



Building a better
working world

Illustrative Socioeconomic Loss Calculation

Canadian Lenders Association

March 8, 2024

Disclaimer

Ernst & Young LLP (EY) was engaged by the Canadian Lenders Association (CLA) to perform an illustrative economic impact analysis resulting from a proposed reduction of the criminal rate of interest from 47.2% annual percentage rate (APR) to 35%. The outcome of this study will provide CLA with an illustrative calculation of the potential socioeconomic impact as a result of these policy changes. In preparing this document (Report), EY relied upon unaudited data and information from CLA, consultations with stakeholders in the industry, as well as other third-party sources (collectively, the Supporting Information). EY reserves the right to revise any analyses, observations or comments referred to in this Report, if additional Supporting Information becomes available to us subsequent to the release of this Report. EY has assumed the Supporting Information to be accurate, complete and appropriate for the purposes of the Report. EY did not audit or independently verify the accuracy or completeness of the Supporting Information. Accordingly, EY expresses no opinion or other forms of assurance in respect of the Supporting Information or this Report and does not accept any responsibility for errors or omissions, or any loss or damage as a result of any persons relying on this Report or the information contained therein.

Canada's Criminal Code currently caps the criminal rate of interest at an APR of 47.2%. However, changes to legislation have reduced this amount to 35%.

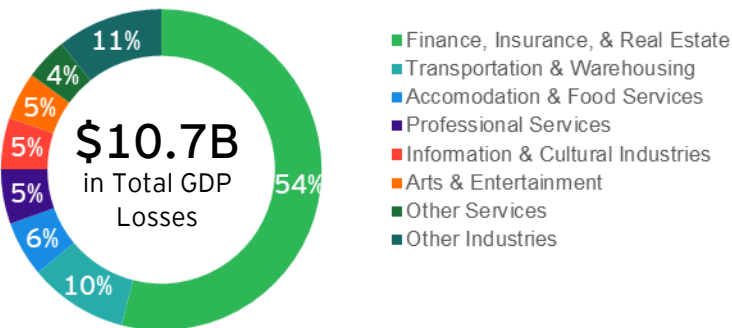
- A change in the APR cap can alter a borrower's access to credit which may lead to broader socioeconomic losses. These losses may be borne by lenders and borrowers in the following manner:
 - Lenders:** A reduction in the APR cap may lead to the inability of lenders to provide commercially viable loans to riskier borrowers, reducing borrower access to credit.
 - Borrowers:** A reduction in access to credit for consumer and business borrowers may displace them to non-traditional lenders.

Total Economic Losses

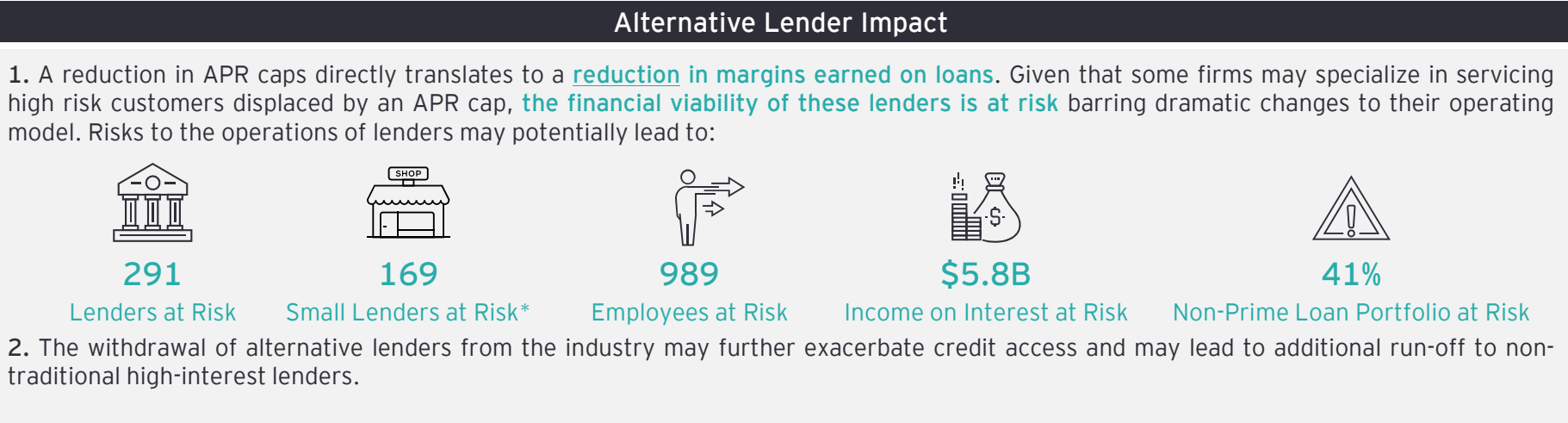
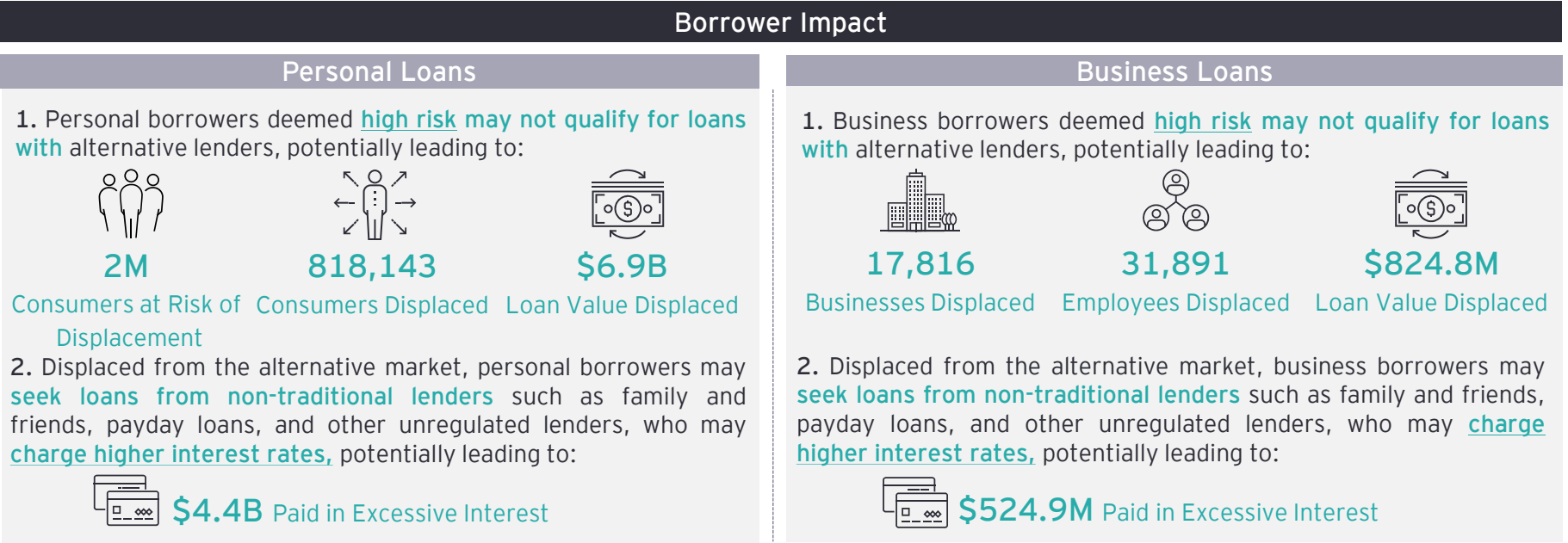
Figures includes direct and indirect losses from consumers and businesses.



Losses by Industry



The illustrative economic loss calculations presented are derived from impacts in the alternative lending industry which may displace a number of consumers, businesses, employees, and interest income. This may potentially place many lenders at risk of closure and therefore poses risks to their employees.



*Small Lenders employ between 1-4 employees and represent a subset of all lenders at risk.

Report Limitations

The scenarios evaluated in this study are hypothetical in nature, resulting in many assumptions in the data, information, and analysis. The potential socioeconomic losses are calculated from the current state of the non-prime credit market and through the combination of various data sources, including benchmark information from representative company financials or consumer spending patterns from other jurisdictions. As such, the findings presented in this Report are subject to change based on additional data made available in the future. This appendix outlines key assumptions and limitations associated with the modelling methodology undertaken in preparing this Report.

Assumptions

- ▶ The number of consumers at risk of displacement was determined by reviewing and identifying suitable consumers for non-prime loans based on creditworthiness and affordability at all credit score levels. This is representative of all who may seek, and qualify for, non-prime loans and are deemed at risk due to changes to the APR cap.
- ▶ The number of consumers displaced was calculated through the identification of the proportion of consumers at risk of displacement that would not have access to alternative capital through friends and family or assets to collateralize their respective loans. These consumers were identified based on various social, economic, and financial profiles, in addition to survey, industry reports, and management discussions with CLA members.
- ▶ The number of businesses displaced was estimated based on the identification of the proportion of non-prime business borrowers at risk of displacement that may not have access to capital through friends and family or assets to collateralize their respective loans.
- ▶ The number of employees displaced was estimated by calculating the average number of employees supported per business by industry.
- ▶ The loan value displaced for business and consumer loans was determined by calculating the total credit outstanding for borrowers displaced from the non-prime market.
- ▶ The excess interest paid was estimated by calculating the incremental interest paid to alternative non-traditional lenders in excess of a borrower's previous non-prime rate. This incremental interest rate is determined by subtracting assumed APR rates from the new hypothetical predatory interest rates commonly found in the non-traditional lending industry.
- ▶ Lenders at risk were estimated based on the financial health and commercial viability of the non-prime lending industry (defined as those businesses that fall in the NAICS Codes: 522291 Consumer Lending and 522299 All other non-depository credit intermediation) as a result of the proposed APR change. Analysis was completed by size of firm, ranging from Small to Large employers, enabling the identification of small lenders at risk.
- ▶ Gross number of Lender employees at risk was determined by calculating the number of employees supported by non-prime lenders at risk based on the size of the lender.
- ▶ Gross Income on Interest at risk was determined through the calculation of total non-prime interest income displaced on consumer and business loans displaced.
- ▶ Non-Prime Loan Portfolio at Risk was determined by calculating the loan value at risk as a percentage of total non-prime loan value currently outstanding in the market.
- ▶ The total economic losses were calculated using the financial profiles of displaced consumers, businesses, and alternative lenders. These profiles served as inputs to an economic model that estimated the impact of changes to the APR cap.
- ▶ All economic losses for businesses consist of losses associated with displaced businesses and alternative lenders.

Data Sources

- ▶ **Transunion:** EY was provided credit performance indicators by 30-point credit score bands to evaluate average borrower creditworthiness and loan affordability.
- ▶ **Statistics Canada:** EY analyzed business counts for lenders and business loans, household expenditure and saving profiles, 2019 Input-Output tables, economic multipliers, and NAICS Codes for the non-prime lending industry.
- ▶ **Consumer Financial Protection Bureau:** EY analyzed US benchmark data by credit risk rating for business indebtedness, revenues, financial performance, employees supported, and industry and charge off rates for personal loans. Adjustments were made to reflect the Canadian market.
- ▶ **Industry Financial Statements:** EY analyzed publicly available financial statements from lenders of various sizes and target demographics to provide indications towards the overall financial health of the industry as well as lending costs.
- ▶ **Industry and Consumer Sentiment Survey:** EY analyzed consumer survey data to estimate non-prime consumer behavior and displacement to non-traditional lenders.
- ▶ **Management Discussions:** Assumptions and inputs were validated through a series of management discussions across non-prime lenders.