



A CONFLICT OF INTEREST

How Canada's Largest Banks Support Predatory Lending

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ACORN Canada Report

The Association of Community Organizations for Reform Now



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WHO IS ACORN?

With over 300,000 member families in more than 100 cities across the Americas, ACORN (the Association of Community Organizations for Reform Now) is a grassroots, multicultural, democratic organization that has been mobilizing and empowering working families on issues of social and economic justice for 37 years. ACORN members are committed to making positive changes in their communities and have been doing this in Canada, as an independent affiliate of ACORN International, since the summer of 2004.

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INTRODUCTION

“We believe that, as the working class population segment increases, and as trends within the retail banking industry make banking less accessible or more costly to these consumers, the industry in which we operate will see a significant increase in demand for our products and services.”¹ (Dollar Financial, parent of Money Mart, the largest payday lender in Canada)

In November 2004, ACORN released a report called “Protecting Canadians’ Interest: Reining in the Payday Lending Industry” that documented the closure of more than 700 bank branches across the country in just a two year period from 2001 to 2003. The report analyzed the locations of these closures and found that they were largely concentrated in lower income neighbourhoods. The report then also looked at the locations of payday loan stores and found that payday lenders had moved aggressively into the vacuum left by the banks.

In this report we examine the involvement of Canada’s two largest banks in financing the “predatory economy” that they helped create and in profiting from the emergence of payday lenders, pawnbrokers, rent-to-own stores, and cheque cashers. These businesses harm our communities and strip billions of dollars from the neighborhoods and working families who are the most in need.

By funding these “shadow banks,” Royal Bank of Canada and Toronto Dominion are enforcing their own brand of economic apartheid and maintaining two separate and very unequal financial systems. This is even more apparent in the investments the banks have made in the largest subprime mortgage lenders in North America.

The banks invite some customers to enter through the front door for chequing accounts protected from overdrafts, savings accounts with high yields, home equity loans at prime rates, mortgages on beneficial terms, and the opportunity to invest in and profit from those customers who enter through the back door.

Those second-class customers can be found on the other side of town, hocking their limited possessions, paying triple digit rates for payday loans, forking over large fees to cash their cheques, and getting tricked into taking out subprime mortgages that may cost them their homes.

Of the two banks, Toronto Dominion is more heavily invested in the predatory economy, owning over a million shares, worth more than \$50 million, in predatory payday lenders and mortgage companies, including 250,000 shares in Money Mart, the largest payday lender and cheque casher in the country.





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PAYDAY LENDING

"Despite the demand for basic financial services, access to banks has become more difficult over time for many consumers. Many banks have chosen to close their less profitable or lower-traffic locations. Typically, these closings have occurred in lower-income neighborhoods where the branches have failed to attract a sufficient base of customer deposits. This trend has resulted in fewer convenient alternatives for basic financial services in many neighborhoods. Many banks have also reduced or eliminated some services that under-banked consumers need . . .

"We believe that the under-banked consumer market will continue to grow as a result of a diminishing supply of competing banking services as well as underlying demographic trends..."² (Dollar Financial, parent of Money Mart)

The existence of two separate and very unequal financial systems has become more and more clear in recent years, although the definition of the different systems has changed.

Previously, the distinction was between those with a bank account and those without – the "banked" and "unbanked." Much attention was focused on the ways that banks shut out lower-income and minority families and on how to bring these "unbanked" families into the economic mainstream.

Now, there is growing awareness of the large numbers of "underbanked" – folks who have a bank account but do much of their business through other types of financial service providers.

Nowhere is this more evident than in the proliferation of payday loan stores. Payday loans require the customer to have a bank account and to provide a post-dated cheque for the repayment amount. Ten years ago payday lending was almost unheard of, and even five years ago payday lending played only a marginal role in the economy. Now it is a \$2 billion a year industry.

- Rentcash, Inc. which conducts business under the names The Cash Store, Instaloan, and Insta-rent, grew from 25 stores in 2002 to 432 stores in 2006.
- In 2003, Money Mart made \$248 million in payday loans in Canada. By 2006, this number had more than doubled to \$554 million.



What is Payday Lending?

Payday loans are short-term consumer loans for small amounts. They derive their name from their due date: the loans need to be paid back on the date when the customer receives their next paycheck.

In order to obtain the loan borrowers must agree to “secure” the loan by handing over a cheque for the loan amount plus interest, post-dated for their next payday.

In most of Canada, the payday lending industry operates completely unregulated and makes money by blatantly violating the law with every loan they make. While the Criminal Code clearly states that annual effective interest rates must not exceed 60%, payday lenders typically charge between 380% - 900% and, not infrequently, more than 1,000%. A customer may have to pay up to \$90 in fees to borrow \$300 for just two weeks.



What are the Other Problems with Payday Lending?

Payday lenders say their loans are meant to help people in a one-time emergency, but in fact payday loans are set up to sink people deeper in debt and trap them in extremely expensive loans.

Payday lenders don't consider whether the person can pay a loan back before approving it. There are no credit checks and most companies have no limits to the percentage of a person's next paycheck that they can receive in a loan. As long as someone has an ID, bank account, and source of income, they can get a loan. That's because payday lenders don't want people to pay the loans back. That's how they make their profits.

Most customers can't afford to pay the whole loan back in two weeks, and if the payday lender deposits their cheque, it will bounce, costing the customer even more in fees. So instead of incurring bounced check fees, the customer agrees to renew the loan, and just pays the interest off or takes out a new loan to pay off the old one, leading to a cycle of debt that can last for months or even years.

A 2004 Ernst & Young study prepared for the Canadian Payday Loan Association found that each first-time customer would end up taking out an average of 15 rollover or rewrite loans.³

One thing that's clear is that payday loan customers don't just walk away from their loans. They can't. As an executive at Dollar Financial, the parent company of Money Mart, said:

“I think it's important to note that we are essentially first in line when it comes to our customer spending. We get paid either out of the paycheck or on payday.”⁴





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There are additional risks associated with payday loans because they are secured with a post-dated cheque. This means that if a borrower does not have enough money in their account when the lender debits the account, the customer will end up with a bounced cheque/ Non sufficient funds fee every time. Some payday lenders will attempt automatic withdrawal once a day or more until the loan is paid back, and the cost of insufficient funds charges or bounced cheques can add up quickly. This can lead to forced account closings and leave a customer's other bills unpaid, lowering their credit scores and impacting their ability to obtain fair loans for things like mortgages, cars, or even education in the future.

Why do bank customers turn to payday lenders?

Payday lenders have built their entire business on the simple truth that lower income families don't have a lot of money and are often in need of funds. Payday lenders beckon customers with promises of "Cash Now", "Easy Money," and "Fast Cash." And the signs don't lie. As long as you're at least 18 years old with a regular source of income and a chequing account, you qualify for a loan.

This is in stark contrast to both the real and perceived reception that lower income families get at banks.

Not only are bank locations and hours not as accessible, but neither are the products.

- 1) Banks generally do not make small loans in the amounts that payday lenders do, such as \$200 or \$300
- 2) Some bank customers say they have taken out payday loans in order to avoid overdrawing their chequing account and having to pay large Non Sufficient Funds (NSF) fees, which are \$37.50 per cheque at Toronto Dominion.
- 3) Most customers do not know about or did not qualify for conventional overdraft protection, which generally has an 18% or 21% APR, significantly less expensive than NSF fees and payday loans.
- 4) Many customers do not know about or did not qualify for a credit card through their bank.

In the United States, the Federal Deposit Insurance Corporation (FDIC) has encouraged the more than 5,000 banks it supervises to offer small-dollar affordable loan products.

"There is a huge demand for small-dollar, unsecured loans, but there are far too few low-cost options available for consumers," said FDIC Chairman Sheila C. Bair. "It is our obligation as a regulator to encourage those we regulate to create products that are beneficial to both the banks and their customers."

However, as shown in the charts below, rather than developing new products to better serve their customers' needs, Toronto Dominion and Royal Bank of Canada have chosen to invest in the largest payday lenders in Canada and the United States.



TORONTO DOMINION BANK and affiliates⁵		
PAYDAY LENDER	NUMBER OF SHARES	VALUE OF SHARES
Advance America	1,555	\$22,000
Cash America	7,700	\$348,000
Compucredit	705	\$28,000
Dollar Financial	250,686	\$7,163,000
First Cash Financial	12,871	\$269,000
World Acceptance Corp	4,700	\$217,000
TOTAL	278,459	\$8,058,000

ROYAL BANK OF CANADA and affiliates⁶		
PAYDAY LENDER	NUMBER OF SHARES	VALUE OF SHARES
Advance America	28,700	\$410,000
Compucredit	18,819	\$749,000
Dollar Financial	600	\$17,000
EZCORP	4,169	\$190,000
First Cash Financial	59	\$1,000
World Acceptance Corp	3,026	\$140,000
TOTAL	55,373	\$1,507,000



PREDATORY MORTGAGE LENDING

Subprime mortgages are intended for people who are unable to obtain a conventional prime loan at the standard bank rate. The loans have higher interest rates to compensate for the potentially greater risk that these borrowers represent.

A subprime mortgage market has only recently developed in Canada, where subprime loans represent just 5% of the total home mortgage loans outstanding. However, the market is growing rapidly. During the first half of 2006, the number of subprime loans rose by 50% compared to the first half of 2005. That is a growth rate almost five times faster than prime mortgages. CIBC World Markets forecasts that the number of subprime loans will increase at an annual average rate of 20% over the next five years – more than double the predicted pace for prime loans.⁷ CIBC Economist Benjamin Tal is very clear about the reason for the growth:

“There is little doubt that the recent acceleration in non-conforming mortgages in general, and sub-prime in particular, is driven by the entry of new players to the mortgage lending business and a transfer of business models from the U.S. This process is only in its infancy.”

This statement should strike fear in Canadian homeowners and future homebuyers. The subprime industry in the United States has proven to be a fertile breeding ground for predatory and abusive lending practices.

Subprime loan volume tripled to \$650 billion (U.S.) from 2000 to 2005, and subprime loans now account for almost one out of every four mortgages in the United States.⁸

While there is a legitimate place for flexible loan products for those whose credit or other circumstances will not permit them to get loans on “A” terms, The problem arises when loan terms or conditions become abusive or when borrowers who would qualify for credit on better terms are targeted instead for higher cost loans. Unfortunately, these problems pervade too much of the subprime industry.

Too often, higher rate subprime loans have been loaded with harmful features – such as large and extended prepayment penalties, financed single premium credit insurance, and excessive closing costs – which cost borrowers even more money, and can keep them trapped into the higher interest rate. When a borrower with good credit in a high rate loan is also charged inflated up front fees, assessed a prepayment penalty, and/or sold financed single premium credit insurance, it often leaves them without enough equity to refinance into a loan at a more reasonable rate. Borrowers are also often trapped into loans when lenders or servicers damage their credit scores by falsely reporting late payments and inflated loan amounts; sometimes the simple fact of taking out a subprime loan or a home-equity line of credit – regardless of a borrower’s repayment record – can damage a borrower’s credit score.

Other borrowers who are not in a position to qualify for an “A” loan are also routinely overcharged in the subprime market, with rates and fees that reflect what a lender or broker

TORONTO DOMINION BANK and affiliates⁹		
SUBPRIME MORTGAGE LENDER	NUMBER OF SHARES	VALUE OF SHARES
Accredited Home Lenders	73,622	\$1,910,000
HSBC	341,507	\$31,228,000
New Century	22,550	\$678,000
Novastar Financial	317,800	\$6,862,000
Ocwen	52,362	\$747,000
TOTAL	807,841	\$41,425,000

ROYAL BANK OF CANADA and affiliates¹⁰		
SUBPRIME MORTGAGE LENDER	NUMBER OF SHARES	VALUE OF SHARES
HSBC	70,777	\$6,471,000
New Century	5,415	\$163,000
Novastar Financial	200	\$4,000
Ocwen	47,519	\$678,000
TOTAL	123,911	\$7,316,000

thought they could get away with, rather than any careful assessment of the actual credit risk. Incentive systems which reward brokers and loan officers for charging more make this a widespread problem. Unscrupulous mortgage brokers convince consumers they are acting to secure the lowest-priced loan when they are actually taking kickbacks from lenders to jack up interest rates, in addition to their standard origination fees.

As shown in the charts above, Toronto Dominion and Royal Bank of Canada are both heavily invested in the U.S. subprime market with lenders whose bad lending policies have recently been making headlines.

On the front page of the business section in the February 9, 2007 Globe and Mail, the top story read: "U.S. mortgage lenders rattle markets. HSBC, New Century warnings raise fears for huge numbers of high-risk home loans." The other lenders listed below have had similar problems. The time does not appear to far away when Toronto Dominion and Royal Bank of Canada will have their own subprime lending arms, as their US counterparts do. A year ago, Bank of Nova Scotia announced it would buy Maple Trust, a mortgage company that worked primarily through brokers. The bank followed this by announcement by introducing its new venture called The Mortgage Authority, which would seek referrals from brokers of borrowers with credit problems. A Toronto Dominion spokesperson said that there would likely be more of this type of activity among Canadian banks. "There's something about our mentality that says, well, if one of us wants to do it, why shouldn't the rest of us do it?" he says.¹¹



SUBPRIME AUTO LOANS

Last year three of Canada's largest banks were in a bidding war to buy an auto finance company that charges customers over 20% interest on their car loans. Toronto Dominion won, beating Royal Bank of Canada and Bank of Montreal, and bought VFC for \$326 million. Toronto Dominion plans to refer to VFC all the customers whose car loan applications it declines.

RECOMMENDATIONS

1. Banks should divest their stocks from all institutions that are part of the predatory economy, such as subprime mortgage and payday lenders.
2. Banks should seek ways to improve their current services and products to better meet the needs of consumers who use payday lenders.
3. Canada's credit unions should implement alternative payday loan programs, such as those used by some U.S. credit unions.
4. Banks should learn from predatory lending problems in the U.S. and work to better serve those customers who are targeted for subprime mortgages.
5. Banks that have a subprime lending division should implement policies so they are not just referring customers down to the subprime division from the bank, but that the subprime division refers customers with good credit up to the bank.



ABOUT ACORN

ACORN is the Association of Community Organizations for Reform Now. Incorporated as a nonprofit in the summer of 2004, ACORN Canada has offices in Toronto, Vancouver, and Ottawa. ACORN Canada is a democratic, multicultural, grassroots organization with members electing local, provincial, and national representatives. Members decide what issues to campaign on and how best to move campaigns forward to benefit ACORN Canada's members and the community at large.

ACORN is also the largest membership organization of low and moderate income families in the United States, with a thirty-seven year history of winning power through campaigns, advocacy, action and negotiation.

ACORN is a new organization in Canada. With over 350,000 in more than 100 cities in the U.S., ACORN is a powerful organization that commands the respect of governments, corporations, and others. Our goal is to build an equally powerful organization in Canada so that the voices of low and moderate-income people can be joined together in building their lives for their families; families that are too often ignored or mistreated by governments at all levels and by corporations.

Believing that real power can only come from roots deeply planted in the communities where ACORN works, ACORN has developed a systematic bottom-up approach to organizing at the neighbourhood level. Based on the experience gained from campaigning on local issues such as a stop sign on the corner, ACORN groups have come together to win important victories on the critical issues of social and economic justice that affect the lives of low and moderate-income families every single day.

ACORN Canada will build on the strength of its sister organization in the U.S. in targeting corporations that operate in both countries and that use unfair practices that exploit low and moderate-income families.

REFERENCES

¹ Dollar Financial Group, Inc., 10K, filed 9/15/06

² Dollar Financial Group Inc., 10K, filed 9/22/05

³ *Globe and Mail*, "The Loan Rangers," John Daly, March 31, 2006.

⁴ From a transcript filed with the United States Securities and Exchange Commission: *Dollar Financial Group, FY 2004 Year-End Operating Results Conference Call*, August 30, 2004.

⁵ Stock holdings as of January 2007 for Toronto Dominion Bank, TD Securities, TD Options, TD Asset Management Inc, and TD Ameritrade.

⁶ Stock holdings as of January 2007 for Royal Bank of Canada, RBC Capital Markets, RBC Capital Markets Arbitrage, and RBC Dain Rauscher.

⁷ CIBC World Markets, *Consumer Watch Canada*, October 10, 2006, "Sub-Prime As Prime Target: The Surging Non-Conforming Mortgage Market in Canada."

⁸ *Globe and Mail*, February 9, 2007, "U.S. mortgage lenders rattle markets."

⁹ Stock holdings as of January 2007 for Toronto Dominion Bank, TD Securities, TD Options, TD Asset Management Inc, and TD Ameritrade.

¹⁰ Stock holdings as of January 2007 for Royal Bank of Canada, RBC Capital Markets, RBC Capital Markets Arbitrage, and RBC Dain Rauscher.

¹¹ *Globe and Mail*, "The Loan Rangers," John Daly, March 31, 2006.



THE PEOPLE SHALL RULE



ACORN Canada

ACORN Canada's central purpose is to effectively represent and champion the interests of Canada's low- and moderate-income urban citizens on the critical issues of social and economic justice. We believe transforming the conditions that adversely affect millions of Canadians can best be achieved with an active national membership – members deeply invested in their organization and focused clearly on lasting, transformative socio-economic change.

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