Predatory
LENDING

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YOUR GUIDE TO

Identifying Abusive or Unfair Lending Practices

PREDATORY LENDING COMES IN MANY FORMS

PAWNBROKERS
are individuals or businesses that offer secured loans to people, with items of personal property used as collateral. The word *pawn* is likely derived from the 15th century French word *pan*, meaning pledge or security, and the items pawned to the broker are themselves called pledges or pawns, or simply the collateral.

PAYDAY LENDERS
offer payday loans (also called payday advances, salary loans, payroll loans, small dollar loans, short-term loans or cash advance loans). These are small short-term unsecured loans, regardless of whether repayment is linked to a borrower's payday.

PREPAID DEBIT CARDS
are typically not considered predatory. However, some of these cards have been criticized for their higher-than-average fees (such as a flat fee added onto every purchase made with the card).

LOAN SHARKS
are individuals or groups who offer loans at extremely high interest rates. The term usually refers to illegal activity, but may also refer to predatory lending activities like payday or title loans. Loan sharks sometimes enforce repayment by blackmail or threats of violence.

LOOK FOR THESE TELLTALE WARNING SIGNS

Failure to present the loan price as negotiable

Most reputable lenders will negotiate the price structure of the loan with you, the borrower. In some situations, you can even negotiate an outright reduction in the interest rate or other charges on the loan. Don't be afraid to ask.

Unjustified risk-based pricing

This is the practice of charging a lot more—in the form of higher interest rates and fees—for extending credit to consumers who are identified by the lender as posing a greater credit risk than others. While a modest increase to cover potential loss is justifiable, watch out for exorbitant rates and fees being charged to cover unjustified risk.

Failure to clearly and fully disclose terms and conditions

This happens most when an unsophisticated borrower is involved, especially with home loans. Mortgage loans are complex transactions involving multiple parties and dozens of pages of legal documents. In the most egregious of predatory cases, lenders or brokers have not only misled borrowers, but have also altered documents after they have been signed.

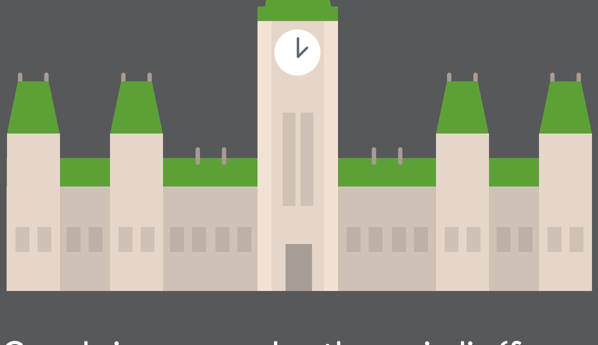
Short-term loans with disproportionally high fees

These short-term loans can come in the form of payday loans, credit card late fees, chequing account overdraft fees and tax refund anticipation loans. The fee paid for advancing the money for a short period of time works out to an annual interest rate significantly in excess of the market rate for high-risk loans.

UNDERSTANDING ANNUAL PERCENTAGE RATE

APR

Knowing how the annual percentage rate (APR) is calculated is the key to understanding your true cost of borrowing.



As a form of consumer protection, lenders (banks, credit unions and financing companies) are required to disclose the cost of borrowing in a standardized way to make it easier to compare lenders and loan options.

In Canada, the calculation and disclosure of APR is governed federally by section 451 of the *Bank Act*. In general, APR in Canada is expressed as the periodic (for instance, monthly) interest rate times the number of compounding periods in a year (also known as the nominal interest rate). The APR must also include certain non-interest charges and fees.

WATCH OUT FOR THE FEES[1]

"CASH MONEY" FOR A $50[1] FEE

You may see a payday lender's late-night TV commercial promoting a short-term, interest-free loan for a modest fee.

LOAN	TERM	INTEREST	FEE
$300	14 days	–	$50

Look very closely before you leap! All lenders are required to disclose the effective APR of their loans in the fine print.

435%[3] EFFECTIVE APR

If you took two weeks to pay this $300 loan back, it would cost $350 total. This may seem OK.

However, if you took one year to pay back this $300 loan, it could cost you more than $1,300. Yikes!

IT ADDS UP FAST

How does the cost of that short-term $300 payday loan compare with other credit products?

Comparing the costs of a $300 loan taken for 14 days[1]	Payday loan	Credit card cash advance	Overdraft protection on a bank account	Borrowing from a line of credit
Interest	–	$2.13	$2.42	$1.15
Applicable fees	$50.00	$2.00	–[2]	–
Total cost of loan	**$50.00**	**$4.13**	**$2.42**	**$1.15**
Cost of loan expressed as a percentage of the amount borrowed[3]	435% per year	36% per year	21% per year	10% per year

Note the considerable difference in costs!

AVOID THE DEBT TRAP

If you get behind on a traditional loan from a credit union or bank, you (the borrower) pay late fees or penalty fees only one time.

The payday loan "debt trap" forces you to pay fees every month. In the end, revolving payday loan fees increase your debt load and financial hardship. This vicious cycle can lead you into bankruptcy, rather than helping you get back on your feet.

[1] The costs and fees shown in these examples are for illustration purposes only.

[2] The monthly service fee that you pay for your banking service package often covers any processing fees for overdraft protection. To be sure, check your account agreement or check with your financial institution.

[3] This is an estimate of the annual cost of the loan. This is calculated by adding together all of the fees, charges and interest charged after 14 days, and projecting the costs over a one-year period.

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Sources: Financial Consumer Agency of Canada, Government of Canada

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