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Government of Canada's consultation on lowering the criminal rate of interest

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This past August, the Government of Canada launched its anticipated consultation paper (the Consultation Paper) to seek feedback from stakeholders and vulnerable members of the public on the criminal rate of interest and the availability of high-cost installment loans often offered by alternative lenders.

While the Government of Canada's policy goal has not resulted in a new criminal rate of interest yet, a reduction in the criminal interest rate could potentially have market-changing implications for lenders and borrowers.

Interest rates in Canada are not to exceed 60% – Section 347 of the Criminal Code

When first introduced in 1980, the criminal rate of interest was established to deter loan-sharking and other predatory lending practices. Section 347 of the Criminal Code (the Code) makes it an offence to: (1) enter into an agreement or arrangement to receive interest at a rate exceeding 60% of the total value of the credit advanced; and (2), actually receive the interest exceeding 60% of the total value of the credit being advanced. Of note, the Code defines broadly the concept of "interest" to include fees, fines, penalties, or commissions. Overdraft charges and discharge fees also fall within the scope of what would be considered "interest". Although the Consultation Paper is addressed at high-cost installment loans, it is important to note that certain payday loans are exempt from the Code.

High-cost installment loans

The Consultation Paper targets alternative lenders in their offering of what is universally considered as "high-cost lending" or "high-interest" loans. Alternative lenders provide loans quickly with less stringent requirements and offer longer-term, higher-cost installment loans. The Consultation Paper reveals that these installment loans have advertised interest rates as high as 47% per year. With the added fees and charges included, and with frequent interest compounding, many of these installment loans amount to having an aggregate annual interest rate of just below or almost equal to the criminal rate of interest of 60%.

A rate fixed at 60% for the last 40 years

The Consultation Paper undertakes to better understand the impact any such reduction in the rate may have on the market, and on the availability of the financial products as we know

them. As highlighted in the Consultation Paper, the criminal rate of interest is a fixed rate not linked to market rates. When the criminal rate of interest was introduced, the Bank of Canada overnight rate was 21%. At that time, the difference between the overnight rate and the criminal rate was 39%. Today, the gap is nearly 60%. As such, the Government of Canada is interested in understanding whether the interest rate pricing set by high-cost alternative lenders is a reflection of the actual credit risk of the borrower, or whether the interest rates on these high-cost financial products are set simply to comply with the ceiling permitted under the criminal rate of interest.

Considerations for Lenders

Responses to the Consultation Paper are due by October 7, 2022. Any change to the criminal rate of interest would apply to all credit products in Canada and would impact a large range of debt products in the market. If you or your business require assistance in determining the potential impact of a lower criminal rate of interest, please feel free to contact the authors of this article.