PREPARED BY AMIR MAHMOUDZADEH, EXECUTIVE V.P., CASH 4 YOU CORP.
JANUARY 2004

Effects Of New Proposed Legislation on The Small Business Sector of The Alternative Consumer Credit Market

---

© Cash 4 You Corp. 2004
250 Dundas Street South • Suite 10 • Cambridge, ON • N1R 5S2
Phone 519.620.1900 • Fax 519.620.3141 • E-mail C4Y@rogers.com

Table of Contents

Overview	**2**
Licensing of Operators	**3**
Regulator Powers	**3**
Cost of Credit Disclosure & Annual Percentage Rate (APR)	**3**
Interest Rate Caps	**3**
Limits on Specific Charges and Fees	**6**
No Rollovers, Extensions, Back-to-Back Loans	**7**
Recommendations	**7**

Introduction

This report is prepared in response to the recent publication by the Public Interest Advocacy Centre regarding the regulation of fringe lending and alternative banking. The report prepared by John Lawford, referred to as "Report 2" [1] in Nov 2003 lacks some insight as to the possible effects of the legislation mentioned in the report on small business. The misrepresentation of such information is directly related to the lack of industry knowledge as a result of minimal or no input by industry professionals in the small business sector. Through a review of the conclusions and recommendations made in the report, it is my intention to shed light by discussing common industry practices that will assist in the development of legislation that is in the best interest of not only the consumer, but also the industry as a whole.

Overview

There is no argument that legislation is required to monitor, control and track the alternative consumer credit market. With its significant growth over the past 5 years, lenders have adopted a multitude of lending practices. Some of which, have had a negative impact on the industry. The extent of the damage to the consumer is questionable and there are no real surveys or evidence to track inappropriate practice and abuse within the industry.

In order to formalize the industry, it is important to understand the root of the problem. The problem may stem from many sources, however, the underlying root and cause for legislation should be clearly indicated to the industry. To establish a cause for legislation we need to determine if the problem stems from the fact that;

- Consumers are burying themselves in credit at a much "higher-cost" than mainstream lenders i.e. financial institutions or;

- Consumers are the innocent victims of mal-practice within the industry and exposed to harsh methods of collections, harassment, wage assignments, excessive late fees and other charges resulting from default, etc.,

Assuming that one or both of the conditions are the cause of such legislation, what end result or threat does this pose to the consumer? Based on the conclusions of "Report 2," the latter of the two seem to be of greater importance, as much of the discussion stems from abusive practices within the industry more so than the per $100 borrowing fee charged by payday lenders.

---

[1] See Report 2, Pragmatic Solutions to Payday Lending: Regulating Fringe Lending and "Alternative" Banking http://www.piac.ca

Licensing of Operators

The licensing of operators would provide a benefit to the industry. Licensing will provide corporations with a framework to operate their business from. In essence, it will act as a filter to streamline the industry and provide the groundwork for payday lenders to establish their "Best Business Practices" similar to that adopted by National Money Mart,[2] the largest provider of retail financial services in Canada.

Regulator Powers

Establishing a regulatory government to monitor the industry is plausible. However, it can be costly and the benefits of which may not be self-evident. The key is consumer awareness. If the consumer is made aware of standard "Best Business Practices," they themselves will monitor the industry and file complaints with already established bureaus that assist in consumer issues such as the Better Business Bureau.[3]

Cost of Credit Disclosure & Annual Percentage Rate (APR)

The adaptation of an "APR" clause within all contracts would educate the borrower as to actual costs of borrowing. However, the notion that consumers will refrain from using the service due to its high rate of interest (assuming that payday lenders are in violation of S. 347 of the Criminal Code) is inaccurate. The usage of payday loans will be based solely on demand, not on "APR".

Reference to consumer complaint mechanisms within contracts poses the threat of illegitimate complaints (consumers who abuse the system), and the costs involved of investigating such claims may prove to be the downfall of such mechanism.

Interest Rate Caps

Competition is the lifeline of the global economy and vital within all business sectors. It provides consumers with relative options as to which companies to spend their money with. It distinguishes market leaders from market stragglers and provides the motive and necessary requirements for businesses to expand and prosper.

It is important to understand that fees charged by payday lenders

> "…are intended to provide the company with a profit after covering operating expenses, including any interest expense incurred by the check casher on the funds advanced to the customer between the time checks are cashed and the time the checks clear through the banking system."[4]

---

[2] National Money Mart's best business practices, http://www.moneymart.ca/
[3] Better Business Bureau's website, http://www.bbbmwo.ca/
[4] Ace Cash Express, 2002 Annual Report, http://www.acecashexpress.com/

The proposed rate cap of 15% on the first $300 as mentioned in "Report 2" does not take several of the above factors into consideration. Particularly in addressing the small business sector within the industry, which stems from stand-alone (1 store) to smaller multi-unit payday lenders (approx. 20 stores or less).

The ideology of adopting the tax rebate-discounting model of 15% on the first $300 and 5% above that amount to the fee structure of the payday loan industry is simply unjust. The operating expenses of a tax facility in no way correlates to the expenses incurred by a payday loan facility. Most importantly, the tax facility is not subject to the common risks of a payday lender. The risk is that the cheque may be returned unpaid once it is presented to the customer's financial institution for reasons of insufficient funds, stop payment or fraud.

The price at which a company sets its payday loan rate is related to its customer base. This is why National Money Mart is able to provide consumers with the lowest rates in the industry for their Fast Cash Advance® service. It should be dually noted that the second largest provider of alternative credit in Canada, Cash Money Cheque Cashing Inc., currently with 44 locations[5], increased their payday loan rate of 15% up to 20% (inclusive of interest and cheque cashing fees) approximately 2 years ago.

Before a rate-cap (if any) is decided, it is important for lawmakers and legislators to realize the "real costs" and expenses from an inside industry prospective. There have been many figures stated, however, these figures are misleading and do not represent the payday loan market as a separate entity. Figures and statistics have been drawn from overall operations of full service financial centres, such as National Money Mart, encompassing not only revenues on payday loans, but also, a wide array of services such as cheque cashing, money transfers and other ancillary services.

The first step is to separate fact from fiction regarding "Net Write-Offs" and the risk associated with the payday loan industry. Net write-offs is referred to the "face amount of returned cheques as a percentage of revenue." In a report written by Sue Lott and Michael Grant, referred to as "Report 1"[6] in November 2002, it is claimed that Dollar Financial Group (the parent company of National Money Mart) reported loan losses as a percentage of original loans of 1.4% for fiscal year ending June 30, 2001. In the same report referencing a separate publication, it was estimated that net write-offs in the payday loan industry was 1% of the face amount of cheques cashed or 8% of revenues lost to bad cheques. To view these statistics from 2 years ago, and base any general theory of revenue loses today is unfair to the industry.

In order to have a sense of current day figures I have compiled information from the 2003 annual report for Ace Cash Express[7] referred to as "Ace", the largest national provider of alternative consumer credit in the United States with 1168 locations, 968 of which are company owned. The figures are based on the operations of 512

[5] Cash Money Cheque Cashing Inc., Store Locator, http://www.cashmoney.ca/
[6] See Report 1, Fringe Lending and "Alternative" Banking: The Consumer Experience, http://www.piac.ca
[7] Ace Cash Express, 2003 Annual Report, 10K Financials, http://www.acecashexpress.com/

company owned stores providing payday loans. In fiscal year ending June 30, 2003, Ace processed a total of 1,587,000 advances. This is an average of 258 advances a month per store.

Ace's reported revenue for loan fees and interest was $70,806,000 representing 30% of total revenue for the company. The balance of the revenue stems from cheque cashing, bill-payments, money transfers, money orders, franchise revenues and other fees. Ace's loan loss provision, as a percentage of gross loans receivables is 40.2%. In fiscal year ending June 2003, Ace reportedly expensed $22,892,000 for Loan losses and provisions, which equals to 32.33% of loan fees and interest (revenue) and 5.4% of overall loan volume. This rules out the precluded notion in "Report 1" of an 8% net write-off rate in the payday loan industry. Also, the 2001 fiscal year end report for Dollar Financial Group regarding losses of 1.4% of overall loan volume is obviously outdated.

As well, due to the nature of the business and the large amounts of cash on site, the payday loan industry is also prone to cash shortages as result of employee theft and errors. This additional expense is estimated by Ace to be approximately 0.9% of overall revenue.

To review the expenses of a payday lender we look back to the 2003 annual report of Ace. Ace reported store expenses of approximately $155,414,000 with additional region expenses of $17,056,000; headquarter expenses of 17,133,000, other depreciation and amortization of $5,423,000, interest expenses of $16,004,000 and other expenses of $1,584,000. This is an average monthly store expense of approximately $18,300 based on 968 company owned stores as of June 30, 2003.

This is what it would mean to payday lenders if the rate-cap is set at 15% (using industry standard averages in Canada):

Average Monthly Transactions	550
Average Dollar Amount of Loan	$220 (30% of borrowers last net pay)
Monthly Loan Volume	$121,000
Revenue	
Loan Fees (15%)	$18,150
N.S.F Fees (1%)	$1,210
Total Revenues	$19,360
Expense	
Net Write-offs (32% of loan fees)	$5,808
Cash Shortages (0.9% of total revenues)	$174

Average Store Expense	$18,300
Total Expenses	$24,282
Net Monthly Revenue	($4,922)

Considering the facts, if a rate-cap of 15% on the first $300 is placed on loan fees, it could potentially devastate all lenders. Those in the small business sector would be most affected and forced to close their doors.

Even if Ace's store expense is only considered (excluding all corporate and region expenses) modeling a stand-alone operation, this would bring the average monthly store expense down to approximately $13,379. The payday lender in this circumstance would break even at the end of the month. With an average investment of approximately $220,000[8] per location, the return on equity is not 23%-35% as suggested in "Report 1."

A rate-cap is only beneficial for market leaders such as National Money Mart, considering their current fees are slightly less than the fees suggested. A rate-cap would decrease competition, which would lead to higher revenues and increased customer base. Money Mart is able to offer consumers with the lowest rates due to its customer base and the fact that a majority of its revenue is earned through other services such as cheque cashing, money transfers, tax services, etc., which increases their net revenues.

Limits on Specific Charges and Fees

N.S.F charges should be set at a rate equal to the highest fee charged by a bank or credit union plus collection costs incurred by the lender. A typical N.S.F. fee charged by TD Canada Trust is $30[9] and Guelph Wellington Credit Union charges $35[10] on N.S.F cheques. It is important to bear in mind that the fees charged by banks to consumers reflect only administrative charges. The fee charged by payday lenders to the consumer should reflect the actual costs incurred to collect on the returned item, which may include bank certification or other charges.

Pre-authorized debits are monitored and controlled by financial institutions and should remain in their control. If a consumer has a complaint or believes that a debit was conducted in error or was unauthorized, they simply need only to advise their bank of the discrepancy. The bank will reverse the debit with a written affidavit by the customer stating the reason for reversal. All service charges incurred as result of the error are reversed as well. The consumer also has an option of placing a stop

[8] See Franchise Information: Frequently Asked Questions, http://www.stopncash.com/
[9] See, Account Related Information and Administration Fees, http://www.tdcanadatrust.ca/
[10] See Everyday Banking Price List, http://www.gwcu.com

payment on all pre-authorized debits from a single creditor and in extreme cases to file a complaint with the Canadian Payments Association[11].

No Rollovers, Extensions, Back-to-Back Loans

The main objective of banning rollovers is to stop consumers from revolving debt. Several payday lenders have a ban on this procedure already. However, it's important to note that consumers who extend their loan simply do not have the funds to repay the entire loan. On average, a rollover is a cheaper alternative than their cheque returning unpaid. The consumer saves the N.S.F. charge with both the bank and lender, which can total up to $60 ($35 bank fee and $25 lender fee) per incident. Rollovers should be limited to a certain number per advance, rather than restricting them completely.

If back-to-back loans are restricted, there will be an overall increase in the usage of payday loans. Consumers requiring immediate cash would have no other choice but to visit multiple lenders to fulfill their request. By doing so, it increases the likelihood of their cheque returning unpaid. In essence, restricting back-to-back loans would make the collection of returned cheques even more difficult and lenders will definitely see an increase in net write-offs.

Recommendations

As reviewed in the report, the fees charged by payday lenders are to provide the company with a profit after covering expenses. Therefore, legislation should be flexible enough to provide consumers with a high level of protection without compromising the business structure or revenues of payday lenders.

There is definitely no question that fees vary widely between competitors in Canada. This is simply how a successful economy functions. Even in the U.S. there is currently no rate-cap placed in states such as Nevada. Rates vary as low as $16.50 per $100 borrowed[12] to as high as $25.00 per $100 borrowed[13]. Businesses set their rates according to their specific business model. If competition simply did not exist, the market would be monotonous, limiting growth capabilities of all businesses regardless of sector or type.

[11] Canadian Payments Association, http://www.cdnpay.ca/
[12] See "Find a Money Tree Branch", Las Vegas, Nevada, http://www.moneytreeinc.com/
[13] Strip Check Cashing, A Division of Casino Money Centers, Las Vegas, Nevada, Tel: 702-732-2541

Acknowledgements

If you wish to endorse this publication and have your name added to the growing list of supporters, please mail a letter of intent to the author. Include your company name, address, telephone number and contact information.