, and Cash n' Stop. While Money Mart and Cash Store Financial are the largest and second largest payday lending firms respectively in Canada (and not, coincidentally, at times bitter adversaries when it comes to the politics of regulation), Cash n' Stop is a smaller regional establishment confined almost entirely to Ontario. The three different firms have been selected for study because they represent the different ways in which the business of payday lending has been carried out in Canada. These three business models are the traditional, direct lending model, the broker model and the insurance model (Ernst & Young 2004, 4). In the traditional model, the payday lender incurs all the operating costs and furnishes the capital for the loans it extends. In the broker model, the payday firm incurs the operating costs but otherwise acts as a broker between the customer and a third-party supplier of capital who is the one actually bearing the risk of the loan going into default. As broker of record, the payday lending firm earns its income by charging fees for its brokerage services. Finally, in the insurance model, the payday lending firm assumes all operating costs, charges a fixed fee for the loan, and, in addition, requires the customer to pay a so-called insurance premium meant to cover the costs of the loan and the risk of a default. The insurance premium is ostensibly paid to a third party insurance company though as shall shortly be shown, the insurance company and the payday loan company are typically one and the same. The insurance model, it should be noted, just as the broker model, allows companies who embrace them to be more creative in their costing structures and charge more for their loans. As acknowledged in the Ernst and Young study on the cost of providing payday loans in Canada, "it is likely that the broker and insurance models may have been adopted to minimize the risk of the operator being charged for violating the 60% limit on interest under the *Criminal Code of Canada*" (Ernst and Young 2004, p. 5).

2.4 Money Mart

The largest provider of payday loans in Canada, and arguably the lender whose storefronts are most closely associated with the business of payday lending, is National Money Mart. National Money Mart is a subsidiary of an American holding company called Dollar Financial, which, while not the largest payday loan provider world wide, or even the largest in the US (although it is among the top five in that country), is nonetheless a major presence in the industry both in terms of its market power and especially in terms of its interventions in the politics of regulation. Money Mart, for example, is a founding and principal member of Canadian Payday Loan Association in Canada, a trade organization specifically created to forestall and eventually negotiate the terms of government regulation of the industry.

Founded privately in 1979 and initially self-financing, Dollar Financial became publicly traded in 2005. Presently it controls a total network of 1,264 stores, 1,078 of which are company owned, while the rest operate as franchises. It has ventures in Canada, US, Ireland, UK, and as of 2009, Poland. While its business model has from the start been that of direct lending, Dollar Financial has recently begun to experiment with variations on this model. Thus, for example, with the acquisition of the Polish paylending company Optima, Dollar Financial is trying out in that country in-home loan service provisioning, an innovation that harkens back to a century-old old British money-lending scheme. As will be shortly discussed, this and other forays by Dollar Financial highlight that company's ongoing efforts to find ways of generating and retaining a dependable customer base that goes beyond the much-mined segment of securely-employed members of the low-wage economy.

Dollar Financial's entry into the Canadian market came about through the acquisition of Money Mart. Largely unremarked in the existing literature on payday lending in Canada, this acquisition also spelled the advent of systematic organized payday lending in this country. Money Mart was started by local entrepreneurs in Edmonton, Alberta in 1982 as a cheque-cashing business. A decade later the business had grown to include 36 company-owned and 107 franchised stores (with another 43 stores operated by a subsidiary franchising enterprise). In 1996 Dollar Financial purchased Money Mart and Canadian Capital Company (Money Mart's largest franchisor). Notably, with these purchases Money Mart was converted from a cheque-cashing business to one which also advanced payday loans as well as providing other related financial services. Unchallenged evidence in a certification hearing at the Ontario Superior Court for the class action suit, *Smith v. National Money Mart Company and Dollar Financial Group, Inc. 2005 ON SC*, explicitly points out that "Money Mart introduced payday loans into the Canadian market in 1996, the same year Dollar Financial acquired Money Mart" (5).

Dollar Financial's Canadian operation has over the years become its largest revenue generator. While it has slightly more outlets in the US (with four distinct companies, Money Mart, Loan Mart, The Check Cashing Store and American Payday Loans, giving rise to a total of 418 company-owned and 57 franchised stores) than it does in Canada (with 400 company owned and 61 franchised Money Marts), it enjoys higher total revenues and revenue growth rates in its Canadian division. For example, revenues (in US dollars) for 2007 in Canada were 212.5 million, while in US for the same period the revenues were 136 million. And significantly, in 2008, Dollar Financial's revenues in Canada increased to 279.5 million, while they only increased to 157 million in US (Credit Suisse 2009). With a growth rate in Canada double that of its American operations (31.6% compared to 15.4% in 2008) it is not surprising that the

Canadian market has become so central to Dollar Financial's overall business development strategy (Credit Suisse 2009).

Since 1996, Money Mart's growth strategy has been to build new stores as well as to continue offering franchises for sale. Currently about a fifth of its stores are franchises, while the remainder are company owned and operated. From the date of its acquisition by Dollar Financial, Money Mart has aggressively sought to establish itself as the sole alternative financial service provider to a "growing number of service sector customers" (Dollar Financial 2008). In its various reports to investors Money Mart repeatedly points to the ever-growing number of service sector jobs in Canada, a customer base it explicitly sees as its primary market. For instance, in its 2009 Quarterly Report Money Mart indicates that nearly three quarters of its customers work in the Canadian service economy (retail, health services, leisure, hospitality and other).

Money Mart's expansion strategy, not surprisingly, is in the first instance directed at enlarging its market share. But that strategy is predicated on what at first sight might seem an inauspicious development—the effective emergence of provincial payday regulation. The connection between provincial regulation and Dollar Financial market expansion plans is nicely spelled out in a recent company press release detailing record profits for its fiscal year ending in June 2009 (Dollar Financial Aug. 27, 2009). In that press release, Jeffrey Weiss, Chief Executive Office and Chairman of the Board of Dollar Financial, is quoted as saying to shareholders: "In Canada, where our largest and most profitable business unit resides, I am pleased to report that provincial regulation is moving ahead as expected in a manner that should establish a viable payday loan industry with strong consumer protections for years to come" (*Ibid*, p.2). What is

meant by this evocation of a “viable payday loan industry with strong consumer protections” is clarified by the authors of the press release in the next page where it is observed that:

In Canada, to date, the provinces of Ontario, Nova Scotia, British Columbia, and Alberta have all announced maximum lending rates above the Company’s existing price structure, but generally below the pricing of many of Dollar Financial’s competitors. As the largest multi-product provider in Canada, the Company is in the strong position of being able to operate profitably at prices below the competition, since all of its products and services contribute to the coverage of joint fixed store operating costs and the generation of profits and cash flow. Under provincial regulation, the Company believes it has an opportunity to further leverage its multi-product store platform and improve upon its approximate 30% share of the Canadian market by offering products and services at prices below many of the Company’s competitors. (*Ibid.*, p. 3)

So it turns out that Dollar Financial welcomes provincial payday lending regulation in Canada to the extent that it works to drive out higher priced competitors. While this business motive underlying Money Mart’s interventions in the provincial regulatory hearings will be discussed more fully in Chapter five, it calls attention to the general thrust of the growth strategy of Money Mart and its parent, Dollar Financial, which is to expand by enlarging market share through either the acquisition or displacement of competitors.

Dollar Financial’s favored tool of expansion is to purchase a small chain or a set of already established stores and bring them under its family of stores. Dollar Financial closely monitors each store’s profitability and frequently closes those which are not very profitable in an attempt to operate only the most efficient stores. This exacting stress on efficiency has led Dollar Financial to close down 114 U.S. financial service stores in 2009. According to Dollar Financial, business efficiency is best achieved through economies of scale, hence its obsession with volume of storefronts and loans. To secure this optimal volume, Dollar Financial is often

very aggressive in trying to undermine its competitors, for instance, by opening stores fairly close to one another in select communities to try to drive business rivals away. Following on this strategy, and in close partnership with its parent Dollar Financial, Money Mart has developed a market and location set of surveys that it utilizes when opening new stores. Employing these tools, Money Mart has quite deliberately, and as it turns out, openly, sought to become the largest provider of alternative financial services for ‘asset –limited, income constrained population’ and to continue to open more stores in “asset – limited, income constrained communities” (*Squires vs. Dollar Financial Inc.* 2007, 7-8). To this end, Money Mart has established a store in every major Canadian city with a population larger than 50,000, except in the province of Quebec which has effectively banned the practice of payday lending (Dollar Financial, 2003). It does, however, have a presence even in that province, operating 30 locations under the name Insta-Cheques, a firm which cashes cheques and provides income tax services. This expansion into Quebec is entirely consistent with the overall growth strategy of Money Mart to saturate every potential market. Like other payday lending firms (as shall be shown shortly), Money Mart has nurtured a foothold in Quebec with the anticipation that the province in due course will rescind or modify its laws on short-term interest rates so as to make payday lending a feasible business there.

Expanding market share by way of an expansion of storefronts and the decimation of competitors is part of the overall business strategy of Money Mart. But of course integral to this whole enterprise is the matter of gaining and retaining customers. Money Mart styles itself as a multi-product financial services provider, a description designed to impress upon potential customers that it is a convenient source of a wide range of services. Thus, in addition to payday loans, Money Mart continues to operate its original business of cashing checks, and offers as

well prepaid “Titanium” Mastercard, currency exchange, electronic bill payments, tax preparation and filing services and Western Union Money transfers. In Ontario some Money Mart stores also trade gold/jewelry for cash, a service which in the overall income mix for Dollar Financial has become markedly more significant in the past year as recessionary pressures have limited the growth in loan revenues (Dollar Financial Aug. 27, 2009).

For all its emphasis on product diversification, however, Money Mart’s main source of income continues to be derived from payday loans, with check-cashing also still a significant component in the company’s revenue stream. As Table 2:2 shows, both in Canada and the U.S., Dollar Financial’s main source of income was from payday loans, while in the UK check-cashing provided the largest share of income. Interestingly, in that latter country, Dollar Financial admits to a loss of business caused by the current recession, especially as it has had an

Table 2:1

Dollar Financial: Geographic Earnings Table*

	Canada	United States	United Kingdom
% of business earnings for Dollar Financial by national divisions	42	35	23

*Based on data provided by Dollar Financial to the 2006 Credit Suisse Conference (p. 6)

Table 2:2**Dollar Financial: Product Mix Table***

Consumer Lending as % of national divisions	43	43	30
Cheque Cashing as % of national divisions	38	40	57
Other as % of national divisions	19	17	13

*Based on data provided by Dollar Financial to the 2006 Credit Suisse Conference (p. 6)

impact on the construction industry, which, in the headier days of the housing boom, was critically reliant on imported labour: “The diminution of the construction industry in the London area, principally due to the slowing housing market, and the return home of migratory construction laborers to Eastern Europe were significant drivers of the decline in check cashing revenue in the United Kingdom” (Dollar Financial Aug. 27, 2009). Always the opportunistic seeker of markets, Dollar Financial followed these migrant workers home and in 2009 commenced operations in Poland.

Money Mart uses its dominant market position in Canada to offer what it contends are the lowest payday lending rates in the country, all the while protecting “customers from revolving debt with [their] best business practices” (Money Mart 2009). Rates aside, the procedures Money Mart has developed for loan provisions reveal a sophisticated marketing approach that undermines its stated policy of protecting customers from revolving debt. Money Mart offers short-term (typically two week) loans of between 30-50% of a person’s biweekly net pay up to a

maximum of \$1500. To obtain a payday loan from Money Mart, a person needs to be over eighteen, have a chequing account (confirmed with a bank statement), a residential address (confirmed with a utility bill) and a verifiable employment history (confirmed with a current pay stub). Upon applying for the loan, a customer's social insurance number and credit history are validated through a central database. This database contains customer data captured in Dollar Financial's proprietary loan management system (Dollar Financial 2009, p. 4). This enterprise-wide computer network system which holds and tracks customers' histories and data is linked to centralized call and collection facilities. Because the acquisition and processing of customer information in the initial loan application represents a significant one-time cost, there is naturally a built-in economic incentive on the part of payday lenders like Money Mart to try to nurture repeat customers (Ernst and Young 2004, 7). In the case of Money Mart, the way their loans are structured contributes nicely to precisely this commercial objective.

When a customer is approved for a loan he or she must provide a signed personal post-dated cheque and receives in turn cash or a debit cash card for the loan amount (this latter has processing fees attached.) Money Mart imposes an interest charge that equals an effective annual percentage rate (APR) of 59%, as well as an "Item Fee" of at least \$14.99 per transaction. Finally, there is a Cheque Cashing Fee of at least 2.99% of the value of the loan (principal and accrued interest) that is the cost Money Mart charges to cash the check written to them by the customer. These various charges are added to the loan amount and form the total that is to appear on the post-dated cheque. Significantly, the principal and accrued interest on the loan is due one day before the customer's next payday. If the customer fails to discharge the loan (principal and interest) on the due date, he or she is deemed under the Money Mart contract to have opted to repay the loan by way of the post-dated cheque thereby voluntarily acceding to all the additional

entailed charges. In this way Money Mart is able to claim that its interest rate for payday loans is below the proscribed 60% threshold rate that signifies usury under the Criminal Code of Canada, all the while collecting all the other fees from those customers unable to pay down the principal and interest on the official due date. And of course should the cheque with those additional fees not clear for any reason, Money Mart charges an NSF fee and requires a renegotiation of the terms of the loan that add significantly to its cost.

In the circumstances, where a loan is structured in a way that almost invariably ensures the highest possible charges will be levied on customers in spite of what on first sight appears to be a comparatively attractive cash discharge option, it should not be surprising to see customers frequently put in a position of having to refinance the original loan in one way or another, even if Money Mart itself does not permit straightforward loan rollovers. Indeed, in its own assessment of the market for payday loans in the present recessionary period in Canada, the CEO of Dollar Financial, Jeffrey Weiss, involuntarily allowed as much in a stockholder's conference call, when he tried to reassure a questioner about the prospects for a rebound in the payday loan business: "we see some customers coming back into our stores to cash checks or to get out a consumer loan that we haven't seen for a few months or more than a few months, and it appears some of them are going back to work..." (Dollar Financial 2009) The repeat customer does, after all, seem to be essential to Money Mart's business model after all, despite its stated commitment to protect consumers from revolving credit.

Just how important the repeat customer is to Dollar Financial's overall business strategy is especially evident in the previously mentioned acquisition of the Polish financial firm Optima and the decision to experiment in that country with in-home loan provisioning. This practice of

sending agents to people's homes, both to solicit business for short-term credit and to collect on the loans, has had a long history in the UK where it is called "doorstep" lending. As is the case with storefront payday lenders, doorstep lenders in the UK have routinely been assailed for charging excessive interest rates and for deliberately targeting the poor as customers for their services. This latter can be witnessed in such practices as surreptitiously purchasing lists of names of people denied loan applications at local credit unions. More pointedly, agents are instructed to try to develop "relationships with their customers over several years." (Sky News, 2008). So even while Dollar Financial officially endorses a Best Practices Code both in Canada and the United States that prohibits it from pursuing long-term lending relations, its actual corporate growth strategy seems to belie the promise.

2.5 Cash Store Financial

Money Mart has methodically worked to carve out a market consisting of reliable repeat customers through the altogether familiar business strategy of carefully searching out locations that contain their ideal demographic segment, and undermining their competition by aggressive pricing and storefront saturation. In conventional business terms Money Mart's goal is at all times to strive to increase its volume of loans and at the same time lower its costs by centralizing its service expenses. While the second largest payday lending company in Canada, Cash Store Financial, is also volume-oriented and cost-conscious, its company history in some ways more clearly illustrates how this common business ambition plays itself out in the payday loan industry.

Cash Store Financial emerged out of the rent-to-own business in Canada. Its founder and present-day CEO, Gordon Reykdal, began his entrepreneurial career as the originator of Rent to

Own Inc. (RTO) in 1991. As the name suggests, the business consisted of offering to typically poor customers the possibility of acquiring furniture or household appliances including electronic appliances through a payment scheme that was structured as monthly rents, which rents could be converted into discounted payments should the customer contract to purchase the item. Mr. Reykdal eventually lost control of RTO in 2001 and went on to found Rentcash Inc. that same year which became the first publicly traded alternative finance company listed on the Toronto Stock Exchange. This company developed two operating branches: one was again a rent-to-own operation while the other focused on payday lending. In Rentcash's early annual reports Mr. Reykdal continued to express considerable optimism about the rent to-own-side of the company which was, after all, his area of business expertise. The rent-to-own side of Rentcash became even more of a center of attention for the company in 2002 when Rentcash Inc. amalgamated with Larkfield Capital Corporation, a company controlled by William Comrie, founder of the Brick Furniture Warehouse, the largest volume retailer of home furnishings in Canada. Mr. Comrie had already owned 17% of Rentcash prior to this amalgamation. The union between Rentcash and Brick was a model in corporate synergies. As a volume dealer Brick's overriding concern was to move product. Rentcash's rent-to-own business served that goal. At the same time Rentcash's own overhead costs were reduced by this commercial arrangement because now it could provide a large selection of furniture and electronics from The Brick (and United Furniture Warehouse which Brick had bought out) stores rather than having to carry its own inventory.

While the rent-to-own side of Rentcash's business flourished in the early years of 2000, the payday lending side at first seemed not to have the same growth potential. Indeed, in one of Rentcash's annual reports to its shareholders during this period Mr. Reykdal expressed his

reservations about competition from other payday lenders, complaining that the entry level into payday lending was fairly low since the only requirement was money. Notwithstanding these trepidations, Rentcash chose to embark on an expansion strategy similar to that of Money Mart by opening up as many branches as financially feasible, attempting in the process to capture its market with a variety of alternative financial services including telephone reconnection services, and ‘non-traditional’ auto financing. As it turned out, despite an expansion of its rent-to-own business it soon became evident that there was more capital available for, and growth to be achieved in, the payday lending side of the business. Accordingly, in 2005 Rentcash acquired Installoan Corp, a regional payday lending company with outlets primarily in B.C. and the two amalgamated under the new entity – The Cash Store Financial. Simultaneously, this new entity spun off its rent-to-own division as a stand-alone publicly traded company, InstaRent, which conducted its business mainly through kiosks in the Brick Warehouse chain. By 2008, InstaRent was absorbed in a friendly takeover by Canada’s largest rent-to-own corporation, Easyhome, which, not coincidentally, had its start as Rent To Own Inc., Gordon Reykdal’s first business foray which he had relinquished control of seven years earlier. The close dealings in this particular industry, as will shortly be shown, are a common feature in much of the alternative financing universe.

Following its reorganization the newly-minted Cash Store Financial went on an aggressive expansion campaign, mostly by opening new stores, but also by acquiring a few already existing businesses. In 2007 *Profit Magazine* named CSF as Canada’s Fastest Growing Company – with a 5 year revenue growth of 33,700%. Because Rentcash did not have enough capital to privately finance this planned growth in its payday ventures, it elected to follow the

broker model of lending.⁵ As is typical of this model, third part capital providers are the official sources of the payday loans while Cash Store acts as an intermediary to the lending transactions. Intermediary in this instance means somewhat more than bringing two separate parties together. Rather, Cash Store plays the principal role in these financial dealings by seeking out a customer base and by taking responsibility for all the administrative tasks of processing loan applications and collecting on the debts. For these services Cash Store charges the borrower a brokerage fee. And, while not mandatory, Cash Store also offers a debit card – the so-called ‘Freedom Card’— to its borrowers at a cost of \$10 with an additional \$5 transaction fee each time the card is credited with money, as well as monthly maintenance fees. If the borrower opts to purchase this card, s/he can have the loan amount loaded on the card immediately. If the borrower does not purchase the card s/he has to wait for the third party loan provider to mail the cheque for the loan amount and then cash this cheque. These third party providers are typically private financial services companies which make loan capital available for Cash Store Financial customers. Because this whole process can take almost as much time as the two week loan period itself, the borrower might find the loan due just days after cashing the cheque. In the circumstances, the “voluntarily-assumed” debit card seems almost an essential component of the loan transaction.

Other fees do on the surface have a more genuinely voluntary appearance. For instance, in partnership with Trans Global Insurance (an Edmonton-based company that happens to be owned by the Brick Corporation), Cash Store provides borrowers with the opportunity to purchase Payment Protection Plan insurance that would cover their loan balance should they become involuntarily unemployed, injured, ill, dead or dismembered. Like all income protection

⁵ Cash Store Financial has recently announced its intention to raise capital by issuing secured notes in order to convert its business from a broker to a direct lending enterprise. See Cash Store Financial, 2012.

insurance schemes, the one offered by Cash Store boasts a seemingly low nominal rate, however, because it covers what is after all only a two week loan period, its actual cost if calculated in terms of an annual percentage rate becomes altogether more significant.

The procedures involved in borrowing from Cash Store Financial are similar to those employed by Money Mart save in a couple of crucial ways. Just as is the case with Money Mart, a borrower needs to be over 18 years old, be able to provide two recent bank statements, proof of residency (usually a bill) and proof of employment. The difference lies in how the fees are calculated and when they are collected. In the case of Cash Store, the customer writes out a cheque due on his or her next payday (usually 7 -14 days) in the full amount of the loan, plus interest (59%--owed to the third party lender), a brokerage fee (25% of the advanced loan), and if chosen, a \$10 Freedom Debit Card Fee as well as the associated loading and maintenance fees. There is also a default fee (ranging from \$25 - \$125 dollars) that is charged if a customer fails to pay the loan on time.

Cash Store Financial has embraced the brokerage model doubtless in part because, as the previously cited Ernst and Young study suggested, it allows for more inventive ways of compiling fees that might defeat the Criminal Code usury limit. But it also was a necessary financing strategy given the expansion ambitions that Cash Store Financial entertained, and the reluctance of mainstream banks at the time to furnish payday companies with loan capital. In the circumstances, the third party lenders drawn to Cash Store Financial were attracted by the comparatively high returns promised on their investments combined with their relatively low transaction costs. While data on them is difficult to obtain because Cash Store Financial tends to be very discreet about its lending partners, some general patterns about these providers of loan

capital can be surmised from the available public information. Thus, for instance, in its early payday lending years Cash Store Financial perhaps unsurprisingly forged financing ties with small capitalized oil and gas companies in Alberta. One of these was Avenir Diversified Financial Trust whose \$16.9 million dollar contract with Cash Store Financial in 2005 helped boost the company from a relatively small regional player into one with national ambitions. But over the intervening years the largest effective third party lender has been Assistive Financial, a privately-held financial services company whose main business has been supplying Cash Store Financial with loan capital. For its services Assistive Financial Corporation earns approximately \$0.0685 per day for every \$100 in loan value, which works out to 25% APR annually after earnings and losses. Indeed in a recent report to Assistive investors, Randy Shiffner, the company's founder, and current CEO and President, stated that historically Assistive had never earned returns below 25% APR, a number, significantly, that included loan defaults (Assistive Finance 2009). Small wonder that the ties between Cash Store Financial and Assistive Finance have become so intertwined that they frequently appear together in regulatory hearings, a point explored further in chapter five.

With the growing success of payday lending as a business model, there now seems to be no shortage of third party loan capital. Inadvertently, more and more information is coming to light about these providers of loan capital as a result of a wave of successful class action lawsuits against payday lending companies. One such recent revelation was that a Toronto area Credit Union was a third party lender to a respondent payday company, a fact that prompts some very basic questions about the distinction between mainstream and alternative financial services. The investment opportunities provided by payday lending increasingly appear to attract so-called legitimate institutional investors from pension funds to banks and blue chip investment funds.

And now that most Canadian provinces have moved to regulate the industry, thereby conferring on it an imprimatur of legitimacy, there may be even more interested third party lenders willing to deal with companies like Cash Store Financial than before. This blurring between alternative and mainstream financing in the light of government regulation will again be explored more closely in chapter five.

Attracting loan capital is one of the prerequisites of a broker-type payday lending company like Cash Store Financial. But in addition, given its objective of displacing Money Mart to become the major firm in its field, Cash Store Financial had from its inception a need for outside capital to finance its expansion. To this end, Cash Store Financial has, like its competitor, tried to make much of the fact that it is a supplier of diverse financial products. In its prospectuses and financial statements addressed to investors, Cash Store Financial is at pains to point out that as well as supplying payday loans Cash Store also provides a variety of other services to ‘income earning consumers’. Some of these offerings are common to virtually all payday lending companies such as cheque cashing services, Western Union money transfers, tax preparation, filing and refund services, and prepaid phone cards. Others are more uniquely Cash Store Financial products. For instance, a pre-paid Mastercard (the incongruously named “Freedom Mastercard”) is available, with applicable loading and monthly maintenance fees. Signature and Title Loans are relatively recent additions to Cash Store Financial’s repertoire of alternative financial services. Signature loans are advanced against the borrower’s Child Tax Credit, or Disability, Old Age Pension, or Employment Insurance benefits. Title Loans are loans for a maximum of \$10,000 for a period of 30 days that are secured against the borrower’s car. Yet another niche market cash Store Financial has lately tried to cultivate consists of those who are suing for an injury. Working with AdvanceXpress (an Edmonton-based alternative financial

services firm), Cash Store Financial offers injury advances of up to \$2,000 for people whose claims are making their ways through the courts. Any subsequent court settlements accrue to Cash Store Financial and AdvanceXpress. Finally, in select locations Cash Store Financial has started experimenting with term loans (from four months to a year) and lines of credit, both for a maximum of \$3,000, and with Insta-mortgages—loans of \$1,000 - \$2,000—secured as second mortgages against a home.

In all of these innovations and experiments, no less than the established payday lending business, the common thread is the financially distressed or disadvantaged customer upon whose needs, either immediate or potential, Cash Store Financial can capitalize. And as Gordon Reykdal has often stressed, the key to capitalizing on this need is knowledge. In the early Annual Reports of Cash Store Financial to its shareholders Mr. Reykdal emphasized his own intimate knowledge of the market for alternative financial services given his extensive experience with the type of customers who frequented his rent-to-own enterprises: “We understand our customers. It is a market segment with which management has substantial prior experience” (Cash Store Financial 2002, 4). It is this knowledge of what might be termed the “financial folkways of the poor” which makes Cash Store Financial an especially interesting case study in payday lending. Knowing that there is a population segment that cannot access traditional means of credit, Cash Store Financial has taken the lead in intensifying its penetration of this market, knowing again that segment also will experience problems with mainstream phone, cable and auto insurance companies.

To capture this particular market and become the principal provider of a host of services for its population of constrained consumers, Cash Store Financial has developed both

organizational techniques and marketing strategies that exploit its already well-established familiarity with its customer base. These techniques and strategies involve three reinforcing approaches: market saturation, an internal company structure designed to maximize volume of loans, and a refined plan for more sophisticated market intelligence gathering. Thus, for example, while his competition expend much of their efforts on improving their actuarial mechanisms for determining whom to loan to and for how much, Cash Store Financial has sought to aggressively disperse its storefronts throughout Canada in the belief that the more presence one has on the ground in those areas where the demographics favour payday lending, the more likely one will make those essential first contacts for a business crucially reliant on repeat customers. At the same time, a strong hierarchical organizational structure of the company, with its centralized computer and processing systems, its daily reporting schedules, and a results-oriented company ethic has been deliberately cultivated to induce storefront competition amongst the company's managerial staff in order to increase loan volumes.

Finally, a brilliant indication of its practical understanding of market intelligence can be found in Cash Store Financial's foray into the telephone and cable reconnection business. Its recent acquisition (purchased in 2005) of the phone reconnection company, Tembo, illustrates just how such intelligence gathering works in the socio-economic setting that characterizes the users of payday loans. Tembo operates in all ten provinces, offering a telephone reconnection service for individuals who no longer are able to maintain accounts with mainstream telephone providers because of payment defaults. Tembo's services start at \$49.95 a month for a basic telephone plan (plus a \$50-55 dollar reconnection fee) with the first bill due on the day of installation. Profitable on its own, this telephone reconnection service also functions as an invaluable source of information about the very individuals who are present or potential payday

loan clients. Small wonder Tenbo credits the accounts of its customers \$30 if they succeed in referring a friend or family member. And of course, Tembo requires direct payment with guaranteed funds which are accepted at Cash Store locations. In this way that close transactional relationship Geertz suggests is characteristic of clientships is maintained although in this case the clientship is a way for Cash Store Financial to keep tabs on its own payday loan customers. The more information the company can gather about the habits of its customers, and especially their location (information that a phone reconnection company is particularly adept at supplying), the greater likelihood it will be able to do repeat business with them, all the while minimizing the risk that these customers will default by disappearing.

The rapid rise of Cash Store Financial as a major player in the payday lending business in Canada has been in no small part due to its considered market-shaping efforts. At the same time, like Dollar Financial, Cash Store Financial has followed the tried and true methods of corporate philanthropy as a tactic in the quest to legitimize its own business. Accordingly, the company and Mr. Reykdal personally donate extensively to health care fields. For example Cash Store Financial has set out to raise 7.5 million dollars over seven years for the Alberta Diabetes Institute. And Mr. Reykdal donated over \$250,000 to help establish Lögberg-Heimskringla – a non-profit paper and cultural outlet dedicated to preserving and celebrating Icelandic culture in North America. For his efforts Mr. Reykdal has been given the position of Honorary Consul for Iceland in Canada (source forthcoming).

2.6 Stop n' Cash

Another large payday lender in Canada is Stop n' Cash. It first opened in Kitchener, Ontario on January 1st, 1998. Founded by local entrepreneurs, Tim Voisin and his brother George, a tax lawyer by training, Stop n' Cash operates the usual services associated with this industry such as cheque cashing, Western Union money transfer, and of course payday lending services. While the Voisin family owned and managed a handful of its stores directly, Stop n' Cash much more than its major competitors places a great deal of emphasis on selling franchises. Each franchise costs \$30,000 upfront, with royalty fees (2 % of total sales) and advertising fees (again, 2 % of total sales) to be remitted on a weekly basis. By 2004, Stop n' Cash had 58 locations in Ontario and 1 in British Columbia. In an interview with the *Toronto Star*, Mr. Voisin also claimed that franchises had been sold in England and Australia and boasted of a default rate of under 2% (Rankin & MacIntyre 2004b).

What sets Stop n' Cash apart from companies like Dollar Financial and Cash Store Financial, aside from its reliance on franchising for expansion and its geographically concentrated market presence, is that it utilizes the third model of payday lending—the insurance model. Under this model the essentials regarding the borrower remain more-or-less the same as that for the traditional and broker-type payday lenders. Thus to borrow a loan from Stop n' Cash one needs to be over 18 years old, with a government issued ID, proof of residency, a social insurance card, two paystubs, 6-8 weeks of bank statement information, and a cheque book. However, the rate structure for loans is decidedly different. For every \$100 dollar two-week loan Stop n' Cash charges a 20 cent interest rate. But in order to receive this loan a customer has to take out a death and disability insurance in the amount of \$19.80 for every \$100 dollar two-week

loan. There is also a one time administrative set-up fee of \$11 dollars. Under the business plan established by Stop n'Cash, 97% of the collected insurance is 'rebated' to the franchisees, while 3% is retained by the insurer. It should come as no surprise that this unique fee structure has made Stop n' Cash the most expensive payday loan provider in Ontario (Rankin & MacIntyre 2004a)

While the standard loan application for Stop n' Cash states that the borrower has the option of finding an alternative source of insurance, the virtual impossibility of contracting for such a service on small short-term loans means that customers invariably are compelled to use the insurer supplied by Stop n' Cash. That insurance company is SNC Insurance, incorporated and headquartered in Barbados. Stop n' Cash had expanded to 53 franchise locations in Ontario before the Superintendent of Financial Services issued a Cease and Desist Order on September 22nd, 2004. The Superintendent determined that SNC Insurance did not in fact provide valid insurance certificates to its clients, nor was it licensed to sell insurance in Ontario. Furthermore it had failed to submit its financial statements for 2001, 2002, 2003 to Supervisor of Insurance in Barbados, as required by law. And as a result of a class action lawsuit initiated by a customer, Peggy Davis, in 2006, it was revealed that George Voisin himself was the founder, principal officer and director of SNC Insurance. After examining SNC's financial reports, the Superintendent of Financial Services in Ontario estimated that for the period from 1999 to 2004, SNC collected \$40 million dollars in premiums for insurance certificates that were bogus.

Although various legal challenges eventually led George Voisin to formally resign from Stop n' Cash, his brother Timothy continues to run the company on the insurance model. An especially high cost lender, Stop n' Cash has seemed to successfully carve out a specialized

niche within the overall payday lending market as a lender of last resort, its high fees more than compensating for the risks it assumes in its lending portfolio. Knowing a customer in the world of payday lending means, among other things, knowing what s/he is prepared to pay for an otherwise unavailable short-term loan.

2.7 The Constituted Consumer of Payday Loans

Asked whether his client was exploiting the poor, the lawyer for Stop n' Cash protested that: "These companies all have customers for a reason. If the business didn't exist, I don't know what they'll do" (Rankin & MacIntyre 2004b). This statement, while a reiteration of the standard industry line that payday companies respond to consumer demand, also contains a hint that the exigencies which cause people to seek out payday loans do not quite conform to the conventional demand curve so favoured by conventional economic theory. Demand in this instance is highly inelastic. It is precisely this knowledge that there are large numbers of people who have persistent unmet financial needs which spurred the growth of the payday loan industry in the first place, and which continues to govern their business strategies for capturing this market. This chapter began with the theoretical observation that markets are mediated in complex and profound ways by extra-economic social ties and networks and that a better way of understanding the transactional relationship between payday loan companies and their customers is that of a clientship nurtured over time. What is evident in this review of the organizational and marketing strategies of three different types of payday lenders in Canada is that a clientship relationship is a created entity assiduously sought by all lenders, and that in their continuing efforts to secure and expand their customer base, they employ various ploys to acquire a suitable

pool of repeat borrowers. That they actively engage in seeking out and retaining loan customers is revealed by such things as the technology Money Mart uses to track clients no less than the information Cash Store Financial elicits from its phone reconnection services. But these merely are the most obvious manifestations of a practice to create a stable set of clientships. The more systematic and invidious side of this practice can be gathered from a recent press statement by Michael Donovan (2007, 1), a former district operator for Check n' Go, the second largest payday lending company in the United States:

There's the industry claim that most borrowers pay off their loans "on time." Clever wording that, because if a customer pays back a loan on the due date but then turns around and borrows the money right back again, strictly speaking the customer is paying the loan on time. Of course we train our sales staff to keep customers dependent, to make sure they keep re-borrowing, whether in the form of a renewal or a back-to-back transaction, forever if possible....The repeat borrower is vital to our business model. It is the basis for bonuses. It is the basis for store payroll budgets. We create complicated metrics with deliberately obscure names like "unique customer count" to disguise—even to our staff—the fact that we are in the business to create repeat customers.

In the next chapter this business of creating repeat customers will be examined from the point of view of the customers themselves.

Appendix of Tables

Table 2.3 This table is current as of September 2009

Name	Year Founded	Lending Model	# of Stores in Canada	# of Employees	Fee Structure: \$100 for 2 weeks Prior to Cap.	Annual Revenues 2009	Growth Strategy
The Cash Store Financial	2001	Brokerage	424	1,600	Max Loan: 50% Net Pay Max: \$1,500 Interest: \$59 Brokers Free: \$20-\$25	150.5 Million	Storefront expansion; national focus Australia Expansion of number of service for targeted populations
Dollar Financial (Money Mart)	1979	Direct Lending	399 Company Owned 62 Franchised	2,500	Max Loan: 30 – 50% Net Pay Max: \$1,500 Interest:\$ 0.89 Item Fee:\$14.99 Cheque Cashing Fee: \$2.99	\$236.3 USD Million	Brand recognition/ loyalty Price cutting International expansion Expansion of services offered
Stop n Cash	1998	Insurance			Max Loan: 50% take home pay Interest: \$ 0.20 Insurance: \$19.80 One time set up fee: \$ 11.00	\$ 70 million (only 2003 available)	Small geographical market saturation (Central, West Ontario) Franchises (mostly in Canada, but some in UK and Australia)

Table 2.4 Growth Trends: 2005 – 2009 # Stores

Name	2005	2006	2007	2008	2009
The Cash Store Financial	277	338	358	384	424
Dollar Financial	343	370	414	480	461
Stop n Cash	53	Not available	Not Available	Not Available	Not Available

Table 2.5 Dollar Financial # of Stores

	2005	2006	2007	2008	2009
Company Operated	214	242	360	419	399
Franchises	129	128	54	61	62
Total	343	370	414	480	461

Table 2.6 Dollar Financial Geographic Distribution:

	Number of Stores
Ontario	225
British Columbia	85
Manitoba	20
Alberta	74
Other	61

Table 2.7 Cash Store Financial Growth:

Year	Branches	Employees
2002	20	75
2003	57	258
2004	108	426
2005	277	1100
2006	338	1300
2007	358	1390
2008	384	1500
2009	424	1600

Chapter 3

THE BORROWERS

3.1 Who Are They?

In the preceding chapter, reference was made to a study conducted by the Environics Research Group for the Canadian Payday Loan Association in 2005 which ostensibly was aimed at providing some demographic information about payday loan borrowers and data about their experiences with, and attitudes toward, payday loan companies. Arguably, one of the principal purposes of this and similar commissioned studies undertaken for the CPLA was to help legitimize the payday lending industry at a time when the question of regulation was being raised in political circles. In this particular Environics study, an assertion was made about the economic background of borrowers that vividly reflected this legitimization assignment. Environics reported that of the 5% of Canadians who have taken out payday loans, “Those with household incomes above \$60,000 are almost as likely [to assume such loans] as those with incomes below \$40,000 (5% vs. 7%).” (Environics 2005, 12.) While the natural inference of this statement is that payday loan companies are not an outlet for loans targeted exclusively or even predominantly at the poor, the data which Environics relied upon to present this image of an equitable lender suggests quite the opposite. To see why, it will be necessary to describe briefly the research protocols and data presentation employed by Environics in its study.

The data Environics used for its research findings was derived from telephone interviews with individuals drawn from two groups of respondents: one consisting of a random sample of 1000 Canadians in the general population, and the other consisting of 1000 recent users of payday loans, the names of which were supplied by the CPLA. Since Environics made no further

disclosures about how this group of names was assembled by the CPLA, it is difficult to determine just how random this second sample was. But this turns out not to be the most problematic aspect of the Environics study. Rather, the presentation of the data was itself devised in such a way as to achieve conclusions at odds with what that data seemed to indicate. The economic background of borrowers is a case in point.

Table 3.1

Canadian Payday Lenders Association Reported Demographics of Payday Loan Customers

Household Income	Payday Loans Users %	General Population %
Less than \$35,000	49	27
Between \$35,000 and \$50,000	19	16
Between \$50,000 and \$75,000	16	20
Over \$75,000	9	22
Don't Know/Refused	6	14

Source: Environics Research Group 2005

The raw data on demographics (shown in Table 1) which Environics included in its report revealed that 49% of its respondents in the borrowers' group reported a family income of less than \$35,000, while only 9% reported an income of over \$75,000 (with a third intermediate group of 35% reporting a family income of between \$35,000-\$75,000.) On this data alone, one might fairly conclude that almost half of the borrowers in the Environics sample (those 49% of respondents reporting a family income of less than \$35,000) fell below the poverty line as defined by Statistics Canada.⁶ Of the intermediate group of borrowers, if only half of them fell in the lower part of the reported range, then how was Environics able to claim in its research

⁶ Using the Low Income Cut-offs (LICO) published by Statistics Canada in 2005, the Canadian Council on Social Development indicated that "A family of four living in a very large Canadian city with a before-tax income of less than \$38,610 in 2005 would have been living below the poverty line." (CCSD 2006, 1).

findings that borrowers were drawn almost equally from high and low income groups when demonstrably a large majority came from the latter? The answer is that Environics chose not to compare directly the percentage of high income and low income borrowers, but rather reported each group in terms of its percentage of the Canadian population sharing its income characteristics. Hence, even though high income borrowers represented a much lower percentage of all the payday loan takers in the sample, when their numbers were reported as a percentage of all Canadians in their income group, Environics was able to state that their 5% incidence compared roughly to the 7% incidence of lower income borrowers among their income group. This statistic-glossed over the obvious fact that a far larger number of Canadians fall into the lower income group as opposed to the higher income group, and that the supposedly near equal incidence rates of loan-takers among these groups disguises their true relative numbers.

This episode in data reporting serves as a cautionary tale that when trying to determine the accuracy of statistical information it is essential not only that the data-gathering and data interpretation procedures are carefully scrutinized, but that the underlying purpose of, or assumptions informing, a study be subject to critical inspection. In this chapter, a critical review of existing studies of the social and economic characteristics of payday loan takers will be undertaken to try to answer the fundamental questions: who typically resorts to payday loans and why? This review will be augmented by data gathered by the author from interviews of payday loan borrowers in one neighborhood in Toronto. Finally, the chapter will address what John Caskey, a long time student of the payday loan phenomenon in the U.S., recently called the “big question”: “Do payday lenders, on net, exacerbate or relieve customers’ financial difficulties?”(Caskey 2010, 1)

It should hardly be surprising that the CPLA, in an effort to dispel widely held perceptions that payday lenders exploit the economically vulnerable, has sought to present evidence that payday loan customers are drawn from all economic classes. In addition to the Environics study carried out in 2005, the CPLA commissioned the public opinion and market research firm, Pollara, to perform six additional studies in 2007 and 2008 collecting socio-economic and attitudinal data about payday loan customers in those provinces which were in the process of instituting regulations of the industry. As might have been expected, each of these provincial studies reiterated the same point that payday loan customers enjoyed family incomes which were “generally on par” with the general population of the province (see Pollara 2008, 2007a, 2007b, 2007c, 2007d, 2007e.)

But what of independent studies? Have they confirmed the evidence presented by the CPLA? There have been five principal independent empirical studies of payday loan consumers in Canada: a 2002 Industry Canada sponsored study by the consumer advocacy organization, Public Interest Advocacy Centre (PIAC), (Lott and Grant 2002); a survey undertaken by Stratcom Strategic Communications in 2005 for the Association of Community Organizations for Reform Now (ACORN), (Stratcom 2005); an Ipsos-Reid study done in 2005 for the Financial Consumer Agency of Canada (part of Industry Canada), (Ipsos-Reid 2005); a Statistics Canada survey on financial security carried out in 2005 (Pyper 2007); and an integrative study conducted by Buckland, Carter, Simpson, Friesen and Osborne as part of a submission to the Manitoba Public Utilities Board Hearing to Cap Payday Loan Fees (2007). These studies have produced divergent socio-economic portraits of payday loan clients. Some do seem to suggest that the CPLA’s representation of its customer base is accurate while others call it into question. For example, an Industry Canada funded study of “alternative financial services” carried out by

Sue Lott and Michael Grant of the Ottawa-based non-profit consumer research organization, the Public Interest Advocacy Centre (PIAC), found that users of these services (including cheque-cashing, payday loans, pawnbrokers, rent-to-own stores, tax rebate discounting, loan brokers, and finance companies) “look like average Canadians, in terms of age, gender, and household income.” (Lott and Grant 2002, 7). These findings are vitiated, however, by the authors’ admission that their sample size was relatively small (202 completed telephone interviews out of a pool of 4206 contacts) and that the margin of error for their generalizations about socio-economic characteristics of the users of alternative financial services was accordingly high. (*Ibid.*, 36)

Another early study conducted by Stratcom Strategic Communications for the Association of Community Organizations for Reform Now (ACORN) used a more fine-grained analysis of payday loan users in Vancouver and Toronto to offer a somewhat different picture of their economic and social characteristics. Drawing on a sample of 419 respondents (out of a pool of 1079 interviewees), Stratcom reported finding that the majority were male, more likely than the general population to have a high school diploma or college degree, but less likely to have a university education. As for income patterns, roughly 70 percent of the Toronto respondents reported an annual income below the median household income for that city, while the figure for Vancouver was about 66 percent. Perhaps more significant was the finding that of the most frequent users of payday loans (those who took out ten or more loans in a year), 46 percent reported household incomes of \$30,000 or less (Stratcom 2005, 6-7). While the ACORN analysis challenges some of the conclusions reached by CPLA-commissioned studies and the PIAC research, it too suffers from its own data collection problems. The Stratcom survey gathered its sample by interviewing individuals exiting commercial payday companies not affiliated with the

CPLA on the grounds that customers of these smaller stand alone businesses had not been assayed by previous studies of payday loan users, and in consequence their experiences had not figured in existing discussions of potential regulatory initiatives. Given the selectiveness of the Stratcom interviewing strategy, however, the representativeness of its “sample of convenience” is open to dispute, the more so because without a background dataset on the target population of its study, no statistical weightings were possible for the reported findings.

A more reliable sampling procedure was employed by Ipsos Reid in its 2005 study for Industry Canada on public experiences with financial services (Ipsos Reid 2005). Ipsos Reid derived its data from an omnibus national survey of adult males in both official languages which contained a subset of questions aimed at identifying individuals who use cheque-cashing outlets, have no chequing and savings account, and those who have been turned down for an account by a financial services institution. Ipsos Reid’s findings confirm the general thrust of the ACORN study, including the preponderance of younger males with some post-secondary education among payday loan users. On the income side, 35.5 percent of individuals who reported taking out payday loans indicated they lived in household with incomes below \$30,000, compared to only 22.1 percent of individuals reporting taking out no loans.

These latter socio-economic characteristics of payday loan customers were drawn out more precisely in a Statistics Canada survey on financial security conducted the same year as the Ipsos Reid study. The Statistics Canada research collected data on the debts, assets, and financial practices including incidence of payday loan usage from a randomly selected sample of 5,300 families. With a focus on families, the Statistics Canada study revealed in much more detail the financial background of typical payday loan users. As in other studies, age was shown to be

significantly correlated to payday loan usage, with younger families three times more likely to have taken out such loans than those aged 35-44. And, in keeping with the findings of Stratcom and Ipsos Reid, income was identified as a key indicator of payday loan use. Though in the case of the Statistics Canada's study, its figures citing 47.5% of the sampled families of loan takers reporting an annual income of \$30,000 or less suggested a higher proportion of lower income users than did the other surveys. The one finding stressed in the Statistics Canada study is that the majority of payday borrowers in their sample had a net worth (total assets minus total indebtedness) well below the median. Over half of the families who used payday loans were in the lowest 20% category for net worth, and nearly 8 in 10 were in the bottom 40% (Pyper 2007, 8). More than any of the other reported statistics, this finding confirms what one might intuitively expect to be the case with consumers of payday loans, namely, that they tend to be amongst the least well-off in society.

What these independent studies of payday lending have tended to show is that the practice of taking out payday loans is, contrary to industry claims, concentrated among economically vulnerable families. But economic vulnerability is still a fairly undifferentiated concept in this literature. For instance, in their summary analysis of the several data sets generated by the Environics, PIAC, Stratcom, Ipsos Reid, and Statistics Canada studies, Buckland et al employed probit regression to try to identify the statistically most salient correlations amongst the variables thought to be determinants of the predisposition to take out payday loans. Their regression analysis led them to observe that the probability of using payday loans is inversely associated with age, income and university education and positively associated with size of, or presence of children in, a family (Buckland et al 2007, 34-35). While these several characteristics of age, education, income, and family size or type do serve to delineate a

population of potential payday loan consumers, these categories can only be reported in terms of statistical probabilities for the nation as a whole and for this reason remain relatively abstract.

A more graphic if inferential picture of typical payday loan users is available through the use of the economic and cultural geographer's tool of location analysis. Location analysis simply means observing the spatial distribution of an activity with an eye to determining an underlying rationale for why it occurs in one place rather than another. In a pioneering U.S. study of payday lending employing location analysis, Steven M. Graves looked at the site-location strategies of banks and payday lenders in metropolitan Louisiana, and in Cook County, Illinois, and found that poorer neighborhoods were both targeted by payday lenders and neglected by traditional banks (Graves 2003). And in another location study by Graves and Peterson that traced the location patterns of payday lenders in a majority of the military towns in the United States, it was discovered that there were greater concentrations of payday lending firms per capita near military populations (Graves and Peterson 2005). The conclusion drawn by the authors of these studies is that the location decisions of payday loan companies reveal a deliberate logic of predation, something made especially vivid by the changing landscape of financial institutions in financially distressed communities.

Needless to say, the idea of predation itself has become a contested concept as researchers grapple with the question of what actually motivates location decisions. For instance, in their analysis of the location patterns of traditional banks and payday lenders in North Carolina, Burkey and Simpkins (2004) present evidence that payday lenders tend to locate in poorer urban areas with relatively higher minority concentrations, younger populations, and less-well-educated citizens. But they demur in describing these location decisions as predatory,

noting that it is equally as plausible to claim that this is simply a matter of supply meeting demand. In a similar vein, in a study on alternative financial service providers (AFSP) conducted for the Federal Reserve Board in Washington, D.C., Robin Prager reports that AFSPs are more numerous in areas where a large percentage of the population is black or lacks a high school diploma, but that they also generally avoid the poorest communities and those with large Hispanic populations. One of the most telling features of the data for this study is the fact that credit scores were found to be a particularly strong predictor of AFSP locations. Counties where a proportionately higher percentage of the population has no credit score have a greater number of AFSPs in general, while those where a larger percentage of the population has subprime credit ratings are more liable to have increased concentrations of payday lenders and pawnshops. This evidence leads Prager to the cautious conclusion “that AFSPs may simply locate where the demand for their services is likely to be greatest because a significant portion of the population does not qualify for more mainstream (and less expensive) forms of credit” (Prager 2009, 21).

Location studies of payday loan companies initiated by consumer advocacy groups, on the other hand, are more likely to press the predatory label, suggesting that these companies deliberately seek out economically vulnerable populations that can be exploited. There is a growing abundance of this latter type of studies in the United States, much of it sponsored by the Durham, North Carolina-based Centre for Responsible Lending (CLR), a non-profit research and policy organization focused on financial products including payday loans. A recurrent theme in CLR-sponsored location studies has been that credit segregation—the bifurcation of communities into different credit markets—has become a growing reality across the U.S., with race being the most conspicuous indicator of this differential access. For instance, King et al (2005) show that despite a state ban on their operation, North Carolina payday lending

companies had found legal means to evade the prohibition and opened storefronts disproportionately located in African-American neighborhoods. Another CLR study finds that in California, “Payday lenders are nearly eight times as concentrated in neighborhoods with the largest shares of African Americans and Latinos as compared to white neighborhoods” (Li et al 2009, 2). In yet another study commissioned by the Chicago-based National People’s Action examining the availability of consumer credit in minority communities in the midwestern cities of Chicago, Detroit, Kansas City, Peoria, and St. Louis, it was discovered that in the aftermath of the financial crisis of 2008, “there is virtually no neighbourhood with a large African-American or Latino population in the study area that displays stable levels of prime credit for homeowners and very few neighbourhoods that do not have a proliferation of high-priced payday lenders” (Bianchi 2011, 3).

While U.S. studies tend to focus on race as one of the most crucial variables distinguishing payday lenders’ location decisions,⁷ in Canada the relatively few location studies that have been carried out have mostly looked at correspondences between the spatial distribution of these companies and the income characteristics of communities in which they are found. Ironically, the first of these location analyses was commissioned by the Canadian Bankers Association (CBA) to counter the widespread impression, doubtless gained from American studies, that traditional financial institutions (i.e. banks, trust companies and credit unions) had

⁷ It should be noted that race does not always figure as the principal explanatory factor in all U.S. location analyses. For example, in their study of the geographic distribution of payday loan companies in Colorado, Gallmeyer and Roberts (2009, 534) conclude that rather than ethnic communities it is “communities characterized by a larger percentage of foreign born, elderly, and military personnel [that] are significantly more likely to host payday lending, even controlling for their economic profile.” As for overall distribution patterns of payday lenders in the U.S. the highest proportion per capita are found in Nevada, Missouri and the southern states of Tennessee, Alabama, Mississippi and Louisiana (CLR, Nov 1, 2010).

willfully abandoned distressed communities, leaving them open to the predations of payday lenders. Surveying the metropolitan districts of Toronto, Halifax, Winnipeg and Vancouver, Jones et al (2005) discovered that 90 percent of payday lenders were located within 1000 meters of an existing traditional financial institution, leading them to conclude that rather than capitalizing on areas left unserved by these institutions, payday lending companies almost always located in proximity to conventional financial establishments.

Another Canadian location study sponsored by the CFSA as part of the evidence it presented at provincial regulatory hearings in Nova Scotia sought to repudiate the common view that payday lenders seek out low income communities to set up shop. In detailing the distribution of the fifteen payday outlets in the Halifax-Dartmouth metropolitan area, the report noted that two-thirds of the enterprises were located in areas with average income higher than \$45,000, and 93 percent were located in income areas of \$35,000 or more (CPLA 2009). Not included in this report, however, was any indication of the distribution of traditional financial institutions, which, if the CBA location analysis is correct, helps explain the location decisions of payday lenders, nor was there any information about principal roads where business in general tend to congregate.

What is of note in the Halifax location analysis is just how anomalous its nominal findings are compared to other U.S. studies of the same type which invariably find distinctive spatial patterns of credit segregation that match neighborhood income stratification. Except for the Halifax study, those same patterns seem to obtain in Canadian urban settings as well. For example, in another location analysis submitted by Buckland et al (2007, 7) as part of a report to the Manitoba Public Utilities Board Hearing to Cap Payday Loan Fees, the evidence is

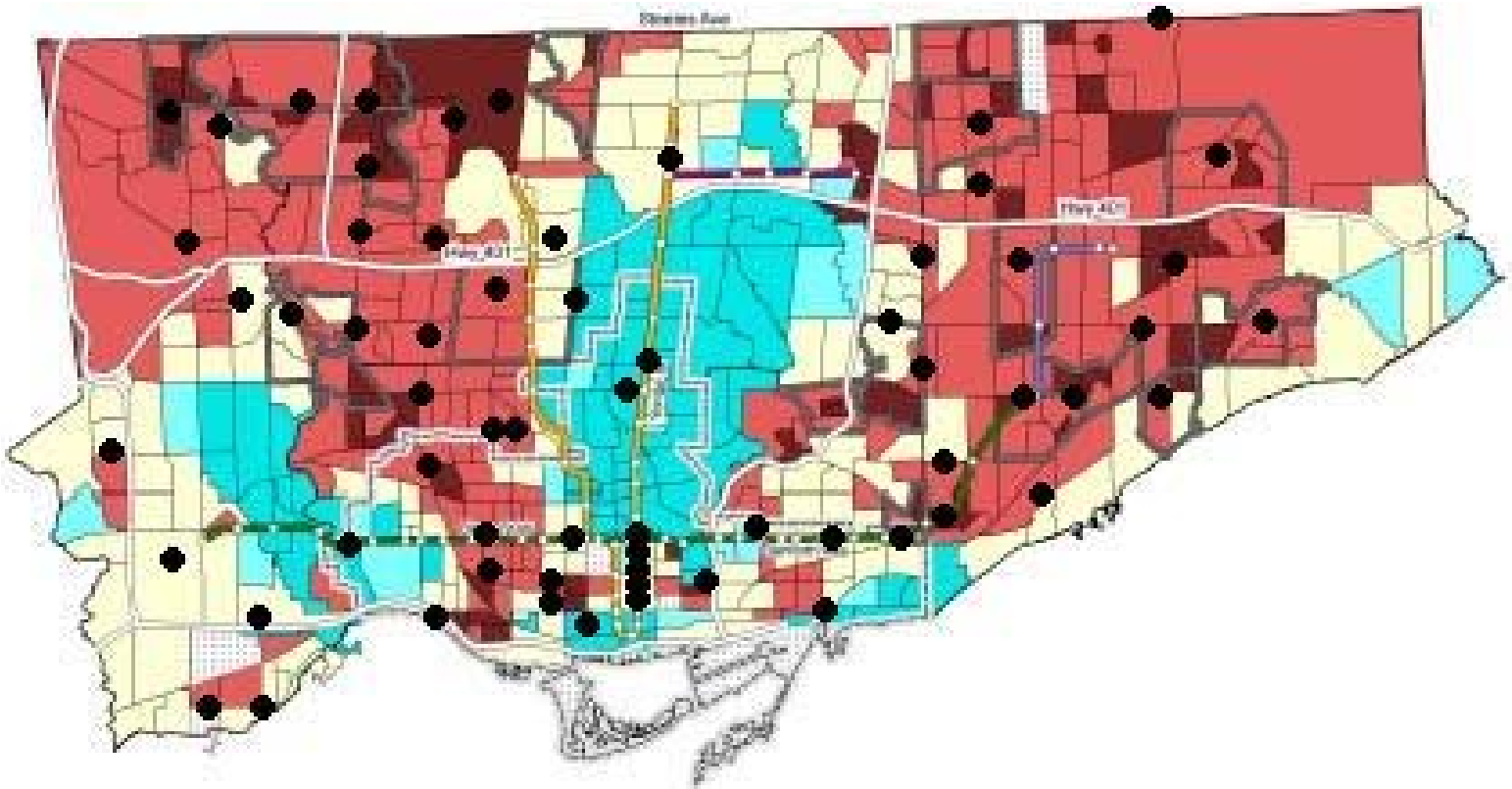
unmistakable that payday lenders disproportionately locate in Winnipeg neighbourhoods with poorer income levels (e.g., lower median income, higher incidence of low-income), lower markers of social capital (e.g., average education levels) and certain ethnic characteristics (higher rates of aboriginal people and visible minorities). Similar patterns have been noted by Bowles et al (2010) in their location analysis of payday lenders in Prince George, B.C.

In order to determine whether there is a robust correlation between payday lender location and neighbourhood income characteristics, a location analysis was undertaken for this dissertation focusing on the Greater Toronto Area (GTA) and limited to Money Mart storefronts. Money Mart was selected for this investigation because it represents itself as the leading payday lender in Canada, and because it is the principal company underwriting the activities of the Canadian Payday Lenders Association which, as noted in the beginning of this chapter, maintains that payday loan customers are found among all income categories in the same proportion as the national population. If this were the case, then it would be reasonable to expect that a payday lender like Money Mart would have storefronts distributed among diverse income neighborhoods in that same proportion. As the evidence shows, this is not the case. When plotted on a map of the GTA, colour-coded to highlight the geographic incidence of different income levels, it is readily apparent the overwhelming majority of Money Mart outlets are located in the lower income areas of the city (see Map 3.1).

While broadly devised statistical analyses of the customers of payday lenders and location analyses of their geographic distribution both point to a particular demographic as the target of these companies, opponents and supporters of payday lending continue to debate whether this is a deliberate predatory business strategy, or simply a market phenomenon of

MAP 3.1

Money Mart Locations City of Toronto*



*Locations taken from Money Mart website: http://www.moneymart.ca/find_stores.asp, 06/12/11

Legend:

Blue	Pale Blue	Pale Yellow	Red	Burgundy
Very High Income	High Income	Middle Income	Low Income	Very Low Income
More than 40% Above Below	20% to 40% Above	20% Below to 20% Above	20% to 40% Below	More than 40%
76 Tracts, 15% of City City	21 Tracts, 4% of City	152 Tracts, 29% of City	206 Tract, 40% of City	67 Tracts, 14% of
Average = \$104,00	Average= \$39,000	Average = \$39,000	Average=\$28,000	Average=\$22,500

Map taken from David Hulchansky. *Three Cities Within Toronto: Income Polarization Among Toronto's Neighbourhoods, 1970 – 2005*. 2006 Census update of the Centre for Urban and Community Studies (now Cities Centre) *Research Bulletin* 41, December 2007.

supply arising to meet demand. The contrast between predation and so-called ordinary market developments may be misleading, however, for as pointed out in the previous chapter, markets are always socially embedded and therefore there are always social mechanisms that mediate transactions between buyers and sellers. How these mediating mechanisms work tells us something about whether customers for payday loans are in any sense constituted in and through the organizational and marketing approaches employed by payday loan companies. To get a better sense of the varieties of social mediation involved in payday loan transactions, the question of why individuals take out payday loans needs to be addressed.

3:2 Why Take Out a Payday Loan?

The question of why people make use of the services of payday loan companies has been widely canvassed in industry, advocacy and academic studies. When posed as part of a survey of payday loan customers, the question elicits three broad kinds of responses. The reasons for using these credit facilities can be classified as having either a structural, behavioral, or market motivation. While these categories are neither exhaustive nor altogether mutually exclusive, they are useful in apprehending the range of answers to the question of why use the services of payday loan companies, and perhaps more important, are reflective of the contending argumentative strategies used in the ongoing debates over the propriety of payday lending.

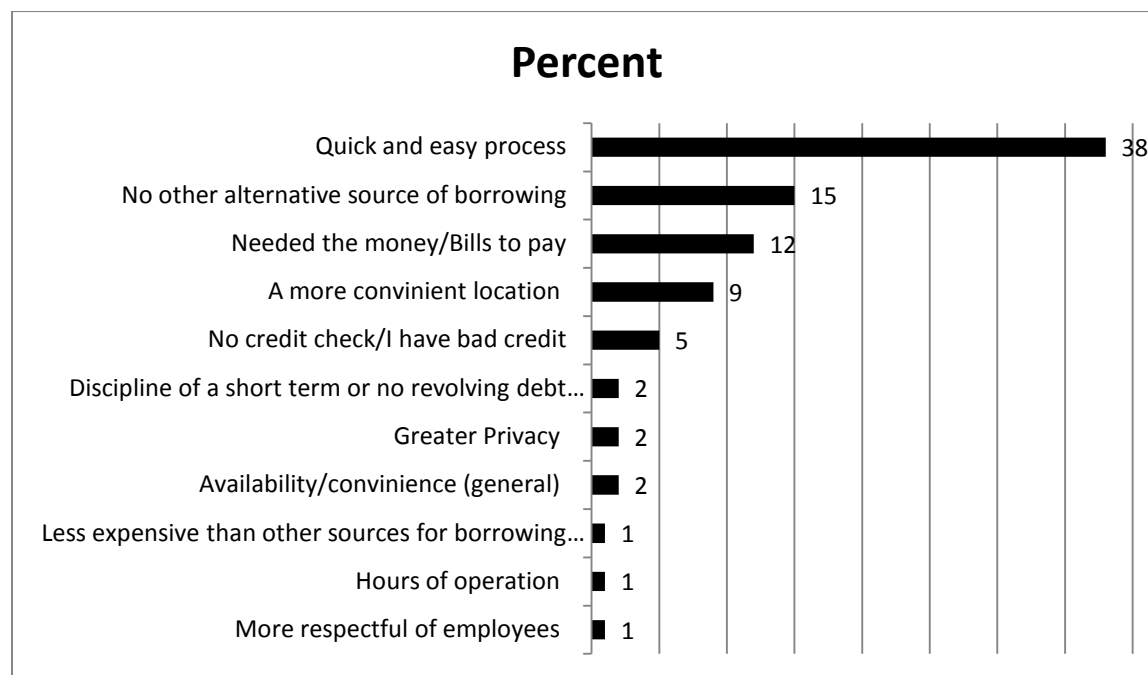
By far the most common reasons adduced by supporters of payday lending for the use of this type of credit advance are market explanations. Typical of these is the claim that in a competitive marketplace for financial services, payday loan clients are drawn to this service because of certain advantages that attach to them, in particular, convenience of use, location. For example, the CPLA-sponsored Environics poll discussed earlier revealed that the majority of

surveyed payday loan recipients said that their principal reason for using the services of payday lenders was that it was a quick and easy source of finance (49% of respondents). Among other reasons given for opting for this form of financing was the convenient location of the outlets (15% of respondents.) Interestingly, the executive summary of the study explained that “**only** [emphasis mine] 21% cited ‘no alternative source for borrowing’ as a reason for why they took a

Table 3.2

Canadian Payday Lenders Association Survey: Reasons for Use

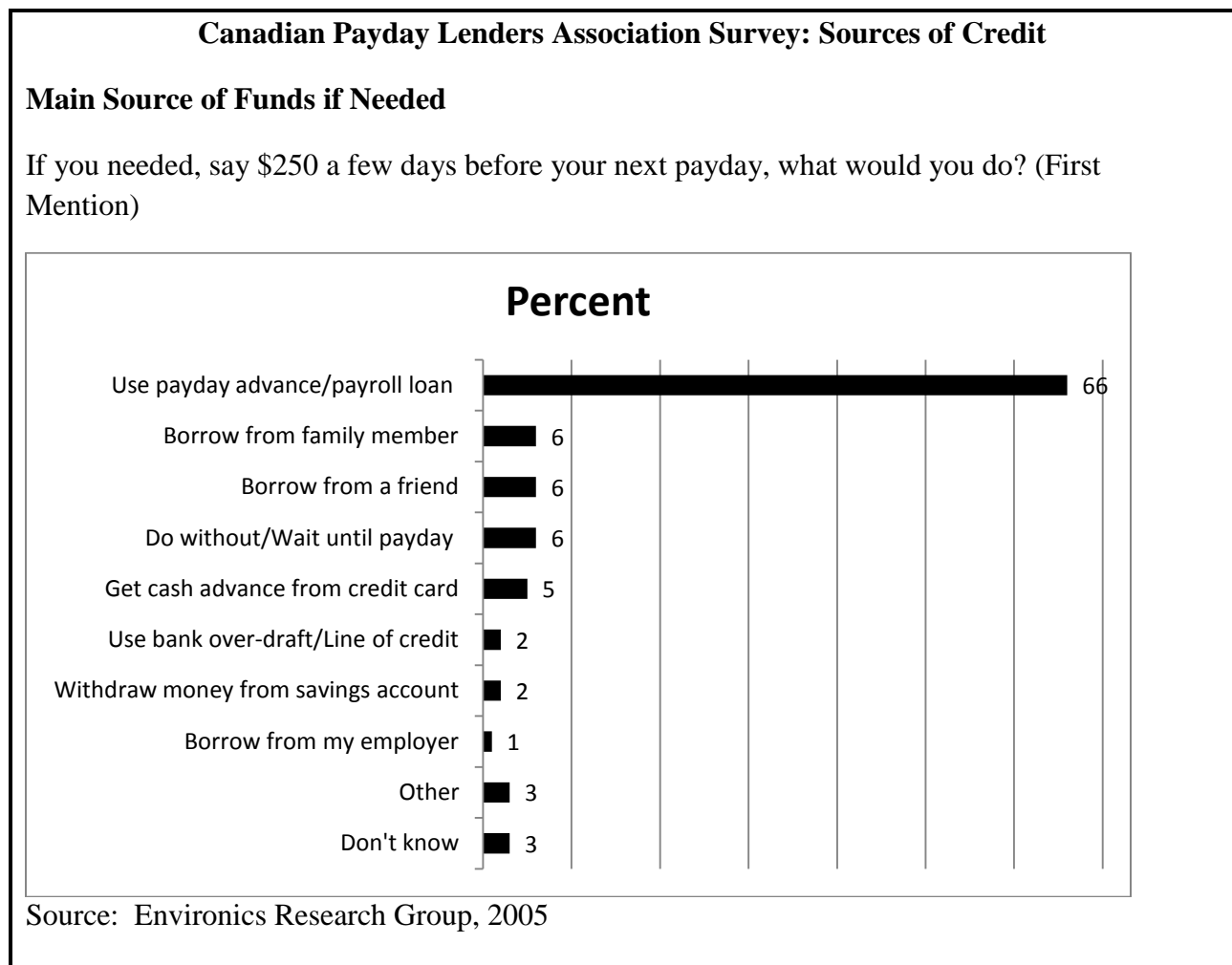
What was the most important reason you chose to obtain a payday advance in the past year rather than use another source of financing? Base: Payday Loan Users (n = 1000).



Source: Environics Research Group, 2005

payday loan”, implicitly claiming this as proof that payday loan companies do not exploit a vulnerable group of borrowers. Deliberately left out of the executive report, however, is the more pertinent statistic captured by the study. When asked what their main source of emergency funds was, payday loan users overwhelmingly identified payday loan companies (66%) as their primary source as opposed to conventional credit mechanisms such as credit card cash advances, bank overdrafts, bank lines of credit, savings account withdrawals, or bank loans (all total, only 10% of respondents indicated these latter as a possible source of needed

Table 3.3



cash). Nor were family or friends a ready source of emergency financing for these respondents (only 12 % reported that they could expect help from this quarter). When compared with non payday loan users, whom Environics also polled for comparative purposes, the financial vulnerability of the former group becomes starkly evident. Non-payday loan users, for instance, reported conventional credit mechanisms as their principal source of emergency financing (43%), with borrowing from family or friends the other major alternative (31%).

Despite this unambiguous evidence of necessity as the underlying cause impelling a majority to seek out cash advances, the payday loan industry tries to perpetuate the view that it services a niche market drawn to its products because of their overall convenience. Surprisingly, a number of advocacy-based, academic and government studies of payday lending accept the niche argument at face value. For example, in one of the more comprehensive government-commissioned studies of the alternative consumer credit market, the Ramsay Report (2000) gives credence to the market niche interpretation of this industry by acknowledging that while many users turn to these high-cost lenders because they have no reasonable alternatives, another reason for their patronage might be that these firms offer advantages over the mainstream financial sector including “convenience, the absence of the need to fear a denial of credit and the ability to access goods or money immediately” (iii). In a similar vein, the authors of the previously mentioned PIAC study on alternative financial services, after underlining the changed economic environment for the working poor as a principal reason for the growing usage of alternative financial services, go on to report that consumer preferences are what really explain their patronage: “AFS customers have turned away from mainstream financial institutions, emphasizing the service aspects of AFS as the major reason for their preference” (Lott and Grant, 7).

While market arguments stress the competitive advantage payday lenders enjoy in terms of the services they offer to consumers, behavioural explanations focus on consumer rationality itself. Those who offer behavioural explanations begin with the premise that a payday loan is a very expensive form of credit and proceed to ask why consumers of such loans are willing to accept these high costs. Behavioural studies of payday loans have suggested three different kinds of answers. One is to simply say that payday loan customers are addicted to credit, never having learned to defer consumption in favour of savings. A former U.S. Treasury official, Sheila Blair (2005, 38), exemplifies this kind of thinking when she observes:

The rapid growth of payday lenders is a symptom of the problem, not the cause of the disease. A payday loan is what it is: a high-cost form of small dollar, short-term credit that credit-impaired consumers want and need, given the comparatively higher costs of NSF or late fees and the lack of lower-cost credit alternatives. The escalating demand for the product reflects the woeful inability of millions of Americans to effectively manage their finances and accumulate savings.

By contrast, the rational consumer model inspired by neo-classical economic theory takes it as an axiom that consumers, apprised of their choices and their relative costs, will always make rational decisions to maximize their satisfaction. From this perspective, the facts of consumption are their own justification. Applying the rational consumer axiom to the payday loan market, a number of authors have concluded that so long as a competitive market environment for financial services is in place, the choice of a payday loan must be regarded as a rational economic decision made to advance utility (e.g., Elliehausen and Lawrence, 2001; Kidd, 2004; Elliehausen, 2006; Morgan, 2007).

A third behavioural explanation seeks to contextualize economic rationality. Rather than assume that there is a pure exchange rationality which serves as a normative measure for real-world exchanges, this approach acknowledges rationality is bounded by

circumstance and place as well as cultural and ideational factors (see, for example, Thaler, 1991; Zelizer, 1994; Robinson and McGoun, 1998). From this standpoint, the decision to take out a payday loan, even if not optimal from the point-of-view of an ideal utility-maximizing calculus, nonetheless “makes sense” in the context in which the decision is made. Studies such as those conducted by Fikkert (2008) that involve in-depth open-ended interviews with payday loan customers frequently resort to bounded rationality explanations to account for the economic behavior of respondents.

Interviews conducted for this dissertation, as shall be shown below, do affirm the importance of bounded rationality as a behavioural factor explaining why certain classes of people persist in taking out economically inefficient payday loans. But these interviews also show that equally important as explanatory factors are those structural causes that created the circumstances in which payday lending itself became a feasible industry. Structural causes, the third broad explanatory strategy used to account for the phenomenon of payday loans, encompass a variety of developments that together point both to the emergence of ever larger numbers of economically distressed individuals, and to changes in formal and informal systems of finance that have combined to constrain access to credit for this class of people.

One of the most obvious and most frequently commented upon structural reasons contributing to the rising use of payday loans has been the growing income polarization in recent decades, evident in virtually all developed industrial nations but especially in North America (see, for example, Caskey 1994; Sherraden and Barr 2005; Buckland and Dong 2008). A striking statistic offered by Statistics Canada (2006) in its Wealth of Canadians Study underlines this tendency in a way that speaks directly to the expansion of payday lending in this country. In a

table documenting the percentage change in median net worth of different income groups between 1999 and 2005, the study revealed that persons earning between \$20,000-39,999 endured a 19 per cent decline in their net worth, while those earning \$75,000 or more experienced a 15.2 per cent increase. What particularly bears comment in these figures is that the income group suffering the decline in net worth was precisely the group that other studies have shown to be most likely to take out payday loans.

While a decline in net worth amongst growing numbers of people is clearly one of the conditions underlying the rapid rise of the payday lending industry, other structural factors are also in play. The abandonment of economically distressed communities by mainstream financial institutions gives rise to a constrained choice set for people in need of short term credit, a point made in repeated U.S. studies (see, for example, Graves 2003; King et al 2005). Although the Canadian Bankers Association study already alluded to implied there has been no segregation between traditional financial and payday loan markets in this country, several studies have drawn opposite conclusions, noting that in inner city areas especially there has been a noticeable diminution of bank branches and a corresponding increase in payday loan outlets (National Council on Welfare 1998; Stratcom 2005; Buckland et al 2003; Buckland 2008).

This emergent market segregation, it is worth noting, had its origins in the same general policy-making paradigm that contributed to greater income polarization characteristic of the last several decades. Specifically, the political decision to liberalize financial institutions in the 1980s had a series of both intended and unintended consequences (see Kinter 1993; Northcott 2004). Liberalization of the financial industries meant discarding much of the post-war regulations separating the four “pillars” of finance. This deregulation lead both to amalgamations of hitherto

separate financial entities, and the design of a series of novel interrelated financial services that enjoyed higher profit margins. As banks were allowed to compete with these newer services in ever more integrated financial markets, a de facto market segmentation occurred. Quite simply, with mainstream banks increasingly pursuing those consumer credit markets with the highest potential return on investment (a competitive rush which was stirred by the initial financial services deregulation) poorer neighbourhoods by turn became for them a relatively less attractive market. And as banks increasingly made their profits from newer financial products, and from an ever-growing array of service fees, the monetary incentive for them to quit low-income markets, where individuals had marginal savings to begin with, was understandably powerful.

Just as banks began to abandon poorer neighbourhoods, other compounding factors reinforced this trend towards a relative deprivation of financial service providers in these communities. One such factor not often noticed in academic literature but nonetheless important to this transformation is the changes in local retailing that took place as large retailers like Wal-Mart and other “box” stores captured a growing market share. The success of these firms meant a displacement of smaller local retailers who often had been the practical alternatives to banks for large numbers of the working poor. For often it was local retailers who cashed payday cheques or offered intermittent personalized credit, in large measure because this was a way for them to continue to sell their wares to these consumers. But this particular type of financial relationship, based on trust and personal histories, increasingly disappeared as local retailers succumbed to large-scale chain retailers who would only offer formalized credit services.

Finally, and perversely, the growth of general-purpose credit may have cemented the trend toward alternative financial service providers becoming the practical source of financial services for more and more poor people, especially those whose participation in the labour market is irregular. The point to be made here is that the credit industry itself needs to find an ever expanding market to be profitable. And given the risk magnitude associated with general-purpose credit, it has always been important to this particular industry that it be allowed to charge higher interest rates than regular banks in order to discount their higher exposure to financial risk. In the United States a pivotal court case, *Marquette National Bank of Minneapolis v. First Omaha Service Corp. (1978)*, prompted the effective deregulation of interest rates charged by lenders, and this eventually allowed for the expansion of credit lending into markets formerly shunned by traditional lenders because of the perceived high cost of the lending risk.

In its *Marquette* decision, the Supreme Court ruled that a state which tried to restrict usurious lending by placing a ceiling on interest rates could not prohibit out-of-state lenders charging higher-than-allowed interest rates from soliciting business within its borders. With this decision credit providers could locate in states which had high or no ceilings on interest rates (the preferred states in the aftermath of *Marquette* became Delaware and South Dakota) and proceed to try to drum up business across the nation offering credit services to high risk borrowers at rates that of course were commensurately high. In short, credit companies emerged that began to target neighbourhoods and borrowers whose credit profiles were high-risk, but who, given their lack of any other options, were willing to pay higher rates for their credit, particularly as credit increasingly was becoming the medium of day-to-day commerce. But with the growth of such high-risk borrowing came the growth of personal bankruptcies. It is just such a correlation that Dianne Ellis, a banking analyst writing for the U.S Federal Deposit Insurance Corporation, noted

when she argued that interest rate deregulation in the U.S., and its much earlier effective deregulation in Canada, contributed to a growing bankruptcy rate in both countries in the 1980s and 1990s. What Ellis did not comment upon, but which can be seen to be an important corollary of her argument, is that the period of rising bankruptcies occasioned by the ever greater extension of credit to high risk borrowers coincided with the beginning of the remarkable growth of cheque-cashing and payday lending companies.

3.3 A Neighbourhood Study of Payday Loan Customers in Toronto

In order to better understand the motivations that lead people to take out payday loans, a study was conducted for this dissertation involving interviews with one hundred borrowers in a neighbourhood in the Greater Toronto Area---Etobicoke South—with a high concentration of payday loan outlets. The choice of area and method of recruiting interviewees were guided by a specific research objective. That objective was to elicit information from economically vulnerable clients about their experiences with payday lending with an eye to discovering patterns of social intermediation in this particular kind of credit market. To this end, an open invitation was extended to clients of the South Etobicoke community health and social services centre, LAMP, for participants in a payday lending survey. Because LAMP's activities are aimed at individuals and families requiring social services, the expectation was that the self-selected group of respondents gathered through this canvassing method would exhibit income and social traits that would allow one to characterize them as financially vulnerable. However, because the group of respondents was self-selected, no effort was made to subject their quantified responses to statistical analysis.

Interviews were conducted singly and in groups. While prepared questions were used, the object of the interviews was to contextualize the experience of taking out a payday loan. Hence, rather than simply look at the determinants of demand for credit, the interviews tried to establish the actual dynamics that take place in the interchanges between lenders and borrowers, and in the social environment where these transactions take place. The overall purpose of the study was to try to determine whether those who take out credit advances on a regular basis are enticed into the role of chronic borrowers, whether they are in any way a party to the mechanisms payday lenders use to market their services, and whether they have independent personal and community resources to evaluate their credit options—in short to determine the extent to which chronic borrowers are constituted in their roles by the very companies that claim to be responding to their credit demands. While most existing empirical surveys of payday loan customers rely on correlations among factors such as age, education, gender, employment status and income levels to reach conclusions about loan usage, this study differs in that its main object is to discover those transactional dynamics that make these market exchanges possible.

The feature which immediately stands out in the sample of interviewees collected for this study is how much they differ from those routinely presented by payday loan companies as representative of their customers. As Table 3.4 illustrates, only 11 percent of the sample in this study reported being employed full-time on a permanent basis. Another 32 per cent had a more precarious attachment to the labour market (either in full-time or part time-temporary positions), while 38 percent relied on social assistance and other types of government assistance such as disability pensions, and 16 per cent were retired. While the large percentage of respondents who were on social assistance or who were retired is reflective of the pool of interviewees that would

frequent the services of LAMP, this is nevertheless in stark contrast to the typical customer depicted in the payday loan industry's self-promotions.

Table 3.4

Employment Status (n=100)

Full Time – Permanent Employment	11
Full Time – Temporary Employment	8
Part time – Temporary Employment	24
Social Assistance and 'Under the Table' Part Time Employment	24
Other Government Issued Assistance	14
Retired	16
Illegal Activities	3

Indicators of economic and social status paint a picture of a demographic that is on the margins. For instance, while 99 per cent of the respondents said they have a chequing or savings account in a regular bank (a formal requirement if one is to use the services of payday lenders), only 1 respondent reported ever having a credit card, though presently it was unusable because that person exceeded a credit limit and/or failed to make minimum payments. As for other sources of credit, no respondent had a line of credit, and only seven ever had overdraft protection (though for six of these the banks cancelled the service). Finally, when asked whom they relied upon to help out when experiencing a financial shortfall between regular income payments, only 7 per cent mentioned family and friends. Another 24% admitted that while their first avenue might be family and friends, almost always these social resources would themselves be short of funds as well. Fully 69 per cent said their only source of credit was payday loan companies, a

figure that matches relatively closely the proportion these companies have themselves reported in their own industry study (see Table 3.3).

At odds with the payday loan industry contention that its customers are only occasional borrowers, however, is the data this study has compiled on usage as shown in Table 3.5. A remarkable 87 per cent of interviewees claim to use payday loans at least once a month, and an even more astonishing 19 per cent say they take out weekly loans. These repeat borrowers reported that they routinely patronized different outlets in order to continue to qualify for credit to allow them to pay off previous loans. However unrepresentative of payday loan customers the sample assembled for this study might be, the sheer number of respondents who admit to being repeat customers engaged in revolving credit contracts, and the frequency of these loan contracts, conjure up an unmistakable image of financial servitude, something time and again commented upon in academic and advocacy literature on payday lending (e.g., Stegman and Ferris 2003; Ernst et al 2004; Flannery and Samolyk 2005; Parrish and King 2009; Stratcom 2005; Ipso-Reid 2005).

Table 3.5

Frequency of Payday Loans

Number of Loans Per Year	N = 100
52 or more	19
24 – 36	36
12	32
3 – 6	11
2 or less	2

The study further discovered that it was, in fact, not uncommon for these companies to encourage repeat borrowing. A typical story, related by one respondent (D), acutely illustrates just how inducements are used to exploit ordinary aspirations:

I tell you—I really want to tell you—they shouldn't be allowed to do this. They got me at a weak moment. I shouldn't have, I really shouldn't have. I need \$190 because I came up short mid-month. I went down to Money Mart, no problem got the \$190. I think about it, I think about it for a while, then decided I can handle that, I can pay that back. Two weeks later I got my cheque, came back exactly with the cash. The guy tells me he can give me \$500 right now, limited time offer. Tells me if I needed to treat myself I can get it now. It was my weak moment. They shouldn't do that. Two weeks later I only have part of the money. I can't pay the whole thing back and it keeps growing and growing. They shouldn't offer this to people with fixed incomes. Where am I going to get the money from? They just shouldn't.

In a similar vein, another respondent (F) related just how inviting the lure of a loan rollover was made to sound:

I was told I didn't have to pay back the whole original loan when I came to pay it. There wasn't any money and I could barely come up with the money to pay. It was a relief. I didn't have to pay back the whole amount and it was okay to renegotiate. I didn't expect that, I was so grateful. I also got a twenty in my hands right there and then. That was the deal if I would renegotiate right there and then then I wouldn't have to pay back the whole amount and I would get that twenty and two more weeks. It was such a relief. Of course I took it right there and then.

Yet another respondent (A female) relates an insidious practice where loan rollover is offered in place a payment plan:

I asked her [Cash Store employee] how can I pay back that loan. I kept paying and paying for weeks and I still kept paying. Couldn't ever get up to that amount that they told me I had to give back when I got my paycheck. But I kept paying little bit every week. So, I asks her to give me some sort of a payment plan, like the fellow on TV says he'll do if you buy furniture from Bricks. So I says to her how much do I have to put down each week to pay this off. She tells me the best way to pay it off is to get another loan. I swear 6 weeks later I think I owe more now and I kept up with payments. I went to the other shop the other day and they

gave me \$320 that's almost the whole amount, but now it's the same story again.

A cynical customer (A male) simply accedes to the reality of a never-ending cycle of debt:

I am never gonna finish paying those fucking loans back. The fuck with them, it's always borrow from Peter to pay Paul. When I walk in there the guys now don't even ask if I have the whole damn loan to pay back after I get paid. Nah, fuck, no more of that where they have to fucking convince you to not fucking leave their asses hanging with no customers to bleed. Now they just tell me here are the \$20 bucks or sometimes \$40, sign here and here and come back 2 weeks later. The fucking \$20 then goes to pay the next fucking guy. That's just how it is. That's just fucking business for you.

Finally, a respondent (R) shares her despair about the inevitability of the debt cycle and way in which payday loan companies time their inducements to that cycle:

You know, when that month end comes things don't look so good. Everything starts to run low and empty. That's when the flyers [paylending offers] start to come in. Sometimes 2 or 3 in the same day. If I get money from them it will take me several month to pay off and you always know those people who never do. You know things people do for money. I go to church every Sunday. God loved Job too and Job just suffered never did anything because he had faith. God loves me, You know, He loves you and everybody else. We're not meant to do bad things to ourselves for money....Hard to resist [the offers in the paylending flyers] towards the end of the month. Some days there isn't enough money left over to buy the fillings for the sandwiches. You know, there are only so many pieces of toast you can eat in a row before you give in and go down to see someone with that offer.

Repeat borrowing is not only routine among the respondents in this study, but also turns out for roughly a third of them to be a matter of necessity to meet previous payday loan obligations, as Table 3.6 shows. There are good reasons to think that the credit trap among

borrowers, which this 33 per cent figure illustrates, may in fact be under-reported. For in response to a supplementary question, when respondents were asked whether and why they used

Table 3.6

Reason for Payday Loans

Reason for Taking Out the Loan	N = 100
To bridge the gap between paychecks	38
To help pay off other payday loans	33
Emergency	23
Alternative and/or supplement to criminal activity	6

more than one payday loan company, of the 96 who admitted utilizing several different businesses, the most common reason given was to cover other payday loans (see Table 3.7).

Table 3.7

Why Several Different Payday Loan Companies Were Used

Reason More Than One Was Used	N=96
To pay off other payday loans	42
Owed money to the regular one and Needed money to pay that one off	22
Heard another was cheaper	15
Maxed existing loans out and needed a new source of payday loans	6
Needed a larger amount than offered by one only	11

Not only are a significant proportion of the individuals in this study likely caught in credit traps, but they are also reliant on payday loan companies for an array of services that de facto make them their primary financial institution. For instance, as Table 3.8 shows, 92 per cent of interviewees used these companies for both payday loan and cheque-cashing services, and 78

per cent reported using still other products like bill payments, phone services and prepaid credit cards:

R: I pay my phone bill with Cash Store. Bell disconnected my phone 2 years ago and now I can either pay at the bank or at Cash Store. It's cheaper to bundle everything together and pay it there. I get better treatment and rate that way if I need to borrow money.

P: I take out a loan against my paycheck when I really need the money – holidays and summer, but I can't afford to wait 10 days for the bank to clear my check. I always cash it with Money Mart. And they give me a deal on bill payments. I would have to pay a lot more at the bank

A: I don't use the bank much. It's a rip off. Wait 2 weeks for my check to be cleared. Wait 1 week for my bills to be paid. They've got my money. They just want to hang on to it. I can't wait that long. I need the money today. I don't even visit the bank no more.

I: Cash Store is my bank. I got my phone reconnected through them, I got my sofa, get my paychecks cashed, birthday presents [paid her daughters phone bill, pre-paid Master Card for a family member] and etc. I don't have a fancy line of credit or credit cards. I also use Money Mart when I am in trouble with Cash Store.

This latter admission of paying off previous loans with new loans from different providers proved a quite common practice among respondents to this survey. This reported pattern of cycling debt through separate payday loan outlets reinforces other anecdotal evidence of loan traps made up of multiple lenders. For example, in their series for the *Toronto Star*, Rankin and MacIntyre relate numerous stories of borrowers revolving debt through successive lenders. One of the most affecting of these was Kim Elliot who described a three year weekly ritual of withdrawing her weekly wages to pay off one payday loan, only to immediately borrow from a series of other outlets to pay off her remaining outstanding loans. In her words, these recurring transactions meant: "Borrow from

Peter to pay Paul, that's basically what it came down to." (Elliot as cited in Rankin and MacIntyre 2004a, 1)

Table 3.8

Services Used

Type of Service	N = 100
Just Payday Loans	6
Payday Loans and Cash Checking	14
Payday Loans and Cash Checking and Bill Payments	29
Payday Loans and Cash Checking and Bill Payments and Phone Services	37
Payday Loans and Cash Checking and Bill Payments and Phone Services and Prepaid Cards	12
Payday Loan and Money Transfers	2

Given that these respondents were so inclined to both draw on such a wide variety of financial instruments offered by payday lenders and to cycle their debts through multiple lenders, the obvious question is why not use lower-cost banks for their credit needs. It is in the answers to this type of question that one begins to detect both institutional and socio-economic dynamics that have contributed to a segregated market for financial services. For example, when queried

Table 3.9

Relative Preference for Payday Loan Companies and Banks.

Reasons for Preference	N=100
Prefer banks, but they don't offer short term loans	42
Prefer banks, but doesn't live near one	6
Prefer banks, because using a bank makes me like everyone else	11
Prefer payday loan companies, because they charge less interest	21
Prefer payday loan companies because of location and/or easy access	2
Banks are for rich people, they don't understand my needs	8

on their attitudes to banks relative to payday loan companies, some interesting results were obtained. While a majority (59 per cent) of interviewees said they preferred banks to payday loan companies, 42 per cent maintained that conventional banks don't offer short term loans while another 6 per cent said they did not live near banks. A particularly telling statistic is that 11 respondents explained their preference for banks in terms of what it implied for their social status, claiming that using a bank made them feel like everyone else. This last remark about financial citizenship finds its counterpart in the responses of those 31 per cent of respondents who cited a preference for payday loan companies. In line with findings of other studies, a surprising 21 per cent explained their preference by saying that payday loan companies offered lower interest rates than banks for their products (for comparable studies see Buckland, 2010, Fikkert, 2011). More pointed was the response of 8 interviewees who said that "banks were for rich people, they don't understand my needs."

The widespread perception that payday loans are a less expensive form of credit compared to what is available at banks, and the concomitant belief that banks are not for people like them, underscores the self-perception of an insuperable socio-economic divide that time and again was encountered during interview sessions. When discussing banks and payday loan companies, interviewees would consistently express negative views of banks:

The bank doesn't want me. I see all the pretty moms with their kids dressed up lining up at TD. She's got a husband working. I take care of myself and my kids alone. Their dad hasn't been around since the youngest turned 2. I barely have enough to last through most of the month. The bank doesn't want people like me. (K)

The bank is for rich people. If you have \$20,000 at the bank they don't charge you nothing. It used to be you put in a \$50 and you'd have interest every week. Now they charge you so much, the \$50 would be gone in a couple of months. (R)

The interest rates the bank charge is huge. And if I bounce a couple of checks I am out almost \$100. I know exactly how much I have to repay Money Mart. I only go to the bank when they have those customer appreciation days or something – I go in for free coffee and cookies. (D.)

The palpable sense of alienation from mainstream financial institutions that so many of the respondents in this survey articulated (see also Fikkert 2008, 45-55) is doubtless one of the reasons why they patronize payday lending facilities. In the circumstances that many of these low-income credit-seekers find themselves, their preference for payday loans might well reflect a rational choice. Authors such as Buckland (2010) who have looked at populations of loan-takers situated at the margins of the labour market make just this point that for those for whom access to credit is severely impaired, the choice of high-cost payday loans “makes sense” from a bounded rationality perspective. But at the same time it should also be noted that the companies offering these loan products deliberately encourage the belief among their clients that mainstream financial credit is exorbitant, while regularly hiding from them the total costs of payday advances (CRL 2001; Chin 2004; Martin 2010). The result of these industry practices is the perpetuation of a mutually reinforcing set of convictions and behaviours that help fuel demand for payday loans.

Not only are customers encouraged by the payday loan industry to regard payday advances as a lower cost alternative to mainstream sources of credit, but they are also presented with a range of inducements both to become repeat borrowers and to help expand the customer base. Offers of discounts on repeat loans, one-time specials for new loans, or considerations for referrals are common marketing techniques employed by payday loan companies (Martin 2010). The reasoning behind such techniques is not hard to discern. As Dan Feehan, CEO of the payday

lender Cash America, has been quoted as saying: “the theory in the business is you’ve got to get that customer in, work to turn him into a repetitive customer, long-term customer, because that’s really where the profit is” (cited in Martin 2010, 571). In the survey undertaken for this dissertation, confirmation of this business goal was not difficult to find. For instance, 78 percent

Table 3.10

Have you ever been asked by a payday lending company to refer someone to them?

Answer	N=100
Yes and I got a preferential treatment when I did	42
Yes, they asked for names of friends and family who might want coupons	8
Yes, they told me to refer people that I know and they gave me their business cards to give out	28
No	22

of respondents claimed to have been asked by payday lending companies to refer others to the business. 42 per cent mentioned receiving preferential treatment for referrals, with another 8 per cent mentioning that coupons were made available to new customers. The stories from respondents sounded a familiar theme:

“The coupons, they come in the mail around about the time the monthly disability checks come in. Bring a friend – get the fee waived off the next loan at Cash Store” (R.)

“I brought maybe five or six of my girlfriends over to the store, Tim, the clerk who works during the day there told me they could just let me have a couple more days if I needed it when I needed it, if they thought I was a good referring customer of theirs. I didn’t mind, I think I am a good referring customer, they have the lowest rate, I’ve been going for years and Tim remembers the names of my kids and their birthdays. I wouldn’t do it if I thought my girlfriends would get a bad deal, I wouldn’t do it if I thought they were just after the money, sometimes people can’t make a go of it properly in life and need a place they can turn to....Tim he’s real honest too, I can’t remember the times I asked for an extra day and he just let it be, no fee, no nothing, just like that, he told me not to worry about it today...If people ask me where to go, I always tell them to go see Tim, I

don't want them to be treated badly when they need a helping hand in life....My neighbours ask more than my friends do, I tell my friends where I am going and what I do, we talk a lot, with neighbours it's the things to ask after hellos and how you doings." (P.)

"I didn't think it was the right thing to do, but I gave them the names and phone numbers of two of my friends. They ask for this anyhow, you have to provide references before they give you your first loan. Their names were already in my file. I broke my leg, so I couldn't work for a while, the guy at the Cash Store told me that I can get a one time reduction on the fee of the loan, since I couldn't pay anything for a month, if I could let them contact my two friends and tell them that I referred Cash Store to them. One friend got ticked off, the other used the 50% off the fee coupon they sent him." (T.)

While there is abundant evidence that payday lending firms actively try to conscript and retain their customers, there is also evidence that at least some of these customers understand their status as prey and try in different ways to push back. Thus half of the respondents in the survey, when asked whether payday loan personnel were interested in their well-being and responsive to their needs, replied either that they were "crooks", or that they affected affability and concern for purely business reasons. And a number recounted stories of how they tried to "beat the system" with their own little deceits. D, for instance, explained that with a little judicious comparative shopping it was possible to exploit price competitors:

I've always used Money Mart, but one time I was behind so I went to Cash and Dash by Roncesvalles [street] there. They were \$10 bucks cheaper. Next day I came by with three of my friends. I maxed the loan out there, so I can't go back, but [one of my friends] keeps going there regularly now. They're cheaper if you just borrow \$200, but I think they're getting to know that some people from around here won't ever pay them back. I know a couple of people who couldn't get a loan there no more. (D)

Another respondent, K, related her own misappropriation of a credit facility in a matter-of-fact way, explaining that circumstance and need justified the act:

The girl living next door to me said – they're giving out free cookie packages down at Value Mart if you sign up for the credit card. You don't need nothing,

just your ID and signature. Me and my boyfriend went down there. Three weeks later I get a card in the mail with \$5,000 on it. I says to him ‘we’re getting furniture!’ After that I never open the mail, I just write deceased on it and send it back.

While these and similar stories of petty fraud were not uncommon amongst the population of this survey, there was at the same time a prevailing recognition among these chronic borrowers that payday loan companies retained the upper hand in their transactions. This was especially apparent in the answers they gave to the question of what happens if a loan repayment is missed. As one might expect, collecting on a defaulted loan involves

Table 3.11

What Happens if You Don’t Repay?

What Happens	N=100
Phone harassment	44
Can’t use one’s bank card	8
Threat of credit rating ruin	32
I pay off some, while I never pay off others	11
I ignore them	2
I don’t know	3

harassing phone calls, as 44 per cent of the respondents stated. But the more telling figure is the 32 per cent who relayed the information told to them by payday lenders that a default means their credit rating would be ruined. A number of interviewees expanded upon this point, stressing how truly harmful such an occurrence would be for their lives:

My father won’t speak to me anymore. They keep calling him several times a day trying to find me. I don’t even know how they got his number. I never gave it them. My dad told me I should be ashamed of not being to support myself by my own hand. A year later, they still keep calling him every single day. Several time a day, weekends too. (R2)

They’ll phone everyone – friends, people you live close to, my neighbours, my landlord. It doesn’t matter if you tell them you don’t know me, they’ll keep calling, ‘coz they know you ain’t going anywhere. They know if they just keep

phoning and phoning you are going to hafta go and do something 'bout it or your family and friends keep yelling at you 'bout the phone calls in the early mornings and late at nights when they see you. I fought with my landlord once. He tried to raise the rent on us. He said I wasn't credit worthy anymore in his eyes. He said too many people been looking for me, asking 'bout me and where I am at. Telling him I owe them lots of money. I told him to go and fuck himself, I never borrowed more than a couple of hundred between paychecks. Lots of my money my ass, wouldn't be living where I am at if I had lots of money. I told him he would have to move us out himself if he tried to get a dime more. I told him my brother stayed at the Don [Jail] Hotel for assault, he would be more than happy to help that Paki fuck head move us. Greedy stinking bastard just pissed off then with that raise your rent shit, because you aren't credit worthy shit talk. (D)

This year I bought that pre-paid credit card. It's good for my credit rating to use it. I don't have to worry about paying it back, because I pay for it up front. Last year I was late on my payments all the time, they told me my credit rating was in the dump tank, told me I wouldn't be able to get anything anymore. You need good credit rating now days. I asked them to help me take care of it. I am never late now. Almost done repaying my second loan and I use the debit card all the time. (C)

I am looking to the future, taking care of my credit rating. Every time I make payments on time it gets a little better. I am not going to be living like this. I am taking night classes. My son is going to school now. Someday I'll buy a house and a car. You need credit, good credit rating. Laura [employee at Money Mart] always tell me that I have to make sure they got my payment by the deadline. If it's late it could destroy my whole good repayment on time history. I am taking care of my life now. (L)

I couldn't pay. I didn't pay. He said that if I didn't come and see him today, he would put my name, address, employers name and phone number in a system. He said I wouldn't have any credit rating anymore and that I wouldn't be able to get a loan, or if I did it would very expensive from now on. Unless I went to see him that day. I couldn't afford that. I took another loan a few bus stops over and used that cash to get some more time on the loan. He said that he didn't put my name in the system, but that he will if I don't finish paying it back in full. (G)

J. is a female in her late 30's. J lives with her mother in a home that her mother and father bought in the 1950's and paid for in full. J. works in a grocery store and takes a bus to and from work. Her story speaks volumes about the coercive techniques used on unsophisticated borrowers:

The manager said that they've called the bank and told them to reduce my credit rating. They told me that unless I paid back those two loans in full immediately my credit rating would be so bad I wouldn't be able to buy anything anymore now or in the future. They said that they will tell the bank to cancel my account and I wouldn't be able to get another bank account anywhere because my credit rating would be ruined. (J)

Notwithstanding the fact that habitual users of payday loans can hardly claim to have much of a credit rating to start with, the mere threat of a complete institutional withdrawal of credit opportunities, whether credible or not, is greatly feared by those who live on the margins. The asymmetry in power between credit seekers and providers is particularly acute when the seekers have few options.

3.4 The Big Question

When Caskey poses the question of whether payday loan companies relieve or exacerbate their customers' financial difficulties, he carefully delineates both sides of the debate. On the one hand, there are those who argue that the availability of payday advances encourages incautious spending decisions, or, worse, leads to entrapment in a never-ending spiral of indebtedness caused by the lending policies of these credit providers. This latter point has been prominently argued by Stegman and Faris (2003) who asserted that the financial success of payday loan companies derived from their "successful conversion of more and more occasional users into chronic borrowers" (25). This contention about the role of payday companies in promoting unremitting borrowing has been affirmed by numerous subsequent studies in both the U.S. and Canada (including the survey done for this dissertation.)⁸ Curiously, Caskey, himself

⁸ There is no shortage of literature documenting the phenomenon of repeat borrowers and the practice of loan rollovers. See, for example, Ernst et al (2004); Chessin (2005); Flannery and Samolyk (2005); Buckland et al (2007); Mann and Hawkins (2007); Parrish and King (2009); Martin, (2010); Melzer (2011)

often regarded as a critic of payday lending based on his pioneering book on the subject (Caskey,1994), responded to his own question by stating that the results of recent works in experimental economics on the costs and benefits of payday loans were inconclusive.

There is, however, another group of writers who maintain that on balance the availability of payday loans is a positive development for people with minor credit needs. Elliehausen and Lawrence (2001) have made just such an argument by treating payday advances as orthodox loans willingly entered into by credit-constrained individual who thereby gain “a little control over their financial situations that they otherwise would not have” (57). In a similar vein, Morgan (2007) uses a straightforward demand model of economic transactions to conclude “the simple fact that payday lenders have triumphed over pawnshops suggests that payday lending raises household welfare by providing a preferable alternative” (23). These and other defenders of payday lending (see also Kidd, 2004; Ciccone, 2006) purport to be economic realists who for the most part recognize that these types of loans are high cost and exact an onerous burden, but who nonetheless insist that a constrained choice is still a choice. In the circumstances in which payday advance borrowers find themselves, the selection of this credit instrument must be regarded as welfare enhancing, particularly when assessed against less palatable options.

In this same spirit of realism, it is worthwhile adding that payday loan customers can be resourceful in their own efforts at improving upon their position as credit-takers. Whether this involves taking out loans without ever intending to pay them back, or engaging in deceptions like writing “deceased” on credit collection letters, or simply playing along with the system by furnishing names of potential customers to payday loan outlets in exchange for rate discounts or loan extensions, credit-seekers who survive on the economic margins of necessity develop

strategies both of resistance and adaptation. But just as many of these customers try to secure what advantages they can in their constrained credit market, it is also the case that payday loan companies use their well-developed information-gathering resources to mitigate their risk of loss. In this play between lenders and borrowers the odds seem to favour the former.

Aside from this structural advantage payday lenders enjoy in the field of information, they are also able to materially help themselves by creating the demand that their products are designed to meet. There are ample reasons to think that payday lenders do try to manipulate demand. As a former payday lending employee admitted, debt entrapment is an ingrained business strategy:

[Lenders] may say they are providing a service to people who just need some money once in awhile until payday. But we were trained to encourage customers the day they paid a loan off to make another loan as early as the next day... We tried to get customers to keep getting loans and borrow up to their maximum approval amount whether they wanted it or not. (CRL 2001)

The ongoing debates over the welfare costs of payday lending has presented governments with a familiar quandary. Prohibiting an industry upon which so large a population has come to depend for short-term credit has the potential to worsen the financial condition of many. Allowing the industry to be governed purely by the dictates of a competitive marketplace begs the question of whether power asymmetries and market failures are the true face of this particular type of business. The next three chapters offer a detailed examination of how this quandary was met by policy-makers in Canada.

Chapter 4

Payday Lending Regulation Comes to Canada: A Policy Network is Formed

4:1 Introduction

In 2007 changes were made to Sec. 347 of the Canadian Criminal Code which permitted provinces to regulate payday loan industry through licensing and consumer protection laws. This regulatory change involving a federal devolution of authority came about after a consultative process that included industry representatives, consumer advocates and academic experts—in short, what students of public policy call a policy network.⁹ Policy networks, it has been frequently argued, have evolved as a way of developing policy in an increasingly complex and fragmented regulatory environment in a manner that is both routinized and politically manageable. While early studies of policy networks highlighted their role in supporting policy-making in an era of government “overload”, more recent studies suggest that these networks are displacing the traditional political-bureaucratic decision-making process as government reinvents itself in the neo-liberal age (Skogstad, 2005). This chapter will show that while the development of payday lending policy in Canada displays all the characteristics of governance through a policy network, the final policy outcome, or rather, outcomes, reveal a process more complex than is typically depicted in the literature on this phenomenon. In brief, I will argue that governance through a policy network remains a highly politicized undertaking, and that while both the process and the outcomes examined in this chapter exemplify the shift to the post-Keynesian regulatory state, the various stages in the formation of this particular policy network

⁹ The literature on policy networks is voluminous. For a sampling of some of the contending approaches to this subject, see Rhodes 1997; Thatcher 1998; Jordan and Maloney 1997; Coleman & Skogstad 1990; Scharpf 1991.

and its operation illustrate the underlying political tensions that can never be fully contained by it.

It is of course hardly novel to say that conflict remains a feature of those interactions that make up policy network deliberations. But what this chapter shows is that such discord can go beyond the usual conflicts of interests among actors seeking to maximize their own interests and calls into question the entire consensus-building project which policy networks are supposed to embody. Assumptions about consensus-building in the literature on policy networks and its conceptual cognate, policy communities, vary according to the unit and level of analysis contemplated. For example, conventional accounts of policy networks presuppose the existence of a minimal level of shared values among state and non-state actors as they negotiate their way in policy forums. More recently a number of public policy scholars have emphasized that the more-or-less regularized and co-ordinated interactions characteristic of policy networks are not simply a way of describing interest intermediation but rather comprise a unique mode of governance in which “actors with distinctive, but *interdependent interests*....strive to solve problems of collective action on a central, *non-hierarchical level*.”(Börzel 1998, 260). From the perspective of this “mode of governance” approach to understanding policy networks, the notion of consensus building takes on a much more important role in explaining both process and outcome of network negotiations. Theorists identified as *rational-institutionalists*, for instance, stress the systemic role which ideas, values, identity and trust play in constituting the institutional framework within which network actors collaborate on and negotiate for preferred policy outcomes, while those who subscribe to a *cognitive approach* underscore the active process of communicative action by which these values, ideas, etc. are constructed (Börzel 1998, 263-4).

Missing in much of these theoretical debates about consensus-building in governance networks, however, is a sustained consideration of what must lay at the centre of any political consensus—the legitimacy both of the interests seeking to broker a policy outcome and of the brokering process itself. As shall be argued in this chapter, governance through networks remains decidedly political and divisive depending on how these dual legitimation requirements are dealt with. This is the larger theoretical lesson that emerges from this present chapter focusing on the genesis of the federal act, Bill C-26, which delegates to Canadian provinces the authority to regulate payday lenders. A subsequent chapter will examine the regulatory programs introduced under the auspices of this legislation by three provinces, Manitoba, Ontario and Nova Scotia. The regulatory schemes introduced by these three provinces have been selected for close scrutiny because they contain discernable differences in their underlying policy goals, and this variation testifies vividly to some of the contradictory forces and values that afflicted the negotiations undertaken by the relevant governance network.

4:2 To Regulate or Not to Regulate: Some Institutional and Policy Considerations

From its inception in the mid-1990s till 2007 payday lending had been an industry relatively insulated from regulation either at the federal or provincial level. Indeed it is arguable that the industry came about in large part because of previous government efforts at deregulation of the financial industry in this country, and continues to enjoy the benefits of this deregulatory posture that has epitomized the world-wide neo-liberal revolution. To understand what has been at stake in this deregulatory thrust, it is best to begin with some of the basics of financial regulation in Canada.

The legal regulation of credit and financial services is a responsibility that cuts across federal and provincial jurisdictions. Thus, while the federal government has the constitutional authority to regulate banks and federally incorporated trust and loan companies, provinces have the authority to regulate credit unions and provincially incorporated insurance, trust and loan companies. The federal government has statutory authority over interest rates, although in practice their regulation increasingly has become a shared jurisdiction. Each province has its own Trade Practices Act which covers unfair and deceptive economic practices. These can provide some form of consumer protection depending on specific provisions and their enforcement. Likewise, common law doctrines and private law remedies related to fraud, deception and unconscionability serve as a form of regulation in the financial services sector, but only to the extent that private law can be mobilized by consumers to protect their interests.

The cross-cutting and overlapping lines of legal authority over the financial services industry described above have not led to a well-developed or coherent national approach to the regulation of credit. And as far as the regulation of cheque-cashing and payday lending businesses specifically, the record seems even worse. The authors of an early Industry Canada sponsored study of cheque-cashing and payday lending businesses, for instance, simply declare that the various regulatory tools available to government to regulate these enterprises have been seriously underused:

Legal responses to payday lenders include legislation at the provincial or federal level to: control interest rates, license payday lenders or regulate their practices, and/or disclose their practices. Non-legislative regulation may include the application of the common law doctrines of fraud, deception or unconscionability. Despite the presence of legislation and judicial decisions at the federal and provincial levels in these areas, regulatory activity on these fronts has been minimal (Lott and Grant 2002, 6).

One of the reasons cash-chequing and payday lending firms have fallen through the regulatory cracks, so to speak, is that they do not fit neatly into any of the categories that make up the so-called four pillars of finance: banks, trust companies, securities firms and insurance companies. This means that existing federal and provincial legislation that covers these institutions does not automatically apply to this sub-species of money lenders. Instead, it tends to be provincial consumer protection legislation which most directly applies to these companies. The fact that such legislation varies significantly from province to province, and the fact that compliance and enforcement mechanisms are likewise uneven, means that this avenue of regulation is not particularly robust.

The relative indifference of policy-makers to the regulatory void which allowed a more-or-less legally unsupervised payday lending industry to establish itself and flourish in Canada in the 1990s and early 2000s contrasted with public policy initiatives in a number of U.S. states during this period designed to subject payday lending to strict controls. This U.S. policy-making experience warrants some attention because the varying policy frames employed by different states, and latterly, the federal government, in their legislative responses to payday lending help shed light on the options that were eventually contemplated in the belated Canadian regulatory exercise.

4:3 Comparative Lessons: Payday Regulation in the United States

With financial regulation in the United States such a fragmented field, state authority over interest rates charged by state-chartered banks has given them de facto control over payday lending through usury legislation or related regulatory instruments. As might be expected in so decentralized a political system, state regulation of payday lending has varied considerably

across the country. With most states still retaining rate caps on small loans until the 1990s, payday lending was not really a viable enterprise until state governments began to succumb to lobbying campaigns to enact “safe harbor legislation” that would permit high-interest short term loans. Such legislation first began to appear in southern and Midwestern states in the early 1990s, and by the end of the decade, over half of the U.S. states had passed either safe harbor laws for payday lenders or deregulated entirely the field of small loans (Keest 2001, 413). Such payday-friendly state legislation was augmented by the earlier Supreme Court decision in *Marquette Nat. Bank of Minneapolis v. First of Omaha Service Corp 1978.*, which effectively allowed payday lenders to partner with nationally-chartered banks based in states with high or no interest rate limits, and then sell their products through those same banks in other states that might have tried to ban them through a low interest rate ceiling (see Fox and Mierzwinski 2001).¹⁰

Needless to say, these various deregulatory undertakings were met with vocal and sometimes effective opposition with the result that by the beginning of the new millennium, pressures to reregulate small loans in order to stem the practice of payday lending began to yield success. Currently there are twelve states and districts which utilize different measures to prohibit payday lending.¹¹ For instance, New Jersey and New York prohibit payday loans through check-cashing laws that ban the practice of loaning money on the security of post-dated

¹⁰ It must be noted that this particular method of “renting a bank” to circumvent state usury laws has for all intents and purposes been made obsolete by a 2005 FDIC rule prohibiting federally regulated banks from making more than six loans a year to the same customer, thus eliminating the market for repeat borrowers which fuels so much of payday lending profits (see Stegman 2007, 179).

¹¹ The jurisdictions prohibiting payday lenders are Arkansas, Connecticut, Georgia, Maryland, Massachusetts, New Jersey, New York, North Carolina, Pennsylvania, Vermont, West Virginia, and the District of Columbia. Information derived from Payday Loan Consumer Information, Consumer Federation of America website retrieved February 10, 2012 from <http://www.paydayloaninfo.org/state-information>.

cheques, and through usury laws which limit interest charges. Massachusetts, on the other hand, has chosen the simple expedient of severely limiting the rate of interest that can be charged on small loans that are transacted in any way within the state (Melzer, 2011, 550). Of the states that authorize payday lending, four—Maine, New Hampshire, Ohio and Oregon—license payday lenders but strictly limit what they can charge and closely regulate them in other ways. Among the remaining states, five—Delaware, Idaho, South Dakota, Utah and Wisconsin—have no caps on the charges payday lenders can impose on their customers, while the others have varying degrees of interest rate limits. One study has calculated the array of permitted rates in these latter states to range from an APR of 156% in Texas to 1955% in Missouri.¹²

While this diversity in regulatory approaches excludes easy generalizations about state-level policy-making,¹³ there is nonetheless a compelling story to be told about the general policy battles that permeated regulatory discussion on payday lending in the U.S. in the last couple of decades. At the forefront of those battles has been a host of community and church groups, public interest advocacy organizations, consumers' associations, academics, bloggers and public intellectuals who have cautioned against the hazards of a fast-growing payday loan industry and who have pressed for government action. Amongst the most visible of these advocates have been the Consumers Federation of America (CFA), the Association of Community Organizations for Reform Now (ACORN)¹⁴ and the North Carolina-based Centre for Responsible Lending, the

¹² APR was calculated on the basis of a \$250 loan (Paydayloans.org, 2012)

¹³ Although see Graves and Peterson (2008) who suggest that states where Christian fundamentalism is a powerful force tend to have regulatory schemes most favourable to payday lenders.

¹⁴ ACORN has now disbanded in the United States though its Canadian branches continue to operate.

latter a frequent contributor of briefs and affidavits to those state legislatures which have adopted regulatory measures aimed at curbing payday lending.

Something of the tactics and stakes involved in these advocacy efforts can be seen in the work of another recent entrant into the payday lending wars in the U.S., a coalition called Americans for Fairness in Lending (AFFIL) whose partners include the Consumers Union, the N.A.A.C.P. and the United Automobile Workers. The principal focus of this coalition has been to devise a national publicity strategy to warn consumers that the practices of predatory lenders produce results akin to natural disasters like earthquakes, hurricanes and floods, and to build public support for more regulation of the payday loan industry (AFFIL 2010a). Financed partly with a Ford Foundation grant, AFFIL launched a professionally designed ad campaign in 2007 to coincide with the release of a documentary and accompanying book on predatory lending called *Maxed Out* by James D. Scurlock, the filmmaker who had gained fame with his earlier work, *Supersize Me*, which exposed some of the health risks associated with the fast food industry (Elliot 2007). AFFIL's initial budget of \$500,000, however, paled in comparison to the \$10 million that the U.S. payday loan association, the CFSA, spent that same year launching its own publicity initiative to reassure the public that the industry's voluntary "customer pledge" to help shield borrowers from lending abuses rendered any further regulation needless (*Ibid.*)

These competing campaigns acquired a certain urgency as the financial crisis that began to overtake the U.S. in 2007 caused lawmakers to start reconsidering the general policy of financial liberalization that had permitted the payday lending industry to grow and prosper in the first place. Indeed, Congress in its 2006 Defense Authorization Act had already moved to curb some payday lending practices by prohibiting payday and title lenders from charging military personnel and their families more than 36% APR for their products. The sponsor of that bill,

Democratic Senator Richard J. Durbin of Illinois, failed to gain Congressional support for an extension of this legislated lending cap to all borrowers in succeeding years (Chan 2010). But by 2009 a new omnibus financial regulation bill (which would come to be known as the Dodd-Frank bill) came before Congress and among other things it proposed to give the federal government legislative oversight over non-bank financial institutions including payday lenders. Predictably, the payday loan industry amplified its lobbying efforts to stop this policy initiative. According to one report, the payday loan industry as a whole doubled its expenditures on lobbying in Washington in 2009, with the CFSA alone increasing its spending by three-quarters to \$2.56 million (Epstein 2010). As part of its marketing strategy to impede regulatory reform, the payday loan industry created an advocacy group called “Consumer Rights Coalition” in 2009 modeled on the very same public interest research groups that have typically criticized it. Ostensibly a consumer organization composed of payday loan customers, the Coalition dedicates itself to the preservation of access to this form of credit: “Faced with a tightening credit market and new financial regulations, more than 200,000 consumers of short-term financial services from across the nation have joined together to speak up for themselves in order to protect, improve and expand their access to realistic and reliable credit options” (Consumers Rights Coalition 2012).

With aid of lobbying instruments such as the Coalition, the payday lending industry was successful in stopping amendments to a House version of the financial regulation bill that would have set caps on payday loan charges and limited the number of such loans a lender could make to customers. But they were ultimately ineffective in preventing the final compromise legislation which contained provisions for the creation of a new federal agency, the Consumer Financial Protection Bureau, with authorization to supervise non-bank financial institutions. Using this

legislative accomplishment as a self-proclaimed testament to its own modestly funded lobbying campaign, AFFIL chose to wind down their organization in 2010, content that the nascent federal agency would realize their ambition of restraining predatory lending (AFFIL 2010b). Yet a year after its creation, the Consumer Financial Protection Bureau had yet to establish any enforceable rules and its mandate no less than its management remain hotly contested political issues (Indiviglio 2011).

With the machinery of government in Washington so paralyzed by partisan discord, it turns out that the more successful attempts at payday regulatory reform have in recent years come from state legislatures. Here too, however, the payday loan industry has invested heavily in lobbying. For instance, in 2008 it was reported that payday loans companies spent \$30 million on ballot initiatives in Ohio and Arizona to try to roll back interest rate caps in those states. The Arizona lobbying effort proved particularly crafty with a local affiliate of the CFSA promoting a ballot initiative that on the face of it seemed highly critical of payday lending but in fact proposed regulatory reform that would have rescinded existing strict regulations of the industry (Anand 2008). While these two lobbying drives ultimately failed to realize their objectives, payday lending firms have not let legislative setbacks deter them from trying to exploit the market for small short-term loans. Thus in Arizona these companies sought to circumvent the regulated rate for payday loans by reinventing themselves as providers of automobile title loans (loans secured by the title to a borrower's automobile), something that had been left unregulated by the state. Likewise in Ohio, payday loan companies began offering installment loans (loans with an installment repayment plan) which likewise were not subject to the state's interest rate regulations for small loans (Epstein 2011). And in a number of other states that have tried to ban payday lending through interest rate caps, payday loan companies have sought to charter

themselves on Native American reservations whose sovereign nation status allegedly exempt their operations from state regulation (Mont 2011).

The various and sundry attempts by federal and state governments to introduce legislative measures to control payday lending, and the sophisticated and well-financed lobbying and other exploits undertaken by payday lenders to escape, or at least set the terms for, the regulation of the industry reflects a political dynamic that has been at work for some time now in the U.S. The long-standing policy debate engendered by this political dynamic has typically revolved around the questions of whether payday lending is an exploitative economic practice, and what form of regulation is suited to this industry. On the question of exploitation, proponents of payday lending have characteristically invoked neo-classical economic reasoning to point out the propriety of this model of credit provisioning. A paradigmatic argument of this type has been advanced by Lawrence and Elliehausen (2001, 2008; see also Elliehausen 2006), whose work is frequently cited by payday lenders in defense of their business. On Lawrence and Elliehausen's account, payday customers are typically credit-constrained but generally knowledgeable about the relative costs of credit alternatives. In the circumstances, the fact that they deliberately choose payday loans indicates that such loans are on balance welfare-enhancing products if for no other reason than they "give consumers a little control over their financial affairs they otherwise would not have" (2008, 315). This proposition that demand justifies supply is usually coupled with a classic market-based normative argument against regulation. Morgan (2007) has supplied one of the best known of these arguments in a study for the Federal Reserve Board of New York in which he tries to operationalize the concept of predatory lending. Defining predatory lending as a "welfare-reducing provision of credit," Morgan contends that on the basis of the empirical measurements he was able to devise to assess the impact of payday loans on

typical borrowers there is no compelling evidence that the latter are made worse off by their reliance on such credit advances. And his prescription in light of the common criticism that payday lenders charge exorbitant fees is to ensure that no regulation in fact take place so as to allow a maximum number of entrants into this credit market, thereby guaranteeing the price-reducing effects of competition:

Using a small set of data, we find that payday loan rates and fees decline significantly as the number of payday lenders and pawnshops increase. Despite their alleged naiveté payday borrowers appear sophisticated enough to shop for lower prices. The problem of high prices may reflect too few payday lenders, rather than too many. If scrutiny and prosecution risk limit entry into payday lending, the lack of competition may drive rates higher. In the end, the simple fact that payday lenders have triumphed over pawnshops suggests that payday lending raises household welfare by providing a preferable alternative (22-23).

This idea that whatever market failure occurs in the commercial field of payday lending is directly attributable to misguided government attempts to place caps on interest rates for small loans is of course vigorously contested. For instance, in its response to the Morgan study, the Center for Responsible Lending (2007, 1) prepared a detailed rebuttal which pointed out, among other things, that there is no evidence to suggest that competition among payday lenders has led to a reduction in the price of loans in those states with no limits on, or high allowable, interest rates. Market failure, in the view of critics of the payday industry, is decidedly a cause of hardship for borrowers, not lenders. For those critics who try to retain a neo-classical economic framework to explain market failure in this particular commercial field, the most common approach has been to focus on disclosure problems which prevent customers from appreciating the true cost of payday loans. Another theme taken up by neo-classically oriented critics is the notion that payday lending firms have de facto created an oligopolistic market in the small short-term loan business because more traditional lenders abandoned the field to them. Still other

censors of payday lending eschew the neo-classical style of argument and assume a perspective drawn from some favoured concept of distributive justice. In one such view, payday lending is considered exploitative if it can be shown that typical borrowers fail to meet some independently determined standard of economic sufficiency and hence are subject to paying high interest rates for their credit needs. An alternative conception is that borrowers are only exploited if the structural disadvantage they start with because of their economic insufficiency is further aggravated by payday lending practices such as those enticing them into repeat loan rollovers.¹⁵

The policy prescriptions that follow from these various critical approaches vary according to the problems they identify as paramount. Thus, while all critics might agree that information asymmetries between lenders and borrowers in the field of payday lending require a more-or-less stringent application of truth-in-lending laws, those who stress the inordinate market power of payday lenders will typically seek additional regulatory actions. For example, Brooks (2006) proposes that payday lenders be obliged by law to convey borrowers' loan repayment history to national credit reporting agencies, thus helping those borrowers with a superior repayment record to establish a better credit rating which would then make them attractive customers for more traditional low-cost lenders. A more proactive approach has been suggested by Barr (2004) who favours governmental incentives to facilitate the development of less expensive credit instruments for the poor by mainstream financial institutions. Mann and Hawkins (2007) think the solution to exploitation is to drive out the small payday lending firms most likely to engage in predatory financial practices through such devices as a low interest rate cap, while at the same time encouraging large national payday lending firms to populate the

¹⁵ This distinction between exploitation measured according to an independent standard of sufficiency and exploitation as a result of the relative advantage of lenders draws on the work of Mayer (2003).

market on the assumption that their aversion to reputational risk will motivate them to keep away from predation. And finally, among those critics who rely on a concept of distributive justice to assess the payday loan industry, some like Peterson (2008) argue from the basis of a sufficiency standard that there must be an absolute limit to rates charged by payday lenders enforceable by a stricter application of state usury laws. Others like Mayer (2003), who adopt the perspective of relative advantage, counsel a more flexible regulatory regime that allows payday lending but prohibits those practices like loan rollovers that might entrap the chronically financially disadvantaged borrower into a never-ending debt trap.

While these several different prescriptions point to something of the range of the debate on payday lending that has absorbed much of the policy-making community in the United States, it should be noted that there has also been available to that community a model state statute for payday lending prepared by Elizabeth Renaut (2001) for the Policy Institute of the American Association of Retired Persons (AARP). Included in the model statute are such provisions as mandatory licensing, strict disclosure rules, a requirement that lenders keep strict accounting and other records to be made available to regulators for compliance checks, a maximum allowable interest rate of 36% per year with an additional administrative fee of up to \$5, and a list of prohibited actions including a ban on loan rollovers and an embargo on using the criminal court system to collect on unpaid debts. The AARP model statute has proved influential as a number of individual states began to adopt some or all of its provisions in the 2000s (see Stegmann 2007), though many of these regulatory reforms continue to be faulted for not going far enough in ending predatory lending, or for functioning as instruments to legitimize the payday lending industry (see Aitkin 2010).

4:4 The Payday Loan Policy Debate Comes to Canada

Given that policy-makers in Canada came to the payday loan issue later than their U.S. counterparts, it is not surprising that there has been a spillover of policy ideas generated by earlier American debates into this country. For instance, Ian Ramsay's important study on payday lending commissioned by Consumer Affairs and the Ministry of the Attorney General of B.C. ends with an appended model piece of legislation for payday lending which is taken directly from the AARP model state statute (2000, 55-65). John Lawford (2003) in his Industry Canada-funded study of alternative ways of regulating payday lending likewise makes generous use of the AARP model statute in his recommendations.¹⁶

The appearance of these initial policy studies of payday lending, many of them financed or directly commissioned by government agencies, signaled that policy-makers in Canada were finally taking an interest in regulating this alternative financial sector. Cognizant of this possibility, the payday loan industry embarked on its own public relations efforts to deter would-be regulators from scrutinizing their practices too closely. In their publicity campaigns industry officials had made it plain what their preferred regulatory structure would look like. For instance, in a response to proposals for the regulation of the cheque-cashing and payday loan industry put forward by the aforementioned Lawford study, an executive of Cash 4 You Corp prepared an analysis that highlighted the reputedly negative consequences of interest rate caps, disclosure requirements on the real annual interest rate of loans, and the creation of a state regulatory mechanism (Mahmoudzadeh 2004) Typically, the arguments were self-serving, but at the same

¹⁶ See also Robinson (2006) whose policy prescriptions for payday lending also parallel regulatory schemes proposed in the U.S. Buckland et al (2007) are most explicit in their borrowings, relying on the distinctions and arguments of Mayer (2003) in their regulatory recommendations. For a broad comparison of the Canadian and U.S. approaches to payday lending, see Ben-Ishai (2008).

time they also bring into relief some of the conceptual limitations that underlay the Canadian regulatory reform drives aimed at curbing many of the dubious practices of the fringe financial sector. To see how it is worth recounting in a little detail the Cash 4 You Corp response to reform proposals.

First, the industry statement played on the neo-liberal aversion to state presence in the market by acknowledging the need for regulation but warning about the possibly prohibitive costs of another government bureaucracy whose benefits might be better achieved by a compulsory licensing system that integrated the industry's own "best business practices" code as a public standard. With such standards in place consumers would have the opportunity to use local better Business Bureaus to monitor the industry and assist in complaints. This particular recommendation had a particular irony given that a past-president of the Canadian Payday Loan Association, Rob Whitelaw, was none other than a past-president of the Canadian Association of Better Business Bureaus. Since leaving the CPLA Whitelaw has become a critic of the payday lending industry.

Moving on to disclosure issues, the statement both assents to the proposition that actual interest rates should be published while denying the need for a complaint mechanism because of the potential for abuse of such a system by borrowers! Finally, and most importantly, the statement goes on at length to explain that while generally a prohibition on exorbitant interest rates is warranted, it is nonetheless a good idea not to put a firm cap on these charges lest this drives out a much needed business from a sector of society underserved by financial institutions. To strengthen this last point, the author of the statement undertook his own analysis of high risk lending to small-time borrowers to show that the profit margins for payday lenders are thin and could be destroyed by over-regulation. What bears comment on this industry

rationalization of a soft regulatory scheme is that by and large the arguments it embraces are the very ones that would come to dominate the policy-making discussions when regulation did become inescapable.

4:5 Payday Loan Regulation in Canada

The decision to regulate came after several years of mounting public pressure, intermittent meetings with industry and consumer advocacy groups and provincial officials, and a legislative proposal pre-empted by a federal election and subsequent change of government. Parliament at long last addressed the question of how to regulate the rapidly growing payday loan industry by passing Bill C-26 in the spring of 2007. The official reason for this legislative initiative was that the various fees and charges payday lending companies typically levied on their customers for short-term loans, if calculated as interest on an annualized basis, easily contravened Canada's anti-usury law contained in Sec. 347 of the Criminal Code which prohibits interest charges above 60% a year.¹⁷ Rather than introduce new measures to more effectively enforce this usury prohibition against payday lending companies, Bill C-26 contemplated a quite different solution to the problem of their reputed excessive charges. Under the new legislation the 60% threshold designating a usurious interest rate was retained, but payday loan companies were specifically exempted from criminal prosecution if they limit themselves to small loans of short duration, and provided that they are licensed by provinces that choose to opt into the

¹⁷ Estimates of the costs of payday loans vary. For example, in research done by The Toronto Star on the cost on a Money Mart payday loan, it was reported that the charge on a seven day \$100 loan amounted to an annual interest rate of 988% while a fourteen day loan for the same amount yielded a rate of 519%, and a twenty-eight day loan produced a rate of 284% (Rankin and MacIntyre 2004a). Needless to say, payday loan companies contest the validity of reporting their charges in terms of an annualized interest rate, arguing that it distorts the value of their services in the same way that a requirement obliging hoteliers to report their room charges in terms of a yearly rental rate would (CPLA 2005).

federally-defined regulatory scheme. Consenting provinces would be authorized by the legislation to act as regulators of the industry if they commit to enact appropriate consumer protection legislation and set limits on the overall costs of payday loans (Bill C-26 *Canada, House of Commons*, 2007). Since its passage most provinces and territories have adopted enabling legislation to set up their own regulatory regimes as provided for by the federal act.

The almost unanimous political agreement amongst federal political parties to shift jurisdictional responsibility for payday loan companies stands in contrast to the prescriptions many academic policy analysts and consumer advocacy groups had advanced for this industry. For instance, Jacob Ziegel, a long-time analyst of commercial and consumer law, has repeatedly questioned the wisdom of ceding to provinces control over interest rates for institutions like payday loan companies, worrying that such action could lead to a hodgepodge of regulations with no overarching national standards (Ziegel 2006). In similar vein the Consumers' Association of Canada has consistently argued against any devolution of authority over the payday loan industry on grounds that the existing law on usury was never adequately enforced by provincial officials, a fact that should inspire little confidence in any provincially-devised and –enforced regulatory scheme for payday loans (Consumers' Association of Canada 2004).

While criticisms such as these have been routine amongst legal scholars and consumer advocates, the payday industry itself, or at least that part of it that has joined forces to create a national association, the Canadian Payday Loan Association (CPLA), had in the main welcomed this government initiative (Whitelaw 2005). Indeed, after failing to convince the federal government that industry self-regulation was the best way of ensuring that payday lenders would refrain from illegal or unconscionable behaviour, the CPLA, a conventional industry association generously staffed with ex-politicians and senior political aides, itself pressed for a new legal

regime based on provincial regulation. This latter is a familiar tactic among industry associations hoping to secure a minimally invasive regulatory regime, for as is frequently observed, in a federal state, provincial governments are more easily influenced or captured by business than their federal counterparts (Coleman 1987). But just as this industry tactic came to fruition, serious discord erupted within the CPLA which called into question the whole *raison d'être* of the regulatory exercise that gave rise to Bill C-26.

The significance of these industry divisions, and the subsequent effect that they had on the unfolding regulatory process, can best be comprehended by first attending to the master narrative to which all parties to the policy process initially seemed to have subscribed.¹⁸ That master narrative proposes that payday lenders provide a needed service in the form of short-term credit not supplied by conventional financial institutions, and that any prohibitive regulatory scheme would only serve to drive those who need this service to seek it from loan sharks associated with the criminal underworld. In the circumstances, the best policy course of action would be to find a feasible mechanism for controlling the more reprehensible payday loan practices while ensuring the survival of the industry. When this master narrative is unpacked, however, it can be seen to contain within its frame four interrelated policy problems: 1) the problem of industry legitimation, i.e. how can a practice that falls under the official definition of usury in the Canadian criminal code be justified and defended in policy terms? 2) the problem of governance legitimation, i.e. how can a policy process for the governance of a controversial industry be devised so as to provide assurances that a public interest is being pursued? 3) the problem of policy mix, i.e. how to design a coherent policy regime that ensures payday lenders

¹⁸ What I call a master narrative in this chapter is similar to what Meidinger (1987) denotes as an “epistemic frame” shared by “regulatory communities” of state, business and NGO policy networks.

continue to have a market capacity while borrowers have a credible measure of protection? 4) the problem of policy instrument in a federal state, i.e., given that responsibility for consumer protection is divided in a federal state, which jurisdiction has the policy instruments most suitable for accomplishing the previously mentioned objectives? As it turned out, the fate of the latter two policy problems of mix and instrument were not only intimately tied to the first two problems of legitimacy, but in addition, their resolution proved to be an integral part of the legitimation process. To clarify this connection between policy output and legitimacy it is necessary to explore some basic conceptual distinctions about the process of legitimation.

4:6 Some Considerations on Legitimation and Governance

In his widely cited work on political legitimation, David Beetham has argued that there are three dimensions to the legitimacy of the state in liberal democratic societies: its success in meeting the needs and values of its citizens; the degree of public control over decision-making under conditions of political equality; and the sense of shared identity the political process is able to generate (Beetham 1991). Some theorists of network governance have argued that this particular form of political decision-making contributes to the legitimacy of government on all three of these dimensions by ensuring that stakeholders with a direct interest in a policy area have a say in its articulation (Scharpf 1997; Joerges and Neyer 1997). But others have cautioned that the exclusivity of networks, not to mention the ever present possibility that power imbalances among participants, might distort the deliberative process or undermine the capacity of the state to play a directing role in policy formulation, calls into question the democratic credentials of network governance (Skogstad 2005).

These opposing views on the contribution of network governance to political legitimacy of the state are unlikely to be resolved at the theoretical level—rather, they invite the question to be addressed empirically. But in order to do so, another question about legitimacy requires attention. Asking whether a specific exercise in network governance helps democratic legitimacy begs a crucial question—does the interest around which a network forms enjoy a prior moral-political legitimacy such that it is publicly accepted as an appropriate object of political negotiation and policy formulation? Note that this prior question reverses the analytic approach to legitimation for it focuses the inquiry on how moral-political discourse is organized in support or opposition to an interest, something in which all actors in an incipient or real network participate. And, as shall presently be argued, contests over the moral-political legitimacy of the interests that compose the network are the crucial intervening variable that governs any subsequent democratic legitimacy that derives from network governance.

Studies focusing on the construction of legitimacy at this basic organizational level tend mostly to concentrate on the problem from the perspective of the societal interests which seek to influence the policy process. In the field of organizational sociology, Suchman's typology of strategic and institutional approaches to managing legitimacy has been helpful in conceptualizing the various strategies organizations use to gain, maintain or repair what he terms pragmatic, moral and cognitive legitimacy (Suchman 1995). But largely absent in Suchman's synthetic approach, and in many of the case studies informed by his typology (e.g. Cashore 2002; Lawrence, Wickins and Phillips 1997), is the state's active involvement in this process of advancing the legitimacy of the interest that it has undertaken to regulate. As for those studies that do consider the state's part in such a legitimation process, either the state's own motivation for shoring up support for an interest is presupposed without further inquiry (e.g. Coleman

1991), or the concrete means it employs to achieve such a result are simply taken to be instances of a repertoire of available policy instruments without a consideration of their possible contradictory effects (e.g. Howlett 2000). What I propose to show in the following account of payday regulation in Canada is that different levels and organs of government in the policy process actively undertook to help legitimize the payday lending industry as a policy objective in and of itself, and that this course of action had direct (and contradictory) implications for both the policy mix and the policy instruments that were finally selected for the regulatory regime outlined in Bill C-26. In terms of policy mix, what this means is that once the political decision was made that payday lending would be deemed an acceptable form of credit provisioning, state resources were deployed to define the public interest in a way that gave precedence to fashioning a regulatory environment conducive to the prospering of a payday lending industry. And in terms of policy instruments, once the political decision was made to legitimize payday loans with their relatively steep fees, the choice of regulatory instruments was narrowed. For to legitimize payday lending meant that the criminal sanctions available under the usury proscription in the Criminal Code had to be discarded. In the event, the main remaining policy instruments for the regulation of this industry were consumer protection laws that fell largely under provincial jurisdiction.

4:7 State, Market or Self-Regulation?

The proliferation of non-traditional lending sources became a cause for concern amongst numerous anti-poverty and church groups as well as credit counseling agencies by the early

2000s.¹⁹ In the United States, where community and credit counseling organizations such as ACORN and the Center for Responsible Lending had waged their own protracted political campaigns against the payday industry since the 1990s, several state governments began to enact legislation in the early 2000s to rein in or prohibit payday lending.

It was against this backdrop that federal-provincial consultations on payday lending took place. The Consumer Measures Committee (CMC—a federal-provincial body of officials with a mandate to support and develop policy proposals for consumer protection) created a working group (officially called the Alternative Consumer Credit Working Group--ACCWG) to generate schemes for improving consumer protection in what was termed the “alternative consumer credit market.” Significantly, at this early stage of policy formulation, the ACC working group had already set the fundamental tone to all future discussions of payday lending regulation by stating: “The consistent message from stakeholders has been to address the undesirable practices within this industry in a manner that allows its continued existence. Provincial / Territorial (P/T) governments agree with this approach” (ACCWG 2002). The imperative of securing a measure of moral legitimacy for the payday loan industry was thus already proclaimed by government officials even before substantive intra-network negotiations commenced by the simple expedient of defining away objectionable commercial practices as aberrations in what otherwise is an indispensable financial service.

Once bureaucratic consultations did start in earnest, payday loan companies themselves began to organize, the better to negotiate the terms of their impending regulation. In May of 2004 the Canadian Payday Loan Association (CPLA) was created as an industry association with the

¹⁹ A series of investigatory articles in the *Toronto Star* in 2004 captured something of the growing public trepidations over predatory lending practices thought to be endemic among payday lenders in Ontario. See the series under the general title, “A Matter of Interest,” June 19-22, 2004.

intention of engaging in a public dialogue about the financial services they provided. For a business that had only established itself in Canada a little over half a dozen years before, the swift formation of an industry association suggested a unity of purpose more commonly found in mature industries. And indeed initial appearances seemed to reinforce the view that the CPLA possessed a coherent organizational and public relations strategy, representing as it did the major payday loan companies in Canada and boasting a membership that included over 80% of all payday loan providers in the country.

The tactic of forming an industry association is a familiar one in business-government relations, not least because if business hopes to have an influence on industry-wide state policy, it is valuable to create an interlocutor with whom state officials can consult. The converse is also true. Governments seeking support for regulatory initiatives in the world of business often prefer to be able to confer with an authoritative industry association (Atkinson and Coleman, 1989). But there are further strategic benefits from forming an industry association. For one thing, it can impart to the industry the symbolism of professionalism which, as Suchman points out, is something that can contribute to the moral and cognitive legitimacy of the interest the organization represents (Suchman 1995, 595). And second, apart from its obvious public relations mandate, the organization can serve as a potential vehicle for self-regulation should the need or opportunity arise.

Not surprisingly, given the preliminary signals from the ACC working group that some form of regulation of the industry was inevitable, the CPLA from the outset saw its mission as that of persuading policy-makers that industry self-regulation was the best approach to bringing order to the business of alternative financial services provision. It quickly proceeded to develop what it described as a Code of Best Business Practices, and called for a self-regulated

compliance mechanism to be established. This proposal for self-regulation through a voluntary industry code of conduct was modeled after a similar initiative undertaken by the U.S. industry association, the Community Financial Services Association of America (CFSA), in its efforts to pre-empt state legislators from introducing restrictive regulatory regimes.

In the case of the Canadian industry association, the tactic of employing a voluntary code of conduct not only failed to thwart government discussions of regulatory options, but it contributed to divisions within the CPLA that eventuated in the departure of one of the principal founding members, the Canadian-owned Cash Store Financial (previously operating as Rentcash). Cash Store Financial grew wary of the role the U.S.-based Money Mart had taken in the CPLA, arguing that the industry organization had become its captive and promoted policies which were designed to advance the American firm's dominance of the Canadian market. The discord within the CPLA centered on two main issues: its policy on loan rollovers and its political strategy of participating in the consultative process with government officials. While originally a public supporter of the CPLA's inclusion of a no-rollover provision in its Code of Best Business Practices, a directive meant to deflect growing criticisms that payday lenders deliberately tried to ensnare borrowers in an endless cycle of debt, Cash Store Financial became much more equivocal about this stratagem with the decline of its own share value when it adopted a no-rollover policy.²⁰ According to Cash Store Financial, a ban on loan rollovers was something that primarily benefited the more established Money Mart whose large market share could compensate for any lost business such a policy might represent.

²⁰ For an account of the business implications for Cash Store Financial of adopting a no-rollover policy, see DeCloet, 2005.

As for the policy of participating in consultative mechanisms, Cash Store Financial early on voiced its concerns that engaging government in discussions over any prospective regulations that included caps on the rates payday lenders could charge would be contrary to the principles of self-regulation and free enterprise for which the CPLA supposedly stood (Clarke 2008). As consultations proceeded, the discord between Cash Store Financial and Money-Mart dominated CPLA, over the rate cap issue intensified to the point that the payday loan industry as a whole found it more difficult to present a unified position on regulatory issues. Indeed, the growing hostility between them itself became an issue within the regulatory process, proof that the institutional constraints which an industry association is meant to impose on its members can be defeated by firm rivalry, particularly if the latter is grounded in fierce competition over market share. In the conceptual language of actor-centered institutionalism used by some students of network governance, such a development underscores the interminably contingent character of network constraints (Scharpf 2000, 771).

4:8 From Criminal Law to Regulatory Law: Regulation as Legitimation

As the industry side of the policy network began to fray, a political agreement was reached on the policy instrument which to all appearances seemed to match what payday lending companies had sought as their second best option—regulation by the provinces through consumer protection laws. Such an outcome seems to undermine the hypothesis proposed by Bressers and O’Toole (1998, 232) which holds that in networks characterized by weak cohesion and weak interconnectedness, the choice of policy instruments is less influenced by the target groups of the proposed regulatory regime. What might help explain this departure from Bressers and O’Toole’s intuitively plausible hypothesis is that the state’s own regulatory preferences may

have coincided with those of the payday loan industry for independent reasons. What those independent reasons were can best be grasped by considering the policy options canvassed by the policy-makers in advance of the agreement that finally yielded Bill-C26.

One option was simply to retain the criminal code prohibition on usury and have it strictly enforced. Indeed, an even stricter version of this option was pursued in a non-governmental Senate bill introduced in 2004, which would have defined as criminal any interest rate 35% above the overnight Bank of Canada lending rate (Kitching and Starkey 2006, 13). Without the support of the governing Liberal party, however, this Senate bill made no headway. As far as enforcing the existing 60% interest rate ceiling, up until 2007 no criminal charges had been laid against a payday loan company, despite that fact that several class-action law suits had been certified against various firms on the grounds that their charges contravened the usury prohibition. The customary reason given for not proceeding with criminal charges has been that Section 347 of the Criminal Code is unusual in that it requires the consent of the provincial Attorney-General in order to prosecute an offence under it. These provincial officials, it is routinely argued, have been reluctant to grant their prosecutors the authority for fear that it would drive away payday loan companies, leaving consumers to the mercy of loan sharks (*Ibid.*, 11).

Another option would have been to leave the payday loan industry unregulated and allow their practices to be controlled by the courts in the course of resolving those class-action law suits already underway. But this was a risky option for the industry because if the complainants were successful in these civil trials, there was always a potential that the court awards could bankrupt the payday loan firms. As the next chapter reveals, it was exactly this latter risk that seemed to materialize at the very moment that network negotiations began in earnest.

Chapter 5

Payday Lending In Canada: The Courts Have Their Say

5:1 Introduction

This chapter looks at the role that courts have played in shaping the policy on payday lending in Canada through their civil law rulings involving Sec. 347 of the Criminal Code prohibiting interest charges above 60%. Students of public policy have for some time recognized that tort and contract law can be an area of substantive policy-making. It is widely acknowledged, for example, that private litigation was an important if problematic driver of policy changes towards the tobacco industry in the U.S. in the 1990s. Scholarly literature on this phenomenon of “regulation through litigation” typically has focused on questions of its efficacy and legitimacy.²¹ And not surprisingly, the debates generated by these questions have mirrored the larger on-going debate about the policy-making role of courts. Just how accessible are courts as an avenue of policy-making? Is the language of the courts the most suitable idiom to frame complex policy questions? Are courts sufficiently equipped with the expertise necessary to evaluate and monitor complex policy issues? Is there anything approaching democratic accountability in judicial policy-making? While these questions are not trivial, there is an important sense in which the almost exclusive attention they focus on the normative contrast between judicial-, bureaucratic- and democratic-decision-making (or law, administration and politics) obscures a fundamental reality about the political as well as the legal process. Neither politics nor law is bounded by formal institutions; rather in the real world of individual and

²¹ For an overview of some of these questions see Viscusi,(2002)

social conflicts, ambitions and claims, there frequently if not always is an inter-institutional dynamic at work as different actors seek their advantage. This inter-institutional dynamic, it shall be argued, helps explain some of the twists and turns in the story of contemporary payday regulation in Canada.

5:2 A Question of Political Jurisdiction

On the face of it, it would appear that payday lending policy in Canada has been an exclusively political matter—something decided in Parliament and provincial legislatures after a protracted bureaucratic consultative process. But as the previous chapter has shown, how to regulate payday lending proved to be a politically elusive question. To begin with, there was the jurisdictional issue. Because they were not deposit-taking institutions, payday lenders did not fall under the traditional definition of financial institutions subject to federal authority over banking. On the other hand, the fact that they charged interest for loans made payday lenders *prima facie* subject both to federal authority over interest rates, and to the criminal law prohibition on usury contained in Sec 347 of the Criminal Code. And finally, to complicate the jurisdictional issue, consumer protection in Canada is a field that is jointly shared by provincial and federal governments, leaving it an open question as to which level of government is either entitled or best placed to design regulations protecting those using the services of payday loan companies.

In practice these jurisdictional quandaries had combined with political neglect to leave payday lending virtually unregulated for the better part of a decade until public pressures became sufficiently vocal to call forth a policy response. The resulting governance network described in the preceding chapter proceeded to try to negotiate a policy solution acceptable to all parties involved—a devolution of authority over payday lending to provincial governments. In the story

just presented one is apt to conclude that the regulation of payday lending in Canada has followed a familiar political script where some combination of public pressure, industry self-interest and inter-governmental negotiations produced a policy outcome with the requisite compromises needed to secure its passage in Parliament. But a second look tells a significantly different story. What motivates this second look is a puzzle left unanswered by the straightforward story of political compromise and co-operation offered by most chroniclers of Bill C-26. If the major concern with payday lenders was their extortionate interest rates, then instead of a devolution of power why not make use of existing policy instruments, i.e. Sec. 347 of the Criminal Code?

While Sec. 347 has had a problematic history, as recounted in Chapter 1, and its application has for that reason been uncertain, one could still argue that it does remain an appropriate legal instrument to apprehend the more dubious lending practices of payday lenders. Yet curiously, since the inception of modern payday lending in Canada, there has been only one criminal prosecution of a payday lender under Sec. 347, in Winnipeg in 2006. The company in question, Paymax Canada Inc., was accused of charging customers interest rates as high as 2000% APR (Cryderman 2008). The owners of Paymax eventually agreed to a guilty plea in 2007 which saw all charges against them stayed while their corporation was found guilty of contravening Sec. 347 resulting in a \$100,000 fine (PUB 2008, 114). Other than this one successful court action, why has there been so much reluctance to use existing criminal law sanctions against payday loan companies? The generally accepted explanation for this absence of prosecutorial ardor when it comes to payday lending has to do with the peculiar provision in Sec. 347 which requires that approval be granted by a provincial attorney-general before a prosecution can proceed. This structural precaution was built into Sec. 347 precisely because of

its potentially wide reach. The reasoning the law-makers used here was that a check in the form of ministerial pre-approval of prosecutions would help ensure Sec. 347 would not be employed capriciously to stifle legitimate enterprise (Waldron 2002, 2).

While there is art in this design, it still begs the question as to why payday lenders have so successfully escaped the reach of Sec. 347 since the rates of interest they charge for their short-term loans are comparable to and in many instances higher than what classic loan sharks have demanded for their cash advances. The answer, it seems, turns on the politically-constructed distinction between legitimate and illegitimate provisioning of credit. This distinction is nicely captured in a summary report prepared by the Parliamentary Research Branch on the aforementioned Bill C-26 aimed at payday lending. In the report the authors make note in passing that up until 2006 no provincial government authorized the prosecution of a payday lender for fear that “the lack of a payday alternative would result in consumers using illegal alternatives such as loan sharks” (Kitching et al. 2006). In other words, provincial officials tolerated the exorbitant rates charged by payday lenders to ensure that their operations would be treated as at least nominally legal in contrast to those of loan sharks associated with organized crime. In the circumstances, it may well have been, as one report suggests, that the anomalous prosecution in Winnipeg was motivated not by a new-found prosecutorial resolve but by political calculations as the provincial NDP government, frustrated by inaction on the part of its federal counterpart, sought to force the hand of the incoming Conservative government on the long-gestating payday loan policy file (Goar 2006).

However one chooses to construe it, the virtual abdication by both levels of government of any responsibility to oversee the lending practices of payday lenders prior to 2007 meant that there was a regulatory gap in an economic activity of some consequence to an ever-growing

proportion of the population. But as students of consumer law have been apt to point out, regulatory gaps are frequently the site of lawsuits which in effect means that regulatory burden for these areas is shifted to the courts. As it turns out, a case can be made that this is precisely what happened to payday lending. In the absence of policy-making at the political level, for a period of time in Canada courts ended up driving the policy agenda on payday lending through their rulings in discrete cases. In the remainder of this chapter I want to turn to this episode of court-engendered policy-making, or what might better be called “policy-framing” of the payday lending problem.

5:3 Case Law Involving Sec. 347

The contribution of courts to this policy-framing exercise came about principally through their application of Sec. 347 of the Criminal Code to contract and tort cases involving payday loan companies. That courts should have played this role is somewhat surprising given that for the first two decades after its passage jurisprudence on Sec. 347 had been modest and largely restrained despite the dire warnings of many legal academics and practitioners that this misguided law would implicate too many perfectly acceptable commercial practices (see Ziegel 1985-86; Antle 1994, Nicholls 2000). During this period courts had generally concluded that unless an agreement expressly required a borrower to pay a rate of interest above 60%, there would be no finding of an illegal transaction. This narrow application of Sec. 347 was modified in two simultaneous judgments handed down by the Supreme Court of Canada in 1998: *Degelder Construction Co. v. Dancorp Developments Ltd.* and *Garland v. Consumers' Gas Co.* The *Degelder* case revolved around the terms of a construction second mortgage. The appellant had

claimed that the various fees and bonuses charged by the respondent trust company in addition to its interest rate charges, if calculated over the time period of the contract, amounted to payments of interest at a criminal rate contrary to Sec. 347. The complicating factor in this case was that although the contract had stipulated repayment over an eleven month span, the loan was in fact not repaid for more than three years. What the court had to decide was whether the interest calculation should be made according to the express time period found in the language of the contract (which would have yielded a criminal rate of 75%), or be based on the actual period of repayment (which would have meant an effective interest rate of less than 20%). The court chose the latter interpretation giving rise to the “wait and see” approach to a judicial determination of criminal interest charges in which the legality of a loan agreement would be determined by the actual payments made as well as the circumstances under which they were made.

While the court in *Degelder* had left intact the contested loan agreement, insisting only that Sec. 347 must be read in a flexible and expansive manner, its judgment in the companion *Garland* case showed just how powerful a legal tool that Section could be as a protection against immoderate credit charges. In *Garland* the respondent, Consumers’ Gas Company (presently Enbridge), faced a class action lawsuit in which the principal claim was that its late payment penalty constituted interest under Sec. 347, and when calculated on an annualized basis, exceeded the 60% legal limit if the payment was made shortly after the due date of the bill. Consumers’ Gas had argued that the late payment penalty could not be construed as interest because it was a charge designed to discourage customers from paying their bills late. Moreover, it was a charge approved by the Ontario Energy Board which regulates utility pricing in the province. While successful with this line of argument at the trial and appeal level, Consumers’ failed to convince the Supreme Court that its late payment penalty was not an interest charge.

Using the same flexible and expansive approach to Sec. 347 it had advocated in *Degelder*, the majority of the court contended that allowing the deferment of a utility bill payment past the due date amounts to advancing credit to the customer, and that the late payment penalty is in the circumstances an interest charge on that credit advance. To drive home the point that Sec. 347 prohibits usurious practices extensively, the majority emphasized the objective of the legislation:

The broad language of s. 347 was presumably intended (as it was in the *Small Loans Act*) to prevent creditors from avoiding the statute simply by manipulating the form of payment exacted from their debtors -- a practice which has historically undermined the effectiveness of anti-usury laws applying a strict definition of interest....It is the substance, and not merely the form, of a charge or expense which determines whether it is governed by s. 347. (*Garland* at para. 28).

And to underscore just how all-embracing a concept of interest was contemplated in the Act, the court inferred from its precise wording a general Parliamentary intent to capture a wide range of commercial practices:

As noted, Parliament expressly expanded the meaning of interest under s. 347 to include one-time charges, whether payable at the outset of a transaction (e.g., fees and commissions) or after repayment is due (e.g., fines and penalties) (*Ibid* at para. 29).

While *Degelder* and *Garland* opened the door to more substantive-based review of loan arrangements, and a more expansive definition of what constitutes interest, the “wait and see” approach these cases endorsed meant that it would be difficult to generalize the circumstances in which courts might find a breach of Sec. 347. Compounding this difficulty is the fact that courts have also established several different remedies for such a breach. At one extreme is a declaration that the terms of a contract found to violate Sec. 347 are entirely unenforceable as a matter of public policy. More commonly, however, courts have tended to employ the doctrine of severance—that is, distinguishing the legal from the illegal portions of a contract and enforcing only the former. Different methodologies have been used to accomplish such severance. For

example, some justices prefer what has been called the “blue pencil” test whereby those parts of a contract deemed illegal under Sec. 347 are struck out of the document leaving intact only those portions which satisfy the test of legality. A simpler method still is to allow the collection of all interest payments in a contract up to the 60% limit, but compelling the lender to forego any amounts in excess of that figure. Finally, and in the opposite direction, some justices refuse to distinguish between legal and illegal components of a loan agreement and rule that lenders who have breached Sec. 347 are entitled only to recover their principal. The distinguishing principle among these several remedies is the degree to which judges are inclined to try to salvage the original intent of the contracting parties after severing those parts of the agreement that offend the law.

The variability of these remedies, and the underlying differences in judicial temper they reflect, are important to note because in the case of payday loan cases involving Sec. 347 a noticeable pattern begins to emerge by the mid-2000’s—a pattern that suggested an increasing convergence in judicial attitudes towards payday lending throughout the country. Generally, there have been two different scenarios in which Sec. 347 has been invoked in civil cases involving payday lenders: breach of contract cases where payday lenders attempt to collect on defaulted loans, and class action lawsuits undertaken by borrowers who argue in court that the terms of their loan agreements involve a criminal interest rate. In many ways the breach of contract cases present the more interesting scenario because often these are cases where judges themselves construct defenses on behalf of defendants. An example of such judicial activism can be seen in *Dean’s Cash Connection Ltd. v. Nelson-Wiger* (2001) where the payday lending company had sought a court order to recover monies lent (\$100) together with fees (\$25), NSF charges (\$75) legal costs (\$160) plus accumulated interest at a rate of 24% per annum. The

defendant, Nelson-Wiger, disputed the interest charges and legal costs on grounds that he had become unemployed after taking the loan and had offered the plaintiff a payment schedule only to be rebuffed. Justice Ingram who heard this case observed that but for the defendant's notice of dispute, this case would have led to a summary judgment in favour of the plaintiff in the amount claimed. Moreover, while this fortuitous notice of claim itself may have been ill-conceived, once appraised of the facts of the case, Justice Ingram applied the relevant parts of Sec. 347 to the agreement and concluded that the \$25 fee constituted an illegal interest charge as per the *Garland* finding. He accordingly severed both the fee and the accrued interest from the loan agreement. And as for the NSF charge and legal costs, the Justice declared that they were unreasonable according to criteria set out in Alberta's Fair Trading Act and likewise excised them from the claim. The upshot of this case was that the payday lender was awarded only the sum of the original loan repayable over a period more conducive to the circumstances of the borrower.

Another early case, *Cash Store v. Lajoie (2002)*, again reveals a willingness on the part of the same Justice Ingram to play an advocate role. This case arose when the plaintiff, Cash Store, sought to recover on a defaulted payday loan taken out by the defendant, Barb Lajoie. Lajoie's initial loan of \$400 was renewed several times by Cash Store, and over a period of several months she paid a total of \$691.81 to the lender without having her principal reduced. In court Cash Store made a claim for an additional \$657 from Lajoie, a sum which included the principal of the original loan plus NSF charges and "administration costs." Lajoie's response to this claim was contained in a "dispute note" filed with the court in which she asked for more time to pay and complained of a privacy breach on the part of the plaintiff. Without a direct defense against the claim by Cash Store, the case ordinarily would have gone to a default

judgment. But in this instance, Justice Ingram allowed that the self-represented defendant was not sophisticated enough to raise an effective defense and affirmed that in these circumstances justice requires the court itself to raise such a defense. Accordingly, Justice Ingram reviewed the details of the loan agreements. What he found was a host of problematic terms. Because Cash Store has pursued the broker model of payday loan provisioning, the contract stipulated that Cash Store had been appointed Lajoie's agent assisting her in obtaining a loan from a third party provider—Advance Finance. By configuring the resulting payday loan as a loan broker transaction, Cash Store had hoped to escape the reach of Sec. 347 through the expedient of distributing the various fees and charges among two legally distinct entities. Other parts of the contract revealed just how severe were its terms of exchange. For instance, although Cash Store had already obtained from Lajoie as part of her application her address, SIN, driver's licence number, health care number, employment information, banking details and five references, the contract stated that if any of the provided information proved to be incorrect then the third party loan provider could continue to recover the debt even if Lajoie had filed for bankruptcy. Punitive as well were the terms regarding NSF cheques which included a \$50 fee for each failed cheque payment. To cover the loan provider's risk still further, the agreement provided to that party a security interest in all of Lajoie's "present and other acquired personal property and proceeds therefrom including without limitation the vehicle as described in Schedule A" (*Lajoie* 2002, 3). Finally, the contract contained a "Direction to Pay" clause which stated that any wages, salaries, commissions or other monies earned by Lajoie from her present or any future employer up to the sum of her outstanding loan and assorted charges were irrevocably assigned to her loan provider.

After examining these questionable contractual details and the payment history to date, Justice Ingram concluded that interest on the loan which contained such items as a broker's fee

and administration costs amounted to 800% when calculated on an annual basis. As such, not only did Cash Store's overall fees violate Sec. 347 of the Criminal Code, but also several of them were illegal under Alberta's Fair Trading Act. In addition, the charges for the loan were unconscionable under the provincial Unconscionable Transactions Relief Act. In the face of such a wide-ranging indictment one might have expected the Justice to exact a harsh penalty from Cash Store. Instead he only denied the company its claim on the default, allowing it to keep the moneys it had thus far collected from Lajoie instead of ordering that sum to be returned. In his concluding remarks Justice Ingram explained the reason for refusing to issue a drastic penalty:

The court, in my view, should not, however, base its decision on the theory that the Plaintiff is a gouging loanshark to be put in its place. It may be in the best interest of society to have firms who are prepared to loan very small amounts of money for very short periods to people in need of such loans. It may further be that in order for such lenders to carry on there are minimum charges that must be charged to make such business viable. It is conceivable that the Criminal Code provision would prevent such businesses from operating (*Lajoie* 14).

Significantly, Justice Ingram's judicial note in *Lajoie* about the social desirability of payday lenders matched the very premise that underlay the political consultative process among federal and provincial government officials, payday lenders and consumer groups which had commenced that same year with a statement of purpose beginning with the instruction: "The consistent message from stakeholders has been to address the undesirable practices within this industry in a manner that allows its continued existence. Provincial / Territorial (P/T) governments agree with this approach" (ACCM Working Group Consumer Measures Committee 2002). So it would seem, according to Justice Ingram's finding, that the courts had heard this message.

But if *Lajoie* signified continuity between the judicial and the legislative policy discourse on payday lending, another case also decided in 2002, *C.A.P.S. International Inc. v. Kotello*,

represented a marked divergence in approach. In *Kotelko* the issues again were whether fees and other charges attached to a small short term loan constituted interest and whether the interest so calculated contravened the limit set in Sec 347. C.A.P.S. International was a Winnipeg-based auto sales and short term loan business with a relatively small customer base. Its loans typically consisted of sums under \$2,000 with repayment terms of three to six months. Kotelko entered into an agreement with C.A.P.S. for a \$1,200 loan, signing a promissory note with a six month repayment term. The promissory note indicated an interest rate of 3.9% a month together with an administration fee of \$275. As well, there were extra charges on default, including \$10 daily for extensions of time to pay and a \$45.00 fee on any "NSF" cheques. Finally, the note specified two cars owned by Kotelko as collateral for the loan and made provisions for extra costs in the event these cars were to be seized for non-payment of the loan. Kotelko provided a series of post-dated cheques to cover his payments but all were dishonoured. He eventually succeeded in making a total of \$440 in payments before C.A.P.S. International decided to go to small claims court to recover the balance of the loan including pre- and post-judgment interest at the rate of 3.9% a month.

Just as in *Lajoie*, the presiding judge in *Kotelko* had little difficulty in finding that charges levied by C.A.P.S. International on their loan to Mr. Kotelko constituted a breach of the Criminal Code as well as offending several provincial consumer protection statutes. Justice Hamilton was adamant that not only was there a formal breach of the law, but that it was a breach directed at an incontestably weaker party:

The charging of a criminal interest rate is not a technicality. It is illegal and demands close scrutiny by the courts. This is particularly so when the plaintiff is in the business of making short term small loans to unsophisticated customers. I say unsophisticated because, although no evidence was lead specifically on this

point, it is reasonable to infer that customers of such loans are not sophisticated borrowers (*Kotelko* 2002, 15)

Justice Hamilton departed from his Alberta counterpart not only in the solicitude he showed to the borrower, but also in the in the remedy he ordered. Finding Kotelko to be unsophisticated, in a difficult financial situation and bereft of legal counsel, all of which conspired to have him unwittingly commit to a loan agreement that contained a criminal interest rate, Justice Hamilton viewed with some hostility C.A.P.S. International's claim for recovery. After carefully reviewing the various severance options which other courts had employed in similar cases he chose instead to deny the whole of the plaintiff's claim, effectively making the defaulted loan uncollectible by refusing to grant a judicial order to enforce any part of the promissory note. Justice Hamilton's rationale for this severe remedy was notable for its understanding of the court's responsibilities in enforcing contracts tainted by criminal illegality:

The public policy objective of s. 347 is to protect the public from loans such as this. While I will refrain from describing this loan as "loan-sharking", it is usurious.... I concluded that the plaintiff is not entitled to the court's assistance in any way to enforce the promissory note. In coming to that conclusion, I was mindful of the fact that there is still some principal outstanding under the loan and that if the defendant chooses not to repay the principal voluntarily, he will have a windfall and be unjustly enriched. But, in the circumstances of this case, the public policy need for a strong and clear message that courts will not assist lenders in the business of loaning short-term money at criminal interest rates to unsophisticated customers far outweighs the public policy concern of unjustly enriching a person by not granting judgment for repayment of [the principal] (*Kotello* 2002, 16)

Where *Lavoie* and *Kotelko* focused mainly on how to apprehend what constitutes interest for purposes of Sec. 347, another case from this same period, *Affordable Payday Loans v. Harrison* (2002), also broached the controversial issue of loan rollovers. The case is complicated because while the plaintiff, Affordable Payday Loans, commenced the action for recovery of two unpaid loans and accrued interest and other charges for a total of \$488, the defendant, Harrison,

counterclaimed for money paid to the plaintiff for other loans on the basis that the parties' loan agreement contravened the criminal interest provisions of Sec. 347. In sorting out these conflicting claims, Justice Donnelly followed the practice established in *Dean's Cash Connection* and severed what he deemed to be the illegal portion of the Affordable's interest claim, awarding only the outstanding loan amount of \$300 and permissible interest charge of \$25. But at the same time the Justice allowed the counterclaim that a series of previous loans which Affordable induced Harrison to rollover yielded a criminal interest rate and awarded the defendant a judgment in the amount of \$2003.28. Even after further awarding the plaintiff an additional \$100 for court costs in light of the defendant's failure to attend a scheduled mediation meeting, Affordable Payday Loans still ended up having to pay Harrison the difference between the two awards which amounted to \$1578.28. The strict accounting which Justice Donnelly employed in reaching this sum reflected a willingness to apply the wording of Sec. 347 to every financial aspect of a payday loan agreement including that which arises from rollovers.

While it is not uncommon for differences to emerge amongst different provincial courts in their findings and in their penalties in similar civil law cases, the divergence between the approaches of Justices Ingram, Hamilton and Donnelly gained significance as the political policy process inaugurated by the 2002 consultative meetings began to drag on and prospects of Parliament introducing legislation to regulate payday lending began to recede. It was precisely as the political momentum for policy-formulation stalled that more and more breach of contract cases involving payday loans flooded the courts, and more ominously for payday lenders, class action lawsuits against them began to be successfully certified. Speaking of these developments, lawyer and consumer advocate Sue Lott stated: "The industry is scared to death of these class-action lawsuits. There's a huge amount of money at stake" (Lott as quoted in Clarke 2008).

In these circumstances, the question as to which approach courts would be inclined to adopt in payday loan cases became more weighty because the answer would for all intents and purposes be policy.

Which direction did the courts follow in the period between 2002 and 2007 when Parliament did finally pass Bill C-26 inaugurating a new regulatory regime for payday lending? While the record is mixed the general tendency has been for courts to take a more forceful approach to payday lenders along the lines enunciated by Justice Hamilton in *Kotelko*. For example, in *Stop 'N' Cash 1450 v. Box*, Justice House of the Ontario Superior Court of Justice consolidated twenty-six separate claims for recovery on defaulted loans brought by the payday lending company, Stop 'N' Cash, and issued a ruling on the basis of a representative action between the firm and the borrower Stephen Box. In his ruling Justice House found that Stop 'N' Cash "in all of these actions has displayed an organized deceptive pattern designed to exploit the vulnerable" (*Stop 'N' Cash 2005* at para.25). With this emphasis on the unequal bargaining power between the payday loan company and its unsophisticated clients, Justice House explicitly declined to follow precedents establishing as the appropriate penalty a notional form of severance which would enforce interest payments up to the legal limit. He chose instead to order only the repayment of the principal and a nominal fee for court costs, adding that the deceptive practices of the payday loan company were sufficiently grievous that he planned to forward copies of the judgment to the Ministry of Consumer and Corporate Affairs and the office of the Attorney General to allow those ministries to review the conduct of Stop n Cash and determine whether further action was warranted.

While Justice House offered a stern rebuke of the deceptive contractual language employed by Stop 'N' Cash, he was still not willing to overturn that contract in its entirety. A

less considerate attitude to contractual obligations was in evidence in *Diamond Placement and Financial Services v. Briggs* (2009) and *Diamond Placement and Financial Services v. Erasmus* (2009). In these two consolidated cases heard respectively before Justice Gorin and Justice Schmaltz of the Territorial Court of the Northwest Territories, the claims for judgment on several defaulted payday loans were summarily dismissed on grounds that the loans were tainted by illegality because their terms violated Sec. 347 and for that reason the contracts were unenforceable by the court.

A final example of a growing judicial disposition to treat the contractual claims of payday loan companies with skepticism bordering on contempt can be seen in a recent case from the Small Claims Court of Nova Scotia where the Adjudicator, W. Augustus Richardson, QC, prefaced his judgment with the observation: “The working poor are poor in part because their income cannot keep ahead of their expenses—and in part because the fragility of their finances shackles them to debt. Their lives are full of stories of cases where debt has become a form of indentured servitude from which they cannot escape” (*Easyfinancial Services v. Billard* 2010 at para. 1). Continuing in this vein he proceeded to analyze critically the terms of the plaintiff’s loan, concluding not only that it ran afoul of both the provincial Consumers’ Protection Act and Sec. 347 of the Criminal Code, but that the plaintiff failed to clearly disclose the outstanding principal on its loan. For these reasons Arbitrator held that no further action could be taken against the borrower and dismissed the plaintiff’s claim.

If courts were gradually more doubtful venues for the recovery of defaulted loans in the period under discussion, they also were increasingly becoming the site of a more ominous threat to payday loan companies as more and more class action law suits began to be launched by disaffected borrowers. A loss in a contract case at worst meant foregoing on the collection of

outstanding debt in a disputed claim (or even dozens of claims if they had been consolidated by the court.) But a loss in a class action suit was potentially much more expensive for payday loan companies because in such tort cases a successful claim for restitution for a wrong could be prohibitive if the class of complainants were large enough. By 2005 there were more than half a dozen class action law suits at various stages of consideration in several provinces in Canada. The first to be decided on its merits in a court of law was a relatively small B.C case, *Kilroy v. A OK Payday Loans Inc.* (2007). In that case the court found that A OK's processing and late fees amounted to interest, that the sum total of the interest it charged on its loans contravened Sec. 347 of the Criminal Code, and that it would be unjust for A OK to enrich itself by retaining the unlawful fees. While restitution for this class was estimated at a relatively low sum of several million dollars, subsequent class action law suits against larger payday loan companies like Cash Store Financial and Money Mart attracted settlements of much greater magnitudes. The pattern in these class action law suits after A OK has been for the defendants initially to mount a strenuous defense, but eventually agree to a settlement. The largest of these settlements to date has been the Ontario case, *Smith Estate v. National Money Mart Company*, where the final settlement was estimated by class counsel to be in the range of \$120 million. The history of this case is worth considering because it illustrates issues common to virtually all class action law suits involving payday lending companies.

The Ontario class action lawsuit was commenced against National Money Mart and its parent, Dollar Financial Group Inc. in 2003 with two representative plaintiffs, Margaret Smith and Ronald Oriet, claiming that the charges on payday loans or fast cash advances made by National Money Mart Company breached section 347 of the Criminal Code of Canada.

Approximately 210,000 individuals eventually joined the class. The plaintiffs originally expected

the monetary value of their claim would exceed \$500,000,000, including pre-judgment interest. Mr. Oriet's dealings with Money Mart were offered as an illustration of the dispute. On January 14, 2004 Mr. Oriet had taken out a \$100 loan from Money Mart for which he presented a postdated cheque in the amount of \$119.18 dated nine days after the loan. That cheque was cashed by Money Mart on January 23. The \$19.18 for the nine day loan was made up of the following components: a finance charge of 59.9% per annum for a total of \$1.14, a \$5.05 cheque-cashing fee, plus an item fee of \$12.99. If all three components of the overall charge were to be considered interest, the effective annual interest rate would be 123,060.2% (*Smith Estate v. National Money Mart 2010* at para. 38). Money Mart not only contested the characterization of these various ancillary charges as interest, but vigorously opposed the certification of the class in the first place, and generally used every legal maneuver available to it to fight the case. One result of the various pleadings Money Mart was able to mount was that Margaret Smith, the lead plaintiff for the class died before the actual case was heard, although it continued to proceed in the name of her estate. Commenting on the length of time it took to resolve the case, Justice Perell, the judge who approved the final settlement, observed with some consternation:

It is to do injustice to the notion of understatement to say that Mr. Smith's and Mr. Oriet's class proceeding has been hard fought. There have been many interlocutory motions and many appeals. Among other things, there were two motions to stay the action, a certification motion, a decertification motion, and a motion for summary judgment. Many issues were litigated, and some were re-litigated. There was one leave application to the Divisional Court, four appeals to the Court of Appeal, and three leave applications to the Supreme Court of Canada. There were 39 orders, 12 endorsements, and 4 judgments. Eventually, the action was called to trial in April 2009, and there were 17 days of trial before Justice Spies (*Ibid.* at para. 11).

One of the principal legal arguments Money Mart employed to avert going to trial over the substance of the class claim was to underline the fact that all their contracts contained an arbitration clause devised to settle disputes out of court. In response to a request to stay proceedings on this basis, the motions judge, Justice Macdonald, ruled against Money Mart, reasoning that “the broad wording of Money Mart’s arbitration clause was an attempt to immunize itself from the Class Proceedings Act and more generally the jurisdiction of the Superior Court” (*Smith v. National Money Mart Company* 2005 at para.4). Although the class action was finally certified in 2007, Money Mart again tried to stop proceedings in 2008 with a similar argument based on the supposed contractual obligation of their customers to resolve disputes through arbitration. This time around there seemed to be much stronger legal support for this argument because shortly after the case against Money Mart had been certified the Supreme Court of Canada ruled in *Dell Computer Corp. v. Union des consommateurs* and *Rogers Wireless Inc. v. Muroff* that arbitration clauses in the contracts under review precluded the commencement of class action law suits. However Money Mart again failed in its legal argument as Justice Sharpe declined to apply the Supreme Court ruling, relying instead on the legal doctrine of issue estoppel²² to hold that the question of the enforceability of the arbitration clause was too closely tied up to the other issues in the case that had already been decided in the proceedings on the motion to certify the class. In making this ruling Justice Sharpe expressed some sober judicial realism in observing that arbitrating such small claims as were typical of the class of plaintiffs would be financially unfeasible and hence:

It is almost certainly the case that a stay would defeat the claims subject to arbitration clauses, not on the merits but for reasons of practicality. Enforcing the

²² Issue estoppel refers to an issue that has previously been litigated and determined between the same parties or their predecessors.

arbitration clauses would not lead to arbitration but would immunize the appellants from any claims. This is hardly a compelling case for the exercise of judicial discretion (*Smith Estate v. National Money Mart Company 2008* at para. 50).

Once Money Mart's legal attempts to stay proceedings were foreclosed, a trial did finally begin in 2009. Midtrial mediation sessions presided over by former Supreme Court Justice Frank Iacobucci succeeded in generating a settlement, albeit one that was controversial. The settlement had five components: (1) a \$27.5 million cash payment in installments by the Defendants; (2) \$56,388,071 debt forgiveness by the Defendants; (3) \$30 million in transaction credits provided by Money Mart; (4) a \$3 million payment to Class Proceedings Fund; and (5) \$2 million in administrative costs (*Ibid.* at para.13). When the settlement was submitted to Justice Perell of the Ontario Superior Court of Justice for approval, class counsel also requested that their fees of \$27.5 million be granted!

In his lengthy commentary on the settlement, Justice Perell voiced several reservations about the way in which the agreement was structured. For instance, the settlement proposed that the class of plaintiffs be divided into two groups according to whether they still had outstanding debt to Money Mart. The class members who did would be designated as part of the Debt Forgiveness Group and have their indebtedness to Money Mart in the total amount of \$56,388,071 released. Those who no longer had any outstanding debt owed to Money Mart would become members of the Transaction Credit Group and would receive both pro-rated shares of the \$30 million worth of \$5 transaction credits set aside in the agreement, and a pro-rated share of cash from what is left (if anything) after the payment of class counsel's fee from the agreed-upon

installment payments of \$27.5 million. Neither of these provisions, Justice Perell contended, was ideal. Members who would receive transaction credits were merely being invited to take out more payday loans—an outcome rather more favourable to the defendant than the plaintiffs:

The transaction credits that members of the Transaction Credit Group will receive can be characterized as a business promotion scheme under which Money Mart discounts its price and makes less profit from a profitable transaction, but Money Mart obtains business it would otherwise not have obtained. In lauding the virtues of the settlement, the Plaintiffs and Class Counsel extol the fact that it is anticipated that Money Mart's competitors are likely to honour the transaction credits. This just demonstrates that the transaction credits are a business promotion for more payday loans. It is hard to paint this as a success for the mission of this class proceeding. (*Smith Estate v. National Money Mart* 2010 at para. 96).

As for those who were scheduled to have their debts released in the amount of \$56,388,071, Justice Perell pointed out that the real costs to Money Mart of this concession were highly inflated:

...releasing bad debts that have already been written off and that may in any event have been uneconomic to recover (given their small value and the expense of collection) is not to incur any financial hardship from the settlement. Rather, it is a normal cost and risk of Money Mart's small loans business (*Ibid.* at para. 97).

Despite his misgivings about the wisdom of these agreement conditions, Justice Perell reluctantly approved the settlement because he agreed with the class counsel that there were compelling circumstances obliging a settlement of the sort that was finally reached. The first of these was the passage of Bill C-26 in 2007 which devolved to the provinces regulatory authority over payday lending. The subsequent passage of the *Payday Lending Act* by the Government of Ontario in 2008 (see chapter six) and its proclamation in 2009 meant in that province certain lending practices of Money Mart that might previously have been illegal under Sec. 347 were now licit. In this regard Justice Perell wryly noted that “the example chosen by the Plaintiffs of

Mr. Oriet's \$100 loan, \$19.18 charge, and alleged interest rate of 123,060.2% is apparently now legal in the Province of Ontario and indeed Money Mart can charge Mr. Oriet an additional \$2" (*Ibid.* at para. 55). These legislative developments, it was noted, helped create an environment conducive to a settlement because the plaintiffs came to realize that the new law would limit their prospective claims while Money Mart recognized that it would serve to curb the size of an adverse judgment.

The second circumstance impelling a settlement was evidence Money Mart supplied in court to the effect that if an award of \$150 million that plaintiffs had come to expect from a favourable judgment were in fact granted, it would set off a financial default on the part of Money Mart's parent company, Dollar Financial. Because the latter company had extensive loan obligations of its own at the time, any sizeable judgment against Money Mart would force Dollar Financial to file for bankruptcy in the United States while Money Mart itself would be compelled to seek relief under the Companies' Creditors Arrangement Act. And because the holders of Dollar Financial's debt were secured creditors, they would have first claims on the assets of the bankrupt firm, leaving any court award to the plaintiffs in the Ontario class action law suit practically uncollectible. Justice Perell agreed with the class counsel that in this scenario any attempt to pursue the original monetary claim could only yield a Pyrrhic victory for class members and grudgingly accepted the need to structure an agreement in a way that would not trigger a default on Dollar Financial's loan obligations.

While Justice Perell approved the particulars of the settlement for the reasons alluded to above, he stopped short of granting class counsel its requested fees of \$27.5 million. In his remarks on this matter of fees, Justice Perell was particularly critical of the behavior of class counsel. For example, he expressed incredulity that class counsel would even contemplate selling

a claim to the expected award in the case to a bank or hedge fund, or even of selling such a claim to Money Mart in exchange for equity in a reorganized firm! He saved his most scathing comments, however, for class counsel's argument that they were entitled to \$27.5 million in fees on grounds that anything less would discourage other lawyers from assuming the risks to pursue legitimate class action cases on a contingency fee basis. Justice Perell averred that this was a self-serving argument made more implausible by the fact that class counsel's estimate of the value of the settlement at \$120 million on which they calculated their own fees was a gross exaggeration of the true worth of Money Mart's financial obligations in the agreement. Chiding class counsel for "their not bargain-basement hourly rates", Justice Perell settled on a final all-inclusive award of \$14.5 million to class counsel, which would only leave \$13 million of the cash settlement agreed to by Money Mart to be distributed among members of the Transaction Credit Group. While claiming this to be an improvement over the terms of the original settlement, Justice Perell was under no illusion about the overall impact of the case:

It was interesting and informative to note that, unlike most settlement approval and certification motions, there was not a peep about behaviour modification, and there was little about access to justice in the Plaintiffs' motion material.... And it would seem that there is no behaviour modification in this class action. Under the new regulations [contained in the 2009 Ontario Payday Lending Act—see chapter 6] Money Mart may continue its business more or less as it has done in the past. I express no view whatsoever about the propriety or social value of MoneyMart's payday loan business, but for the members of the Transaction Credit group, if they are to obtain a benefit under this settlement it is by abandoning the original purposes of this class action, which was to enjoin, not encourage, payday loans pricing policies. Once again, it is hard to paint this as a success for the mission of this class proceeding (*Ibid.* at para. 98-99).

What is notable about the *Smith Estate v. National Money Mart* settlement, aside from the obvious guile displayed by class counsel, is the way in which the financial component of the agreement was devised so that loan forgiveness and credit vouchers made up the greatest part of

the payday company's monetary obligation. This was a pattern that was repeated in another class action lawsuit in B.C., *Tracy (Representative ad litem of) v. Instalogs Financial Solution Centres (2009)*, where a \$14 million award was split between cash and vouchers. Because payday loan companies have been able to gain the benefit of business promotion through credit vouchers and accounting losses from agreed-upon loan forgiveness, their losses in class action lawsuits have been less onerous than might at first sight appear. On the other hand, as even the skeptical Justice Perell was led to admit, the settlement in *Smith Estate v. National Money Mart* did represent a real outlay for the payday company even if it was less than the nominal sum attributed to it. Given that there were more and more class action law suits being certified by the mid 2000s, and given the line of precedents in payday loan contract cases favouring borrowers over lenders, it is small wonder that the Canadian Payday Loan Association had quickly abandoned its push for a strictly self-regulated industry and began by 2004 to lobby for provincial regulation. It is in this change of lobbying tactics that the court's influence on policy formulation can most clearly be ascertained. That influence, it needs be stressed, was exercised during a period between the first appearance of payday lending in Canada in the mid 1990s until 2007 when the industry was largely left unregulated. In this regulatory void the fledgling payday loan association tried to steer the policy discourse towards an acceptance of self-regulation, changing course much to the consternation of some of its members when successive unfavourable court decisions made it clear to the majority of payday loan companies that judicial findings in contract and tort law incorporating Sec. 347 of the Criminal Code threatened their commercial viability to some degree. Courts in this way inadvertently forced the hand of the Canadian Payday Loan Association, inducing it to pursue a political solution to industry regulation.

If court findings in contract and tort law were one of the proximate causes of the push for the legislative overhaul of Sec. 347 giving to the provinces regulatory control over payday lending, what does this episode say about regulation through litigation? One of the obvious lessons to be drawn from this experience is that courts do de facto become arenas of policy-making when political and administrative bodies fail to regulate commercial activities for which there is prima facie evidence of the occurrence of harm. Second, and equally obvious, political policy-making was seen by at least one of the players in this drama as a way of escaping an increasingly costly judicial policy-making. But what of the other players—the payday loan borrowers whose interests the courts increasingly seemed to champion. Have they been ill-served by this policy transference to the political arena—a transference that on the face of it seems to have been primarily motivated by a desire to free payday loan companies from the policy restraints imposed upon them by successive court rulings? This latter question raises the issue of efficacy—that is, are courts really efficacious agents of policy-making? At best one can say that the evidence in the case of payday loans is mixed. In contract law cases it is true that numerous courts issued rulings favouring the borrowers of payday loans, but these findings remained episodic and didn't touch the bulk of payday loan transactions which have never been litigated. As for the large class action law suits, the actual benefits accruing from the settlements have been equivocal. Indeed the tenuous benefits of class action lawsuits are nowhere better illustrated than in the aftermath of the *Garland* decision, which had inaugurated the era of a more expansive application of Sec. 347 to commercial credit arrangements including those of payday lenders. In *Garland* the former Consumer's Gas (now Enbridge) was ordered to pay out a \$22 million settlement for illegal late payment charges. Enbridge subsequently applied to, and in 2008 received permission from, the provincial energy utilities regulator, the Ontario Energy Board, to

impose a special charge on its customers to recover the \$22 million payment as well as other costs and interest charges. As a result of the regulatory ruling all Enbridge residential customers now have to pay a special levy to fund Enbridge's class action settlement! As for the payday loan settlements to date, the companies affected have found their own ways of deriving benefits from the terms of the settlements, all the while working to have laws altered to immunize themselves in the future from such legal entanglements.

Chapter 6

Consensus and Conflict: Strains in Network Governance

6:1 Introduction

With legal mobilization against payday lending a real and mounting threat, the need to find a political instrument to draw its sting became imperative. The option of self-regulation that many in the payday lending industry had preferred was less and less feasible in face of inhospitable courts willing to utilize the normative and legal force of Sec. 347 of the Criminal Code in support of payday loan customers defying their contractual obligations or launching class action suits. And ruled out almost from the start in the network negotiations were policy recommendations from several government organizations, consumer groups and academics to have the state actively encourage or require established commercial banks and credit unions to devise short-term credit instruments for the poor. Finally, a policy option notable for its complete absence in all the discussions on payday lending was the idea of a guaranteed annual income policy, something once mooted in federal circles but long since abandoned in the post-Keynesian era.

The decisive ideological shift away from interventionist government so characteristic of the post-Keynesian regulatory state ended up driving the policy choice in this situation. The logic of choice was straightforward. The growth of the payday lending business indicates a strong consumer demand for the products they provide. Outlawing the business might channel this demand to illegal quarters. Employing coercive state measures to try to force mainstream financial institutions to replicate the existing payday loan industry runs counter to free market

principles, as does pursuing an incomes policy in an effort to minimize the demand for short-term credit. In these circumstances what remains as a policy option is some combination of consumer protection and education measures that would eliminate some of the more conspicuous exploitative practices associated with the industry while providing loan recipients with the information necessary to make informed choices. And given Canada's federal division of responsibilities for consumer protection, it would be necessary for the provinces to take the lead in this latter kind of regulatory initiative.

With the help of political calculations such as these, Bill C-26 was passed and held up as a model of federal-provincial co-operation, though it could just as easily be regarded as an example of the "politics of blame-avoidance" (Weaver 1986). With federal and provincial officials both reluctant to address squarely the social and economic circumstances that contributed to the explosive growth of payday lending in the first instance, the choice of the policy instrument that was Bill C-26 can be seen as a way of side-stepping the policy problem. Indeed, the length of time it took to develop this legislation, and the several false starts that preceded the final bill, suggest that politicians were less than wholeheartedly dedicated to this policy area (Ziegel 2006a).

And when eventually legislation was adopted, its main thrust was to establish a regulatory regime that ostensibly would supply consumers with the wherewithal to make knowledgeable financial decisions. In other words, in what has been named by some as an era of "responsibilization" consistent with the norms of neo-liberalism (Shamir 2008, 2009), the favored technique of governance by state actors increasingly is one where citizens are nominally empowered by some state action and by that token are deemed accountable for their transactions. Notably, this technique of governance has the effect of helping legitimize the object of regulation

by simultaneously conceiving it as socially necessary because its very existence proves a widespread consumer demand, and by shifting responsibility to these same consumers for governing themselves wisely in their consumption decisions. It was precisely this governance mentality which informed the network deliberations that eventuated in Bill C-26, and especially the priority given to the pair of policy concerns regulation was meant to address: “the [ACCWG] is faced with two primary issues: (1) Regulation – how to best foster and ensure an ‘alternative’ credit industry which can provide services to consumers who cannot or do not use traditional sources of financing for their short term credit needs. (2) Education – how to make consumers aware of the relative costs and implications of borrowing in the ACCM [alternative consumer credit market]” (ACCWG 2002, 1).

6:2 Bill C-26: A Policy Instrument that Divides?

The passage of Bill C-26 was not, of course, the final stage in the regulatory saga for the payday loan industry in Canada. In fact, the primary purpose of the bill was to set up the legal mechanism to devolve regulatory authority to the provinces. Under this legislation the 6 % threshold designating an extortionate interest rate was retained in the Criminal Code, but payday loan companies were specifically exempted from criminal prosecution if they limited themselves to small loans of short duration, and provided that they were licensed by provinces that chose to opt into the federally-defined regulatory scheme. Consenting provinces would be authorized by the legislation to act as regulators of the industry if they committed to enact appropriate consumer protection legislation and set limits on the overall costs of payday loans (Bill C-26 *Canada, House of Commons*, 2007). Significantly, Bill C-26 contains only the slightest of

federal conditions that provincial governments must meet to earn the right to be designated as the regulatory authority responsible for payday lenders, requiring only that they have unspecified consumer protections in place for recipients of payday loans, and that they provide for limits, again unspecified, on the total costs of borrowing.

In its press releases the Canadian Payday Loan Association (CPLA) enthused over the new legislation, claiming that it “has been working close (sic) with governments for three years to secure regulation that balances consumer protection with a viable, competitive industry” (Keyes 2007a, 1). Clearly Bill C-26 conferred certain advantages on this industry, for the legislation appeared to have solved the “regulation through litigation” problem confronting payday lenders by removing their activities from the purview of Sec. 347 once provincial regulatory schemes were established. But testimony presented at the Standing Senate Committee on Banking, Trade and Commerce during its study of Bill C-26 reveals that the CPLA’s endorsement of the legislation had a very complicated provenance. Indeed, the barely disguised acrimony that surfaced in the Senate hearings when competing industry representatives testified on the merits of Bill C-26 set out in sharp relief the divisions that would perturb the subsequent regulatory process. The episode bears closer examination not only because it highlights the severity of the rift in the payday industry, and hence the impediments the industry faced in the consensus-building exercise upon which network governance relies, but also because it shows the conceptual terrain upon which the disagreement was fought, and which both sides would come to rely upon to try to contain the damage their fight had raised for the legitimacy of the industry as a whole.

What also made the Senate Committee hearings informative about the regulatory process is that the founding president of the CPLA and his two successors all gave testimony to the

Committee, albeit from distinctly different perspectives. Their career trajectories, it is worth noting, are conspicuous demonstrations of the three legitimation strategies which Suchman has suggested organizations from time to time are compelled to undertake. The founding president of the CPLA, Robert Whitelaw, was a former president and CEO of the Canadian Council of Better Business Bureaus. His tenure with CPLA exemplified the reputational strategy²³ which the payday industry pursued in its initial dealings with government. For who better than a former head of the Better Business Bureau to promote the fledgling payday loan industry association as an organization concerned with consumer protection, and capable of governing itself for that end through its own self-regulatory mechanism? In Suchman's terms, this figure embodied the moral and cognitive approaches to gaining legitimacy. But once self-regulation was ruled out by state officials a different kind of legitimation strategy was called for—what Suchman calls pragmatic legitimacy—which involves bargaining over the details of regulation in a political environment. Not surprisingly, the two succeeding presidents came from the political world, the first, Robert Thompson, a one-time aide to a former Deputy Prime Minister, and the second, Stan Keyes, an ex-Member of Parliament of long standing

In the Senate Committee hearings, it was this latter president of the CPLA who exhibited a more antagonistic attitude to firms that disagreed with the Association's political strategy, establishing a confrontational tone that would come to characterize all subsequent provincial regulatory consultations over payday lending. For instance, in an opening statement, after commending his own industry association for its commitment to consumer protection and endorsing Bill-C-26 in its entirety, he immediately launched a pre-emptive attack on Cash Store

²³ On the issue of managing reputational risk, see Power et al (2002-03).

Financial and its opposition to details of the legislation. According to the president of the CPLA, Cash Store Financial's concerns with Bill C-26 were motivated not by principles but by avarice:

[Cash Store Financial] is not worried about market competition or monopolies. They are worried about rate caps that prohibit \$30, \$40 or \$50 for a loan. It is profit instead of consumer protection. When the rest of the industry charges in the high teens and the low- to mid-\$20s, I say we must protect consumers from companies that will gouge them with high fees. That is the whole point of regulating the industry, to protect the consumer. (Keyes 2007b, 25)

Cash Store Financial's representative was the very same Michael Thompson who had been the immediate past-president of the CPLA. He focused his testimony on the changes to Bill C-26 his company sought. Paradoxically, given his former role as president of the CPLA during a time that the association pressed for provincial regulatory authority over payday lending, he now urged an amendment that would re-establish a greater measure of federal hegemony over the regulatory process. Specifically, Cash Store Financial wanted a change in the wording of Bill C-26 which would retain for the federal government more power in deciding whether a provincial government should be designated as the regulator of the industry within its jurisdiction. The purpose of reinvesting the federal government with this authority, the Cash Store Financial representative argued, was to ensure that a province would not "come up with a rate structure that would exclude a large chunk of the industry" (Thompson 2007, 43). Left unsaid but implied by his subsequent account of the make-up of the CPLA was the apprehension that granting exclusive control over rate-setting to the provinces would furnish Money Mart the institutional opportunity to pressure individual provincial governments to set rates low enough to drive out higher cost lenders and thus reinforce its market dominance.

This altercation in the Senate Committee hearings was a straightforward dispute among self-interested economic actors competing for market share and employing competing regulatory

discourses to support their positions. The CPLA, as proxy for Money Mart, elected to use the normative language of consumer protection while Cash Store Financial relied on the normative language of competition to make its case for its preferred rate structure. While the dispute itself was not remarkable, it soon developed in a way that would threaten the overall legitimacy of the industry, and the regulatory apparatus that was being designed in part to secure that legitimacy became its problematic ground.

6:3 Rate-Setting Comes to the Provinces: The Case of Manitoba

What was a skirmish at the tail-end of the parliamentary process that led to the passage of Bill C-26 erupted into a more-or-less open fight in Winnipeg as Manitoba became the first province to seek designation as the authorized regulator of payday lending under the revised section of the Criminal Code, Sec 347.1(3). Although initially hopeful that the federal government would take the lead in directly regulating exorbitant payday lending rates, the social-democratic government in office in Manitoba decided to assume the regulatory control offered by Bill C-26 only after it became apparent that the federal government was not willing to employ more forceful measures under its criminal law power.²⁴ Once the political decision was made to regulate, the Manitoba government introduced changes to its Consumer Protection Act in July, 2007, setting out a licensing procedure for the industry, establishing the requirements for a standardized loan agreement form, obliging payday lenders to post detailed visible signs informing customers of the true costs of the loan, and finally, creating the procedure for deciding on rate caps for payday loans by way of public hearings before the Manitoba Public Utilities

²⁴ Interview with government official, Winnipeg, Manitoba, October, 14, 2008.

Board (PUB). While the first three components of this governance scheme were relatively uncontroversial and in keeping with the regulatory approach endorsed by the participants in the policy-making network, the last proved to be at odds with what had all along been the agreed upon primary regulatory rationale of securing the viability of the payday loan industry. The decision to authorize the Public Utilities Board to set the rate cap for this industry stood out as a uniquely pro-consumer move on the part of the Manitoba government because of the general consumer protection mandate such an arms-length administrative agency enjoys.

Typically a public utilities board is designed to deal with “market imperfections” that arise where so-called natural monopolies thrive and therefore where firms are able to charge at substantially above their costs (Crew and Kleindorfer 1987). In such circumstances, public utility boards are directed to try to calculate a fair rate of return in the absence of a competitive market. The very fact that the Manitoba government gave its PUB the responsibility of setting a rate cap for payday lenders testified to its perception that this industry enjoyed a captive market.²⁵ And the Manitoba Public Utilities Board reinforced this view in its lengthy report at the conclusion of its hearings where it did not hide its distaste for the payday lending industry:

The Board finds it distressing that an increasing and significant number of Manitobans are taking out payday loans, notwithstanding that payday loans, while

²⁵ The only other non-utility regulated in Manitoba by the PUB is the funeral industry.

meeting an immediate need, may only defer and make worse a borrower's financial problem, and are very expensive and don't build a credit rating.... While, as indicated, receiving a payday loan may assist a borrower in meeting an immediate need, there are problems with payday loans, and not the least of these is the very high cost of credit associated with them. The saying *homo homini lupus* (man is a wolf to man), from a play by Plautus and later paraphrased by the philosopher Thomas Hobbes as "Man to Man is an arrant Wolfe".... is suggestive of the situation of too many vulnerable consumers when it comes to payday loans. (PUB 2008, 5)

Entertaining serious reservations about the social value of payday lending, the Manitoba board held protracted hearings which lasted for more than three weeks and produced over five thousand pages of transcripts. The hearings themselves revealed what was by now becoming a familiar aspect of the regulatory process—the increasingly public split between Cash Store Financial and the CPLA as each filed contesting documents to the Board and engaged in adversarial disputations. That discord was most pronounced as each rendered its own prescriptions for an acceptable rate structure. The CPLA recommended a maximum rate of \$23 per \$100 loan plus 88 cents for regulatory costs, arguing that such a fee regime would permit a competitive industry to thrive in Manitoba. Cash Store Financial, for its part, forcefully rejected the CPLA proposal, claiming that it was barely disguised justification for a costing model based on the market power of Money Mart, and if adopted for Manitoba, would in due course lead to the disappearance of all higher priced competitors. Cash Store Financial recommended instead a cap of 37.5% of the loan advance, plus interest, and from 70 cents to \$2.00 as an allowance for regulatory costs. Where both Cash Store Financial and the CPLA were in vigorous agreement was in their view that the Public Utility Board should restrict its mandate to the “primary objective [of] maintaining a viable, competitive loan industry” and abstain from pursuing a social objective, absent from the enabling legislation, “to protect the low income people”(PUB 2008, 200). At least on this point, the most fundamental in the legitimation process underlying the

entire regulatory enterprise, the two payday foes drew back and made common cause against an agency that stood outside the network consensus which had generated Bill C-26.

In rendering its decision on rates, the Manitoba Public Utilities Board surprisingly selected a rate lower than any of the industry interveners recommended--\$17 per \$100 loan, with the further stipulation that social welfare recipients could not be charged more than \$6 per \$100 loan. Despite this lower than hoped for rate level, the CPLA initially announced its acceptance of the decision and declared that its members would abide by it (though shortly thereafter it filed an application with the PUB for reconsideration of the rate resolution.) Cash Store Financial, meanwhile, rejected out of hand the rate ruling and promptly turned to the courts for relief. In this they were successful when the Manitoba Court of Appeal issued a stay to the PUB rate decision early in 2009 on grounds that the Board failed in its mandate to provide a fair pricing formula which would ensure a viable competitive industry. In that ruling, the burden of which was directed at the administrative law question of whether the Utilities Board acted in a way that was *ultra vires* to its legislative directive, Justice MacInnes admonished the PUB for its unwarranted moralism:

In the course of its decision, the PUB on several occasions expressed its view against the morality of payday loans. It expressed an intention to make payday loans less available and less attractive to consumers, even to the point of doing without, because of its moral and social views of such loans. It criticized the government, which it said appears to have “walked away” from the moral responsibility of more adequately protecting the consumers, including a less than robust practice of prosecuting offenders, and it chastised the banking and credit union industry for not making small and low-interest loans to consumers, thus necessitating the advent and increase of payday lenders (*Re The Cash Store Financial Services* at para 47).

Claiming that the PUB’s decision-making was compromised by its normative biases, Justice MacInnes concluded his judgment with an observation in which he simultaneously

asserted and denied that payday loan customers exercise free choice in seeking this type of credit, adding that should this market option no longer be available, an even more constrained choice scenario would ensue:

On the other hand, there was clear evidence before the PUB that many people with other acceptable alternatives choose to use payday lenders at the unregulated rates, and both Canada and Manitoba, in creating the legislative scheme in question, have recognized that there is a societal need for the payday lending industry for a variety of reasons, not the least of which is that for those who use the industry as their best or only alternative (the very people the coalition, the Attorney General and the PUB are most concerned about), the inability to do so would result in their exposure to loan sharks and the criminal world for access to short-term money (*Ibid.* at para. 107).

After this court decision, replete with its own market moralism reinforcing the master narrative that had been used throughout to define the policy options confronting state regulators, the Manitoba government elected not to challenge the ruling and instead removed the rate-setting power for payday lenders from the PUB while promising new legislation that would directly set the rate cap. Having at first lost at the immediate political level in Manitoba, Cash Store Financial was successful in exploiting its legal capital to achieve its policy goals, proving that the policy stage can always be enlarged by those resourceful enough to seek judicial remedies. More importantly, this maneuver seemed to have the effect of reinstating the broad policy consensus which had acted both to legitimate the payday loan industry and establish the policy priorities that regulation was meant to embody.

6:4 The Contest Widens, the Debate Narrows: Rate-Setting in Nova Scotia and Ontario

While the antagonism between Cash Store Financial and the CPLA over equitable regulatory norms which surfaced in the Manitoba Utility Board rate-setting hearings reproduced itself in Nova Scotia when that province began to take up regulatory control of the industry early

in 2008, there was among the contending parties an acute awareness that their business quarrel had to be safely contained. This solidaristic imperative appeared all the more important because, as in Manitoba, Nova Scotia also assigned its public utility board the responsibility for setting rate caps for payday loans. But in stark contrast to the Manitoba hearings, which lasted over three weeks and included testimony from dozens of industry representatives, consumer advocates and public officials, the Nova Scotia Utility and Review Board (NSUARB) conducted only two days of hearings with just a handful of industry and consumer interveners. And as it turned out, unlike the Manitoba PUB, which evinced a marked preference for protecting consumers, the NSUARB proved much more hospitable to the entreaties of the payday loan industry, particularly those of Cash Store Financial. Indeed, the NSUARB went out of its way to distinguish its approach to rate-setting from its Manitoba counterpart:

It is the opinion of the NSUARB that it is not its task, under the legislation which empowers it, to place its own view of the morality of an industry above that of the elected federal and provincial legislatures - particularly where (as here) there is no suggestion of infringement of the Charter of Rights and Freedoms. Parliament and the Nova Scotia Legislature have determined that payday loans can be legally made at loan costs in excess of 60%.

The NSUARB must proceed from that foundation: its task is to set maximum rates and determine related matters under the enabling legislative amendments, using relevant evidence relating to, among other things, cost and market factors. That evidence includes evidence with respect to minimum rates which permit a wide range of competitors to remain in business. The Manitoba Board specifically discounted such evidence, and recognized in its decision that the rates it set would drive competitors from the marketplace (NSUARB 2008 at para 257-58).

In the hearings themselves, attention was focused almost exclusively upon the question of what constituted a reasonable costing model for payday loan providers. In a heightened replay of the Manitoba hearings, Cash Store Financial and the CPLA again vigorously interrogated each

others' submissions, agreeing only in their respective briefs to the NSUARB that the Manitoba Board's rate-setting decision must be disregarded as a flawed precedent.

The NSUARB more than obliged this latter request when it reached its rate-setting decision, for not only did it restrict its deliberations to the narrow question of a "fair and reasonable rate", but it chose to emphasize the conditions necessary for a flourishing "competitive industry" as the conceptual grounds upon which the determination of an acceptable rate had to be made. This consideration led the Nova Scotia Board to agree effectively with the submission of Cash Store Financial that the regulated rate structure had to be high enough to allow high-cost loan providers to remain in business. In a curious reversal of market logic, competition in this particular setting of payday loans is defined not as a set of economic practices that conduce to lower prices, but rather, as a regulated business environment that secures for high-cost providers a guarantee of market entry. In the event, the NSUARB proved extraordinarily generous in fixing such a guarantee by setting the rate caps for payday loans in Nova Scotia at \$31 for every \$100 loaned, the second highest rate in North America.

Cash Store Financial's triumph by way of a court ruling in Manitoba and a regulatory decision in Nova Scotia did not extend to Ontario the following year when that province engaged in its regulatory exercise. Notably, by the time policy-setting came to Ontario, the industry network participants had ascertained the dangers that can arise from making public their often pointed disagreements over detailed regulatory standards. As a result, in Ontario, the regulatory process was conducted without the open conflict that had characterized the other provincial hearings. The Ministry of Small Business and Consumer Services which was responsible for developing detailed regulations in Ontario appointed a two-person board called the Maximum Total Cost of Borrowing Advisory Board with a directive to consult with payday loan companies

and other interested parties in order to arrive at a recommendation on an upper limit on the total cost of borrowing under payday loan agreements. The Advisory Board held two different sets of meetings to fulfill their consultation mandate. The first consisted of a brief two –day public forum where general principles of regulation were debated amongst network participants. This was followed by *in camera* hearings which reviewed industry and other submissions before a decision was made on a recommended rate structure. The rate structure the Board finally did recommend at the end of its deliberations was \$21 per \$100 loan, a figure that was at the lower end of the CPLA’s recommended range. Lest it be concluded that this rate recommendation reflected a more critical approach to the payday lending industry, it must be noted that in its report justifying its proposed rate structure, the Advisory Board devoted twice as much analytical attention to the question of the problems of profitability in the industry compared to the financial exigencies faced by borrowers (see Advisory Board for the Ontario Payday Lending Industry, 2009, 11-18). And relying almost exclusively on evidence supplied officials, the Board concluded: “Overall, we believe the payday loan industry is not making exorbitant profits from lending activities.... Moreover, our consultations revealed that in fact there are almost no payday loans to those with very low incomes, defined mainly as individuals receiving social assistance” (*Ibid.*, 17-18).

6:5 Regulation, Legitimation, Market Shares and a Manitoba Postscript

The regulatory process for payday lenders in Manitoba, Nova Scotia and Ontario followed a script that had early on been prefigured by the clash between Cash Store Financial and the Money Mart-dominated CPLA at the Senate Finance Committee Hearings reviewing Bill C-26 prior to its passage. In that script, the regulatory process itself was recognized by industry

participants as involving a fight over market access and market shares. But given the imperative of securing a measure of legitimacy for the industry as a whole, and for the regulatory process through which industry interests were being brokered, this fight had to be conducted in suitably normative language, hence the complementary discourses of competition and consumer protection. As far as the variations in policy outcomes in the different provinces surveyed, there is a straightforward explanation that can be discerned from Table 1 which details the relative market shares which Cash Store Financial and Money Mart enjoy in these jurisdictions.

Table 1

	Cash Store Financial (No. of outlets)	Money Mart (No. of outlets)	Provincial Rate Caps Per \$100 loan
Manitoba	30	20	\$17 (stayed by Court)
Nova Scotia	18	8	\$31
Ontario	151	218	\$21

(Statistics compiled by author from industry sources)

Quite simply, the relative success of Cash Store Financial and its rival Money Mart in the regulatory deliberations in Manitoba, Nova Scotia and Ontario correlate with their proportional market share in each province. Where Cash Store Financial dominates, it managed to obtain its desired rate structure, either directly through the formal rate-setting process, or indirectly through

court action. And where Money Mart is the dominant market player, its preferred rate structure was selected.

While this pattern is suggestive of the well-known regulatory capture thesis which proposes that well-invested industry patrons are frequently able to capture the agencies established to regulate them (Stigler 1975), the intra-industry competition that accompanied this particular regulatory exercise adds another dimension to the capture thesis. This competition, combined with the recurring legitimation needs which the payday loan industry confronted, produced a governance dynamic in which the constructed network consensus about the underlying policy goals and protocols of the regulatory process was potentially threatened if industry competitors failed to safely contain their policy disagreements within an agreed-upon normative discourse. What made that framing master discourse useful was that its twin normative concepts of competition and consumer protection were sufficiently abstract to permit contending interpretations matching the rival business strategies of the two main industry players engaged in the regulatory process. But the discourse was useful to the goal of regulating and simultaneously legitimating the payday loan industry only if all members of the governance network subscribed to its tenets, and so long as these principles were not subject to critical scrutiny. In short, the process had to be depoliticized so as to appear a technical exercise in finding the right policy mix of licensing regulations, disclosure requirements and rate-setting that would nurture a viable payday loan industry while providing customers with some plausible legal protections.

This ambition of producing a depoliticized regulatory undertaking seemed to run afoul in Manitoba when that province's rate-setting agency confounded the governance network's master discourse and took seriously its mandate of consumer protection. Only with the aid of a

sympathetic court ruling was the master discourse re-established. Thereafter, participants in the regulatory process took greater care in trying to insure against such disturbances, as for instance in the case of Nova Scotia where a business-friendly administrative agency was charged with the rate-setting task, or as in Ontario, where the rate-setting deliberations were closed to the public.

While administration is frequently conceived to be the converse of politics, it pays to remember that politics is never absent from any collective action forum. Thus it was that politics erupted again in the regulatory process for the payday loan industry just when it seemed that it had succeeded in representing itself as a mundane administrative matter. On April 23, 2010, after delaying making a decision for over a year, the Manitoba government announced that it would legislate the very same rate cap for payday lenders—17% per \$100 loan—that had been established by the Manitoba Utilities Board and later set aside as a result of the Manitoba Court of Appeal ruling. The fact that this was a legislated rate meant that the administrative law arguments that had been successful in challenging the Public Utility Board decision would be of no avail should the payday industry try to dispute this political decision. Not surprisingly, that industry has closed ranks in opposition to this latest regulatory initiative, with the normally conciliatory CPLA taking the lead in condemning the rate decision as an abandonment of consumers:

Today's announcement is bad for consumers. Despite the government's stated intent to strike the right balance, today's move fails to recognize that a viable industry is needed in order to serve those who need access to short-term loans. We are disappointed and find it ironic that the government's decision will in the end reduce access to credit for consumers by reducing the number of outlets that provide this needed service (CPLA 2010).

The Manitoba government's political resolution to test the policy consensus over payday lending proved to be the first challenge to the legitimization objectives the network governance exercise was meant to realize. Other less dramatic challenges have since followed. For example, in February of 2001 the Nova Scotia Utility and Review Board, after a new round of public hearings, decided to reduce the maximum rate for payday loans in that province from \$31 to \$25 per \$100 (NSUARB 2011). While the new rate remains the highest in Canada, the fact that the Board was persuaded by consumer advocates to lower the maximum rate is evidence that the legitimacy of the regulatory process itself increasingly has become an issue of contention.²⁶ Perhaps the most direct evidence of the contentiousness of the new regulatory regime for payday lenders has been the tacit admission by a number of policy-makers involved in the political process which gave rise to Bill C-26 that the result has been less than ideal. Thus the same Industry Canada sponsored federal-provincial working panel which first promoted the idea of provincial regulation of payday lending has now begun to examine alternative sources of credit for low income earners (Beeby 2011). Jerry Buckland, the author of a report commissioned by the Industry Canada panel on alternative credit providers, has acknowledged that Bill C-26 has been a "second-best response" to the problem of payday loans, and that there are more innovative ways of providing credit for the working poor (Buckland as cited by Beeby 2011, 1).

One of the reasons why there have been signs of growing discontent with the policy consensus represented by Bill C-26 is that for many there is a lingering suspicion the main purpose of the new regulatory regime provided by that legislation was not to protect consumers

²⁶ It should be noted that the new rate set in Nova Scotia still seems to reflect the interests of Cash Store Financial. David Roberts, the consumer advocate appointed by the NSUARB to argue the case for lower rates at the public hearings, has intimated that the final decision to establish the maximum rate at \$25 per \$100 was reached because that was the rate Cash Store charges in the neighbouring provinces of New Brunswick and P.E.I., where payday lending continues to be unregulated (Roberts as cited by Patten 2011, 1).

but to give legal legitimacy to the payday lending industry. In a report written for the Public Interest Advocacy Centre, Janet Lo gives voice to just this apprehension: “The provincial regulation for payday lending does not provide low-income consumers with consumer protection but merely results in decriminalization of usury, particularly as low-income and vulnerable consumers get trapped in a spiral of easy loans from payday lenders that they are unable to repay” (Lo 2011, 33). Certainly for some payday lenders, the regulatory obligations of Bill C-26 have been lightly regarded. For instance, in Ontario it was reported by the CBC that some payday lenders routinely skirted the rate cap set in 2009 by sneaking in extra fees (CBC 2011). While the Ontario government recently amended its regulations under the *Payday Loans Act* (2008) to try to forestall such business practices (Holbrook 2011), a similar occurrence in B.C. has proven more intractable. In that province, Cash Store Financial has been found guilty by Consumer Protection B.C. of overcharging customers for payday loans by requiring them to also pay for cash cards despite the overt rate limitations set out in the provincial payday lending act. Ordered on March 23, 2012 to refund customers who were overcharged since the payday law went into effect on November 1, 2009, and further required to pay a \$25,000 administrative penalty, Cash Store Financial has simply chosen the expedient of refusing to comply with the regulatory order, leaving the matter to be decided in the courts (Consumer Protection B.C. 2012).

What these various episodes reveal is that legitimation by way of regulation is a uncertain enterprise, subject not only to political vagaries but to the business calculations of those who are meant to be regulated. In the case of payday lending, the legitimation project which initially seemed so successful with the passage of Bill C-26 has now become more precarious as provincial regulators try to enforce the letter of the law only to find their subjects as often as not noncompliant.

CONCLUSION

The emergence and rapid growth of the contemporary payday lending industry in North America in the last two decades has generated considerable controversy over its moral and legal status. While proponents of free markets characteristically defend payday lending on classical utilitarian grounds, arguing that all freely contracted agreements are by definition welfare-enhancing for the parties involved, critics tend to rely on pre-modern intuitions about fair prices and usury to assail the business for its alleged predatory behavior, both with respect to the interest and ancillary charges it levies on its credit products, and to its reputed propensity to encourage repeat borrowing. The contrast between liberal market and pre-liberal moral views of what counts as an acceptable price for credit has been in evidence in the political process in Canada where federal and provincial authorities, together with representatives from the payday loan industry and consumer advocates, worked for several years to come up with a regulatory regime for this type of small-scale, short-term lending. This political undertaking, prompted by the fact that the newly evolving payday loan industry had for all intents and purposes escaped effective regulatory attention, presented policy-makers with a complicated legitimization problem. At the heart of this problem was the awkward fact that average charges for payday loans far exceeded the rate designated as usury under Sec. 347 of the Criminal Code. Since payday loan companies had convinced the principal government policy-makers that the strict application of Sec. 347 to their business would make it uneconomical and would cause this form of credit to be withdrawn from the market, it became necessary for these officials either to jettison entirely the existing 60% threshold for usury, or to justify a regulatory structure that would permit charges

for small, short-term loans above that level. Acquiescing to the demands of payday lenders for a regulatory regime that would leave intact their existing pricing and other lending practices, however, would call into question the commitment on the part of government officials to protecting a public good defined in terms of a non-market economic morality.

Caught between these conflicting demands with their underlying rationales drawn from incongruous liberal market and pre-liberal moral economic premises, most of the parties participating in the policy network charged with devising a policy consensus over the regulation of payday lending subscribed to a master narrative meant to bridge the divide between these two economic outlooks. That master narrative rested in the first instance on the assertion that, for a variety of different reasons, there will always be people who have a genuine need for small, short-term loans to meet cash shortfalls, and that in the absence of something like a payday loan industry those in need of temporary financing would be compelled to seek credit from criminal loan sharks. Distinguishing payday lenders from criminal loan sharks by means of a simple proposition represented the first crucial step in the legitimation of this industry. A second critical step was the justification of a lending rate which on the face of it seemed to be no different from what is charged by those regarded as members of the criminal underworld. This latter conceptual move was accomplished through a supply-side economic argument, the burden of which is that any rate-setting in this particular credit market by a government regulatory agency had to be high enough to attract enough market entrants to satisfy the demand for short-term loans. In a peculiar reversal of free market language, this injunction stressed the need for high prices to ensure competition in the payday lending sector.

While this pair of submissions was meant to defend the legitimacy of payday lending in face of those vestigial moral sentiments about just prices which arguably inspired Sec. 347, their acceptance by policy-makers raised another legitimacy problem—just how would the public interest be served in a regulatory process where the regulated industry managed to define the terms under which their business would be conducted? For the payday lending industry the preferred solution to this latter legitimacy problem was to insist that industry self-regulation through a self-enforced code-of-conduct was sufficient to protect the public interest. The entry of the courts into the payday regulatory saga made this option less appealing once it became apparent that many provincial judges did not readily accept the basis for the master narrative which had united most participants in the payday loan policy network. As more and more courts refused to enforce the terms of payday loan contracts on grounds that they contravened Sec. 347, and as the prospects of having to pay out large settlements in class action lawsuits predicated on the unlawful nature of industry rate-setting became more imminent, a new resolve emerged amongst major payday lending firms to actively seek government regulation. As more than one commentator observed at the time, the push for state regulation of payday lending after 2005 was funded in part by a desire on the part of the industry to immunize itself from further unfavourable court rulings (see, for example, Lo 2011, 35).

While regulation became a more inviting option for payday lenders in circumstances where courts were increasingly willing to apply the prohibitions of Sec. 347 to civil cases involving payday loan contracts, it remained the case that the regulation the industry sought was still of a minimal variety. Hence the push for a devolution of regulatory authority over payday lending from the federal government (and in particular from the criminal law sphere) to provincial governments with their powers over licensing and consumer protection. From the

perspective of the majority of the payday loan industry, provincial regulation was preferable to federal administration both because provincial regulatory processes have tended to be more amenable to industry supplications, and because the resulting rules don't carry the moral censure and coercive force associated with criminal law. As for the master narrative, provincial regulation would serve to answer the second legitimation problem—how can a public interest be secured in a regulatory process in which the payday loan industry is a major participant helping to devise the rules of its own governance? Provincial regulation offered a solution to this problem by allowing for a public rate-setting process which could be defended as an eminently fair procedure for deciding on acceptable loan charges. And because provincial regulation would focus on consumer protection, there were additional grounds for contending that this process satisfied the governance goal of protecting the public interest.

While the master narrative that has sustained this regulatory episode has proven to be a relatively successful example of how a policy consensus can be constructed around a set of refractory legitimation demands, its cogency as a basis for sound public policy remains an open question. For once the individual assertions of this master narrative are subject to closer scrutiny, their contentiousness becomes readily apparent. Nowhere is this contentiousness more obvious than in the primary proposition used to justify the need for a regulated payday loan industry. That proposition was that in the absence of a viable payday loan industry desperate credit seekers would fall victim to the predations of criminal loan sharks. Aside from the fact that the proposition trades on a distinction between criminal loan sharks and legal payday lenders that is itself in need of justification, it also begs the crucial question—what evidence is there that people who encounter temporary cash shortfalls will turn to the criminal underworld rather than to other informal sources of short-term credit? Writing about her country's experience with the

resurgence of payday lending at the turn of the twenty-first century, Kathleen Keest (2001, 417-18), Assistant Attorney General from Iowa, responded to this fundamental question by observing:

As to the unsubstantiated argument that without these lenders borrowers would have to turn to loan sharks, some are tempted to say, as today's young people do, "well, duh." But less flippantly, those with long experience know that this market was not served by loan sharks in the years before these lenders began appearing in the 1990s. They did not resort to credit, or looked to family or friends, or, for help with such needs as utility bills, to assistance programs.

Remarkably, Canadian policy-makers have uncritically repeated the refrain about the how the arrival of the payday lending industry has helped deter criminal loan sharking (see, for example, Kitching and Starky 2006, 11). Without offering any empirical evidence of this phenomenon, these policy-makers have contributed to a legitimization exercise based on some rather problematic assumptions.

If the threat of a criminal underworld of loan sharks waiting in the wings to exploit the credit needs of a vulnerable population is really a rhetorical diversion, what about the other parts of the master narrative? The second vital proposition in the master narrative centres on the necessity of having high interest rates to ensure the viability of the payday loan industry, and by extension, the availability of a much needed source of credit for that segment of the population that is credit-constrained. This particular proposition rests on the presumption that short-term payday loans represent markedly risky financial ventures that yield only modest returns, a fact that supposedly obliges lenders to charge high rates to justify risking their capital in such a business enterprise. Arguments such as these routinely figure in the public rate-setting hearings undertaken by provincial regulatory bodies pursuant to Bill C-26, as payday loan companies seek to persuade regulators of the necessity of high permissible charges for their loan products. The

problem with this argument is, first, that it is difficult to verify actual profit levels that derive from payday loans because researchers must in the end rely on statistics provided by the industry itself. There are, nonetheless, good reasons for thinking that profit rates have been underestimated and risk factors exaggerated in industry reports as recent studies indicate that both costs of providing loans and default rates are lower than what the industry testifies to in regulatory hearings (see Buckland et al 2007 and Simpson 2007). As for the associated argument that high rates are needed to attract enough loan providers into the market to ensure a range of competitive choices will be available to consumers, not only does the logic seem to run counter to standard liberal economic prescriptions about how competition tends to lead to lower prices, but it implies a norm of competition in the industry that is contradicted by available evidence (see Simpson 2007).

Solutions supplied by the master narrative to that other legitimization problem—the problem of ensuring a public interest is served by the regulatory process—are likewise vulnerable to a host of criticisms. Provincial regulation of payday lending under Bill C-26 has entailed two related developments which together are said to guarantee the public interest is protected by the regulatory process. The first of these is a commitment to public rate-setting hearings where both industry and consumer representatives are provided an opportunity to advance their interests. The public setting of these hearings supposedly ensures the fairness of the process, thus meeting a basic procedural test for legitimacy. Second is the requirement that appears in all current provincial payday legislation that payday loan providers make completely transparent the costs of their products. Such truth-in-lending regulations are meant to repair those information asymmetries that might otherwise give an advantage to payday lenders over borrowers. The assumption here is that individual customers, if accurately apprised of the true

costs of payday loans, are in the best position to determine whether in their circumstances such a product is worth its price. Close inspection suggests that neither of these developments is particularly conducive to consumer protection. For instance, as this dissertation has documented, save for the experience in Manitoba, provincial public rate-setting exercises have been driven primarily by the industry argument that rates must be high enough to make the business viable, with viability invariably determined on the basis of cost information supplied by payday lenders. And as for the ameliorative effects of truth-in-lending requirements on information asymmetries, there are several reasons for thinking that this market remedy offers less than it promises. To begin with, there is a substantial body of evidence to suggest that a significant portion of the population that routinely utilizes payday loans suffers from a financial illiteracy that would hardly be overcome by the mere presence of posted signs or other printed documentation clearly detailing the costs of a loan (see, for example, Buckland 2010). Second, various studies of bounded rationality suggest that something other than a detached cost-benefit style of economic calculation is at work when individuals make their consumption decisions, a fact that frequently is exploited by businesses through such devices as the framing of choices (see, for example, Hanson and Kysar, 1999). In the case of payday lending, there is ample evidence that lenders use framing effects to influence their customers' decisions, for example, by intimating that conventional credit card or bank NSF charges are more expensive than the cost of their products (see Ramsay 2001, 22-24 and this dissertation, ch. 3).

As this dissertation has attempted to demonstrate, however, information asymmetries leading to market failure in the payday loan industry are not just a matter of borrowers being less sophisticated than lenders and not understanding the true cost of loans, or having their cognitive biases exploited by lenders in the presentation of pricing and repayment information. Rather

more significant is the fact that lenders, by virtue of their information gathering techniques, are able to amass a considerable amount of knowledge about their customers, and for this reason have a structured advantage vis-à-vis these customers. Accumulating detailed knowledge of what this dissertation has called the “financial folkways of the poor” (see Ch. 2) has been a crucial element in the growth strategy of payday lending companies as they try to construct a stable client base of repeat borrowers. And while these same customers might also resort to various strategies to improve upon their bargaining position, the fact that they are constrained in their choices for socio-economic reasons means that lenders are almost always better placed to extract the maximum benefit from these financial transactions.

These several observations about the master narrative used to justify the regulatory regime for payday lending inaugurated by Bill C-26 leads finally to the “big question” posed by John Caskey—“Do payday lenders, on net, exacerbate or relieve customers’ financial difficulties?”(Caskey 2010, 1). While most of the normative and public policy debate on payday lending has either tacitly or explicitly been informed by some version of this question, there are good reasons for thinking that it is the wrong question to ask. For if the question of payday lending is posed in this way, too much is conceded to the master narrative used to legitimize payday lending. This is so because the question takes the existing income distribution and other social inequalities as a given and proceeds to ask whether those who find themselves economically distressed are on balance better off having payday loans available to them. Of course once the distribution of incomes and opportunities are accepted as a given, it is relatively easy to demonstrate that payday loans are welfare-enhancing in some marginal sense, just as it is relatively easy to argue that a market in organ transplants, for example, benefits those who are impoverished and bereft of other meaningful income-earning opportunities.

While Caskey's big question proves in the end not to be very instructive, its limitations do point to more fruitful lines of inquiry. Specifically, the re-emergence and proliferation of payday lending at the turn of the twenty-first century signals a social fact—the fact that there are more and more people whose financial resources are insufficient to meet all their expenses from month to month. In light of this, the more urgent normative and public policy question should be: what has caused growing income insufficiencies, and what can be done about it? And if one continues to insist on asking the Caskey question, it should at least be modified so as to introduce a proper comparative measure. For instance, what are the welfare-enhancing properties of payday lending as compared to other forms of micro-financing such as community banks? Such a latter question at least has the virtue of providing a broader public policy perspective on the issue of payday loans than is found in the usual neo-classical economic literature that tries to assay their costs and benefits in the abstract.

In detailing the emergence of payday lending in Canada and the subsequent policy process which resulted in a new regulatory regime for this industry, this dissertation has made the following contributions to our understanding both of the peculiarities of this form of credit provisioning, and of the treatment of financial crime. First, it sought to clarify how the market in payday lending was created by eschewing simple demand-led explanations in favour of a sociological account of market formation that emphasized some of the active measures payday lending firms employ to identify and maintain a customer base.

Second, it has shown how the definition of financial crime can be altered to meet public policy goals. This was manifestly the case with payday lending insofar as it substantially fit the definition of usury under Sec. 347 of the Criminal Code. To exempt payday lending from

criminal prosecution under Sec. 347 it was necessary to distinguish its properties, both in form and function, from classical loan-sharking, an assignment that was performed by a policy network employing a master narrative conceived to legitimize this particular type of credit provisioning.

The definitional maneuver carried out by the policy network appears to lend support to Snider's (2000) proposition that a corporate counter-revolution has effectively compelled the state to withdraw from the field of corporate crime through the expedient of neo-liberal knowledge claims about what constitutes criminogenic activities. The second contribution of this thesis is to offer a more refined explanation of what is involved in the generation and transmission of knowledge claims about what constitutes criminogenic activity. On Snider's account, a functional correspondence between a knowledge claim and presumed corporate interests is sufficient to explain the former's genesis. What this present study of the legitimation of payday lending has illustrated is that the political and discursive dynamic at work in the process of transforming knowledge claims to create a new public policy paradigm is much more complex than what is suggested by Snider's conception of corporate ideology. It is contended in the dissertation that the idea of governance through policy networks more faithfully captures this complex dynamic, especially at the stage at which a normative consensus needs to be fashioned over the legitimacy of the activity for which changes in government regulation are sought.

In the case of the governance of payday lending, this change involved a shift from federal criminal law sanctions to provincial regulatory law sanctions. This jurisdictional modification with its attendant change in commanding sanctions had been justified by the policy network as a more efficacious way of regulating payday lending because a provincially administered

regulatory process would better serve the needs of procedural fairness and market transparency. This dissertation tried to show how the jurisdictional modification brought about by Bill C-26 primarily served a legitimation need, and that its efficaciousness in terms of a governance structure aimed at securing a public good remained questionable.

Finally, this dissertation stressed the politically contestable and hence indelibly contingent nature of the policy consensus that Bill C-26 put into effect. Because that consensus was constructed around an unstable combination of competing moral discourses, its political endurance remains uncertain, as recent developments in Manitoba, Nova Scotia and Ottawa have indicated.

In the course of these several inquiries, this dissertation raised a number of questions that invite further research. For example, a more fine-grained analysis of payday loan users with special emphasis on how payday loans may have displaced previous sources of formal and informal credit would help shed light both on the genesis of the industry and on policy options related to the provisioning of credit to the working poor. Another important research question would ask how the working poor secure credit in a jurisdiction like Quebec, which has effectively prohibited of payday lending. And finally there is the real big question: are existing patterns of income insufficiency likely to expand as neo-liberal market solutions to economic distribution become further entrenched in public policy?

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