CONSUMER INSOLVENCIES, CONSUMER CREDIT,

AND RESPONSIBLE LENDING

By

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> No man is an island entire of itself; every man
> is a piece of the continent, a part of the main;
> if a clod be washed away by the sea, Europe
> is the less, as well as if a promontory were, as
> well as any manner of thy friends or of thine
> own were; any man's death diminishes me,
> because I am involved in mankind.
> And therefore never send to know for whom
> the bell tolls; it tolls for thee.
> - John Donne, MEDITATION XVII

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A. INTRODUCTION

The number of consumer insolvencies in Canada has grown prodigiously over the past thirty years. As late as 1972, the number of individual non-business bankruptcies in Canada, 3,647, was smaller than the number of business bankruptcies. It grew rapidly thereafter and reached 21,025 in 1980. Between 1985 and 1997 the number of consumer insolvencies increased by over 300 per cent, from 19, 752 to 90,034. In 2001, the total number of individual filings amounted to 102,539.

In terms of the annual rate of increase, between 1968 and 2004 the number of filed consumer insolvency cases increased at an annual rate of 12.0%.[1] The sharpest increase, 22.6%, occurred between 1971-1980; the rate was 7.5% between 1980-1990, and 3.9% for the 2000-2004 period. On a population basis, the rate of insolvency was 1.1 per thousand Canadian residents, 18 years and older, in 1980 and 4.0 in 2004[2]. Only the US rate of consumer insolvencies was higher – 7.0 per thousand in 2004, although it has dropped dramatically since the adoption of the US Bankruptcy Abuse Prevention and Consumer Protection Act in April 2005. The comparable United Kingdom rate was 1.1 in 2004. Canada currently has the dubious distinction of having the highest rate of consumer insolvencies in the Western hemisphere. Equally troubling is the fact that the ratio of household debt in Canada to disposable income grew from 91% in 1990 to 127% in the third quarter of 2006 while real earnings of Canadians during this period only increased

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1 Canada, Office of the Superintendent of Bankruptcy Canada, *An Overview of Canadian Insolvency Statistics Up to 2004* (Ottawa: Industry Canada, 2006) at 20.
2 *Ibid*. at 21.

by 4.8%.[3] Also troubling is the fact that the number of senior citizens appearing among insolvent debtors has increased elevenfold since 1999.[4]

Canadian professional reaction to these escalating insolvency figures differs. Leaving aside cases of personal and unpredictable misfortunes (such as unemployment, marital problems, and serious illnesses), credit counselors and trustees in bankruptcy have long been of the view that many Canadian consumers do not know how to manage their budgets. This perception led to the establishment of voluntary credit counseling services in metropolitan Toronto and other parts of Canada and, more importantly, to the introduction of mandatory counselling requirements in the 1992 amendments to the federal Bankruptcy and Insolvency Act (BIA)[5].

Another reaction came principally from creditors. This was that it was too easy for consumers to initiate personal bankruptcy proceedings and to obtain an early discharge from their debts without being required to make a meaningful (or any) contribution to the reduction of their debts. This perception led to the adoption of the surplus income payment regime as part of the 1997 amendments to the BIA[6] requiring the debtor to make prescribed payments from the debtor's income as determined by the Low Income Cut Off (LICO) standards established by the Superintendent of Bankruptcy. The provisions are still in force.

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[3] Vanier Institute of the Family, *The Current State of Canadian Family Finances,* (Ottawa: February 2007) at 17.

[4] *Ibid*. at 18. See further Janis Sarra, "Growing Old Gracefully: An Empirical Investigation into Elderly Bankrupt Canadians," 2006 Annual Review of Insolvency Law 783.

[5] Bankruptcy and Insolvency Act*,* Stat. Can. 1985, c. B-3, s.157.1 [BIA].

[6] See now BIA, *ibid.*, s.68 and *cf*. Jacob S. Ziegel, "What Can the US Learn from the Canadian Means Testing System?" 2007 U. Ill. L. Rev. 195.

A striking feature of this reaction to the escalating insolvency figures was the assumption that the creditors themselves were blameless and bore no responsibility for the credit practices that often lead to a debtor's downfall. The thesis of this paper is that the assumption is incorrect and that there is abundant evidence of creditors' contribution towards debtors' difficulties. The writer is not alone in voicing these concerns. They have received much attention in recent studies, reports and testimony by witnesses in the United States, the European Union and the United Kingdom, and have led to new laws and regulations designed to promote greater creditor responsibility in the granting of credit.[7] In the United States, the same concerns have often also been expressed by consumer groups, welfare organizations and academics specializing in consumer insolvency and consumer credit problems.[8]

If proof were needed in the North American context of the dramatic consequences of irresponsible credit granting practices, it has been provided since the summer of 2007 as a collapse of the subprime mortgage market in the United States.[9] It is now also abundantly clear that, in an era of globalized financial markets and securitization of receivables, serious credit granting mistakes made in one part of the world are quickly transmitted to other countries and can impair the solvency and integrity of the international financial system. Belatedly, at this time of writing January 2008), bills are working their way through the Congress to impose codes of conduct and strong regulatory requirements on the participants in the US home mortgage market.[10] Canada also needs to learn from the American excesses and to adopt prophylactic measures to

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[7] See Part D, III, below.
[8] See Part D, III, 4, below.
[9] *Ibid*.
[10] *Ibid*.

ensure responsible creditor conduct and avoid the financial trauma from which the United States is currently suffering.

Canadian insolvency law has, since the adoption of the Bankruptcy Act of 1919, embraced the concept of responsible debtor conduct as a precondition to the debtor's discharge from bankruptcy.[11] Used in that context, responsible debtor conduct means that the debtor must not recklessly run up debts knowing the debtor would not be able to repay them, and must not dissipate his assets to make it more difficult for his creditors to enforce their claims. It seems logical to conclude that responsible lender conduct is the counterpart of responsible debtor conduct. However, there are several difficulties about this syllogism which will be examined in detail later in the paper.[12] One is that the concept of responsible creditor conduct is not enshrined in Canada's current insolvency law and would therefore have to be adopted as a discrete norm or be given effect to indirectly by imposing specific duties on creditors or restricting a creditor's remedies where a creditor has not behaved responsibly. The other challenge facing advocates of the concept is that it will not be easy to apply given the many different types of consumer credit and the varying debtor-creditor relationships. Nevertheless, as a working proposition, the meaning ascribed to responsible lending in this paper is that the lender must not knowingly or recklessly extend more credit to a consumer than the consumer can reasonably carry and can be expected to be able to pay off having regard to the debtor's existing and future financial circumstances.

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[11] See now BIA, *supra* note 5, s. 173. Like much else in the 1919 Act, the concept was borrowed from the English Bankruptcy Act, 1914 (U.K.), 4 & 5 Geo. V, c. 59.

[12] See Part D, II, below.

The rest of this paper proceeds as follows. Part B examines the causes of consumer insolvencies in Canada and, in particular, the role of overindebtedness. Part C traces the evolution of consumer credit in the Western hemisphere but particularly North America, and is divided into four sections. Part D of the paper addresses the concepts of responsible and irresponsible lending and enquires, in some detail, what sanctions are applied in Western Europe and in the United States and Canada against creditors who do not extend credit responsibly. It also examines the recommendations and legislative proposals that have been made (including recommendations offered by this writer) to enhance creditor responsibility. The concluding part of the paper, Part E, draws some overall conclusions.

B. CAUSES OF CONSUMER INSOLVENCIES

Another of the premises underlying this paper is that excessive amounts of credit lead to consumer insolvencies. It is therefore relevant to ask to what extent existing data support this hypothesis, obvious as it may appear to the reader. The answer is that it is not easy to isolate the causal relationship between consumer credit and consumer insolvencies because of other factors that frequently play a role in consumer insolvencies, such as loss of employment or reduction in earnings, sickness, divorce and separation, and (in the case of students with large student loans) inability to find a well paying job on graduation to enable the former student to pay off the student loans. Nevertheless, over the past 25 years five statistical and case studies have been conducted in Canada to develop a profile of the debtors and their debts and the source of their financial difficulties. Many of these studies (though not all) have used as their source the section

170 BIA report prepared by the trustee in which the trustee is required to state what, in the trustee's or debtor's opinion, led to the debtor's insolvency[13]. The results are shown below. As will be seen, they follow no uniform pattern and adopt no uniform terminology in identifying the causes of the debtor's insolvency:

TABLE 1: CAUSES OF CONSUMER BANKRUPTCIES: CANADIAN STUDIES

	Brighton/Connidis[14]	***McGregor/Berry***[15]
Consumer Debt	49.2%	43.6%
Unemployment	15.2%	30.4%
Health/Misfortune	14.3%	7.1%
Business Related	14.3%	0.0%
Marital Family Problems	6.8%	5.4%

	Schwartz & Anderson[16]	
	No. of Responses	Percent of Total
Loss of Job or Reduced Income	277	18.8%
Personal Problems	161	10.9%
The Debt Repayment Process	90	6.1%
General Inability to Repay Loans	96	6.5%
Credit Cards	86	18.8%
No specific event/ debt or " no response"	164	11.1%
Debts to Government	166	11.3%
Small Business Failure	60	4.1%
All Other Events or Debts	384	25.9%
Total Number of Triggering Events or Debts Names	1,484	

	Iain Ramsay[17]

13 *Supra* note 5, s. 170.

14 J.W. Brighton & J.A Connidis, *Consumer Bankrupts in Canada* (Consumer and Corporate Affairs Canada, 1982), Table 13, p. 33.

15 *Insolvency Bulletin*, vol. 19, Nos. 1 & 2 (1998-99).

16 S. Schwartz & L. Anderson, *An Empirical Study of Canadians Seeking Personal Bankruptcy Protection from* (Industry Canada, Ottawa, 1998), Table 29, p. 86, 1st two columns.

	All Debtors (%)	Pure Consumer Debtors (%)
Adverse Employment Changes	24%	28%
Business Failure	14%	10%
Overextension	9%	10%
Inadequate/Insufficient Income	9%	10%
Loss of Income and Overextension	9%	8%
Marital Breakdown and …	8%	6%
Loss on Sale of Home/Deficiency Claim	6%	6%
Real Estate Investment Failure	5%	6%
Guarantor	5%	4%
Adverse Employment Change Related to Health	4%	3%
Tax Liability	3%	3%
Mismanagement of Finances	2%	3%
Marital Breakdown	2%	2%
Other	…	…
Total	100	100

TABLE 2: PRIMARY CAUSES OF BANKRUPTCY REPORTED BY AGE (JANIS SARRA[18])

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17 Iain Ramsay, "Individual bankruptcy: preliminary findings of a socio-legal analysis: [paper presented at the Conference on the Contemporary Challenges of Consumer Bankruptcies in a Comparative Context held at the Faculty of Law, University of Toronto, Aug. 21-22, 1998.]" (1999) 37 Osgoode Hall L.J. 15 at 61.

18 *Supra* note 4.

	55–59	60–64	65–69	70–74	75+	All
Over-extension of Credit	26.50%	25.77%	27.68%	35.66%	37.75%	29.21%
Money mismanagement	6.24%	9.23%	11.49%	11.19%	10.29%	9.39%
Loss of employment income	15.81%	11.73%	10.70%	8.39%	4.90%	11.24%
Medical reasons	15.59%	15.96%	16.45%	11.19%	10.78%	14.66%
Insufficient Income	10.24%	11.35%	13.05%	11.19%	15.20%	11.83%
Costs of moving	0.45%	0.96%	0.26%	0.35%	0.49%	0.54%
Involvement in failed business	7.35%	8.65%	6.53%	4.90%	3.43%	6.73%
Gambling	2.23%	2.50%	2.87%	2.10%	2.45%	2.44%
Pension not sufficient	1.11%	1.35%	1.31%	3.85%	1.96%	1.74%
Marriage breakdown	5.79%	5.19%	3.39%	1.75%	4.41%	4.34%
Failure to pay taxes	3.12%	3.27%	3.13%	5.24%	3.92%	3.58%
Financial support of child	1.56%	1.73%	1.31%	1.40%	2.45%	1.63%
Fraud	1.11%	0.38%	0.52%	1.40%	1.47%	0.87%
Other	2.90%	1.92%	1.31%	1.40%	0.49%	1.79%

Nevertheless, if we overlook the differences in terminology and assume that "consumer debt" in the Brighton/Connidis and McGregor/Berry studies and "debt repayment process", "general inability to repay loans" and "consumer credit" categories in the Schwartz/Anderson study are equivalent to "overextension of credit" in the Ramsay and Sarra studies, it is fair to conclude that consumer credit extended by financial institutions plays a significant role (in the vicinity of 30 per cent of the total replies) in all the studies, with the possible exception of the Ramsay study. This conclusion should not surprise us. Other studies have also shown the close correlation in Canada between the expansion in the volume of credit card debt and consumer bankruptcies.[19] Of course, the prominence of consumer credit debt in personal insolvencies does not prove that lenders behaved irresponsibly in extending the credit outside insolvency. Whether they did not will depend on what they knew or ought to have known about the debtor when they

[19] Informetrica, *Consumer Bankruptcies: Contributing Key Factors* (Ottawa: 1999), Figure 1, and *cf*. Diane Ellis, "The Influence of Legal Factors on Personal Bankruptcy Filings" *Bank Trends* (Feb. 1998).

granted the credit and about the terms of the credit. These critical issues form the heart of this paper and are discussed in Part D below.

C. EVOLUTION OF CONSUMER CREDIT

In trying to understand the contemporary role of consumer credit, its uses and abuses, it is helpful to understand the evolution of consumer credit. It will be seen that some of the current issues have deep historical roots and echo familiar themes while others are distinctly modern and are a product of computer technology, modern merchandizing techniques, and new methods for the delivery of credit, notably through the medium of credit cards. The term consumer credit is itself of post-Second World War origin. Before the war, lawyers, economists and financers spoke of the different types of consumer credit without appreciating their essential unity. Today, consumer credit is understood to mean[20] credit made available to a consumer for personal or family use or consumption and it is in that sense that consumer credit is used in this paper. Broadly speaking, for the purposes of this paper, consumer credit in the Western hemisphere can be divided into three periods. The first period runs from Biblical times to the end of the First World War. The second period covers the interwar period 1919-1939. The third period extends from 1945 till the present time.

I. First Period: Usury Prohibition, Pawnbroking and Early Installment Credit

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[20] And is commonly so defined in legislation. See e.g., Consumer Protection Act 2002, Stat. Ont. 2002, c.30 as am., Part VII, s.66.

Obviously this very long first period, with the possible exception of the second half of the 19th century, is much removed from the 21st consumer oriented society. Nevertheless, this early period is important for three reasons. First, in the Western hemisphere, concerns over usury and usurious loans dominated much of the thinking about the propriety of lenders charging interest for the making of loans. Second, the pledging of chattels to a lender (including, at the upper scale, the pledging of gold artifacts and jewellery) was the most common, if not exclusively available, security for the granting of loans. Third, installment sales involving durable consumer goods began to appear in substantial quantities in the second half of the 19th century as an offshoot of the industrial revolution. This presaged the installment sales of automobiles for consumer use and the sale of household appliances, furniture, and electrical home entertainment devices that were such a strong feature of the 1919-1939 interwar period.

1. The Usury Problem[21]

Usury among Israelites is prohibited in the Old Testament[22] and migrated from there to the New Testament[23] where it is not restricted in its scope to loans made to borrowers of a particular persuasion. The prohibition was also embraced by the Roman Catholic and, later, Protestant Churches and became part of the moral and secular law throughout Europe. In addition to its theological basis, two rationales were apparently offered for this rigorous condemnation of usury. One was that it amounted to exploitation of necessitous borrowers. The other rationale, which carried the impressive imprimatur of

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21 See generally, "Usury" in *Wikipedia, The Free Encyclopedia.*

22 *Exodus, 22:25; Leviticus, 25:35-37.*

23 Luke 6:35, 19:23.

Aristotle, was that money is inert and cannot breed money. Nevertheless, the medieval scholastics, influenced by Thomas Aquinas and Roman law concepts of damages and unjust enrichment, recognized various exceptions.[24] One of them involved loans at low rates of interest to poor persons by the Franciscans and other charitable institutions known as *montes pietatis.* Exceptions were also common among the Italian city states and fictions were used to justify other types of contract that implicitly violated the prohibition against usury.[25]

In England, starting with the reign of Henry VIII, mercantile interests began to press for a broader relaxation of the usury rules. A statute of Henry VIII permitted the charging of interest on loan with a ceiling of 10% if certain conditions were satisfied. However, the act was repealed in 1551-52 during the reign of Edward VI under the influence of the new Protestant mood.[26] The debate continued[27] between the contending factions and, in 1571, during the reign of Elizabeth I, a new statute (13 Eliz c 8) reinstated the statute of Henry VIII and repealed the statute of Edward VI.[28] An Act of 12 Anne c 16 (1640) reduced the permissible interest rate to 5 per cent and this and subsequent acts excepted described transactions from the general prohibition of usury.

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[24] *Viz*. the concept of *damnum emergens* where the lender could show he had suffered loss as a result of the loan and of *lucrum cessans* where he could show that he had been deprived of a benefit. Sir William Searle Holdsworth, *A History of English Law,* vol. 8 at 100 *et seq*.

[25] Despite these exceptions, Holdsworth, *ibid*. at 107, emphasizes that trade only accounted for a small part of loans and that the greater part of the population was still very vulnerable to exploitation by lenders.

[26] *Ibid*. at 109.

[27] For detailed account, see N. Jones, *God And The Money Lenders: Usury And Law In Early Modern England*, Basil Blackwell (1991), esp. ch 2 and 3.

[28] *Supra* note 24. However, according to Holdsworth, the Act also provided that if action was brought to recover the permissible rate of interest (10%) the interest would be forfeited! Holdsworth claims however that in practice the forfeiture provision remained a dead letter.

English law remained in this state until 1854 (but coupled with the equitable doctrine of relief from oppressive bargains) when all the usury statutes were repealed under the influence of the Utilitarian philosophy of Jeremy Bentham and his disciples in favour of free markets. It soon became clear however that some lenders were abusing their newly found freedom when dealing with necessitous borrowers and Parliament had to intervene. The intervention took two forms. First, the Bills of Sales (1878) Amendment Act of 1882 closely regulated the terms and conditions on which lenders could take household goods as security for loans. Second, in 1900, the Money-Lenders Act conferred power on the English courts to reopen transactions and to grant relief where, in the court's opinion, the interest was excessive or the transaction was harsh and unconscionable.[29] An interest rate of 48 per cent was presumptive evidence of an unconscionable transaction.

19th century Canadian experience with the consequences of abolishing interest ceilings on loans was similar to England's. Prior to Confederation, Upper and Lower Canada had no general interest ceilings for loans[30] but ceilings were retained in the Maritime provinces and survived after Confederation until 1890. In that year, the Interest Act provisions that had consolidated provincial limits on interest rates as they existed prior to Confederation were repealed.[31] The Money-Lenders Act was adopted in 1906[32]

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[29] The Money-Lenders Act, 1900 (U.K.), 63 & 64 Vict. c. 51 was extensively revised in 1927. The Consumer Credit Act 1974 (U.K.), 1974, c. 39 repealed the money lenders legislation and replaced it with a general licensing requirement for credit grantors and with the concept of an "extortionate credit bargain" (s. 137-140). The English courts construed the test very narrowly and it was replaced in the Consumer Credit Act 2005, s. 19. See Part D, III, 1, below.

[30] There were interest restrictions earlier in the century but they were abolished in 1856, presumably in response to pressures and sentiments similar to the English developments.

[31] M.A. Waldron, *The Law of Interest in Canada* (Scarborough, Ont.: Carswell, 1992), p. 9.

[32] Stat. Can. 1906, c. 122.

for the protection of small borrowers and limited interest rates to 12% per annum on loans under $500 made by a "money-lender". Money-lender was defined in s. 2. The Act was "a dismal failure"[33] because of its simplistic approach and the absence of licensing requirements and a definition of interest.[34] The Small Loans Act, which was adopted by the Canadian Parliament in 1939, was based on the Model Small Loans Act prepared by the Russell Sage Foundation in the U.S.[35] and remedied the many defects in the 1906 Money-Lenders Act. The Small Loans Act was generally regarded as a very successful measure prior to its *de facto* repeal in 1981 and its replacement by s.405.1 of the Criminal Code.[36]

Interest ceilings at the state level for loans of all sizes survived much longer in the US than in Canada or England and did not distinguish between commercial and consumer loans. One consequence of this lack of discrimination was that licensed lenders and bankers were unwilling to make consumer loans for small sums, thereby forcing low income consumers into the arms of unlicensed lenders.[37] This picture changed in the first quarter of the 20th century with the adoption by a majority of the states of the uniform small loans act and its much more rate sensitive structure.

This highly condensed history of the treatment of usury in common law jurisdictions is relevant to the topic of this paper because it casts light on an enduring

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[33] Waldron, *supra* note 31 at 11.

[34] The Act was repealed by Stat. Can. 1956, c. 46, s. 8.

[35] On the origins of the small loans legislation in the US and the role of the Russell Sage Foundation, see the lively account in Lendol Calder, *Financing the American Dream: A Cultural History of Customer Credit* (Princeton, N.J.: Princeton University Press, 1999), ch. 3.

[36] S. 405.1 is now s. 347 of the Criminal Code. The reasons for the repeal and the disastrous effect of s. 347 are discussed in Part D, IV, 1, (b), below.

[37] For a vivid description of the operation of unlicensed lenders in the last quarter of the 19the century, see Calder, *supra* note 35, ch. 1, 49-54.

challenge facing policy makers in the consumer credit area: how to protect vulnerable borrowers against extortionate bargains, whether an open and competitive market is the best solution, and whether rate ceilings are unavoidable in this segment of the market.

2. *Pawnbroking Transactions*

The pledging of chattels as collateral, commonly known as pawnbroking when conducted by a lender operating from fixed premises open to the public, is the oldest security device known to most legal systems.[38] For many centuries it was also the only recognized form of security in chattels. Pawnbroking was apparently well established in Chinese society long before it was mentioned in the Bible and before it became a familiar feature in Western Europe via Roman law.

The essence of pawnbroking is that the pawnbroker retains the collateral as security for repayment of the loan. Under Roman law and at common law, if the loan is not repaid, the pledge is entitled to sell the goods to recover what is owed but is not entitled to keep the goods as his own. However, in Canada, legislation has often changed the rule for pawnbrokers and enables the pawnbroker to keep the goods as his own subject to giving borrower prior notice of the pawnbroker's intention.[39] Typically, in common law jurisdictions, once the borrower has forfeited the right to redeem the goods the pawnbroker puts the goods on display for sale at his premises. In England, in earlier

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[38] A very helpful historical overview appears in Wikipedia, "Pawnbroking", online: Wikipedia <http://en.wikipedia.org/wiki/Pawnbroking>. A very highly regarded and scholarly study is that by John Caskey, *Fringe Banking: Check Cashing Outlets, Pawn Shops and the Poor* (New York: Russell Sage, 1994), esp. ch 2.

[39] See e.g., the Ontario Pawnbrokers Act, Stat. Ont. 1990, c. P.6, ss.21 et seq. The reason for this departure from the common law rule (and the enforcement provisions in the provincial Personal Property Security Acts) is that there is often no ready market for pledged consumer goods

centuries, even clothing was accepted by pawnbrokers as collateral. Nowadays, pawnbrokers are primarily interested in items that have a high intrinsic value, such as gold rings, silverware and jewellery. Before the introduction of banking and established credit facilities, monarchs quite regularly pledged their valuables as collateral for a loan.

However, this has long ceased to be the case and, in North America, pawnshops are regarded as lenders of last resort for low income borrowers in need of a loan to tide them over till the next pay check or before the next welfare payment materializes. Pawnbroking facilities are attractive to borrowers because the transactions are simple and the borrower is not required to meet a credit test. Over the past decade or so, after a long period of slow decline, pawning seems to have revived in popularity,[40] though probably more so in the US than in Canada, and has become an important player in the alternative credit or "fringe banking" market among low income borrowers.

The inequality in their bargaining positions exposes borrowers to the potential for unfair practices by pawnshops. Pawnshops have therefore been subject to regulation in England since the 16th century and, at the state level in the US, since the second half of the 19th century.[41] Typically the legislation regulates the cost of the loan and the circumstances under which the pawned items may be forfeited to the pawnbroker. In Canada, at the present time, only Ontario and British Columbia appear to have regulatory legislation. However, in many provinces, municipalities also exercise their regulatory powers to require pawnbrokers to be licensed, and impose the requirement not for the

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[40] Cf. "When credit fails, pawn shops excel", *Globe & Mail,* Feb 26, 2008, B4

[41] Caskey, *supra* note 38.

protection of pawners but to prevent pawnshops from becoming a repository for stolen goods.[42]

3. Installment Sales

The industrial revolution and the generation of higher priced mass produced durable goods made consumer credit in the form of installment sales,[43] or hire purchase agreement, to use the English expression,[44] an ideal vehicle for making the goods accessible, first, to middle class families and, later, to working class families and individuals.[45] We are told that furniture dealers in the US were among the first retailers to make installment credit available to their customers.[46] Sewing machines were the first durable, technologically complex household appliance to find a North American market through installment sales. I.M. Singer & Company, the manufacturer of the Singer sewing machine, is generally credited with leading the way to popularize this method of sale on a national basis.[47] The concept was a simple one. The consumer received

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[42] This has led to litigation and the allegation that municipalities were abusing their regulatory powers. See e.g., *Cash Converters Inc. v. Oshawa (City) (2007) 86 O.R.*(3d) 401 (OCA) and *Royal City Jewellers& Loans Ltd. v. New Westminster (City)* [2007] 11 W.W.R. 622.

[43] Or, to use the technical term, conditional sales.

[44] The form of hire-purchase agreement was used in England, and not the conditional sale agreement common in Canada and the U.S., because the English Court of Appeal held in *Lee v. Butler* [1892] 2 Q.B. 318, that, by virtue of s. 9 of the Factors Act, 1889 (U.K.), 52 & 53 Vict., c. 45, the conditional buyer could pass good title to a third party purchaser of the goods even though the goods had not been fully paid for. Hire-purchase agreements were not caught by the Factors Act nor, later, by the Sale of Goods Act 1893 because, technically, the hirer had not agreed to buy the goods but only had an option to do so in the future. See *Helby v. Matthews* [1894] 2 Q.B. 262, and Royston Miles Goode & Jacob S. Ziegel, *Hire-Purchase and Conditional Sale* (London: British Institute of International and Comparative Law, 1965).

[45] Familiar examples were sewing machines, ice boxes, pianos, furniture and bicycles.

[46] Calder, *supra* note 35 at 162-165; E.R.A. Seligman, *The Economics of Instalment Selling* (New York: Harper & Brothers Publishers, 1927) at 14.

[47] Calder, *ibid.* at 162.

immediate possession of the goods on payment of a modest sum and a commitment to pay the balance of the price in instalments over an agreed period of time, which fell well below the expected life expectancy of the goods. Meanwhile, until the payments were completed, the seller retained title to the goods. If the goods were intended to be used for profit generating purposes (as in the case of seamstresses acquiring sewing machines for use in their home enterprises) the earnings could be expected to be more than sufficient to pay for the price of the goods. In the case of domestic appliances, such as ice boxes and furnaces, the savings in food purchases or the greatly improved domestic comforts more than offset the price of the goods. Items such as bicycles made attractive installment purchases because they could be used both for pleasure and as greatly improved means of transportation for those who did not own horses or have access to public means of transportation.

However, not all installment sales were well regarded. A large volume of 'low-grade' trade was conducted by small enterprises that made much use of "pullers in". These were agents who went from apartment to apartment looking for customers and escorting them to the stores they represented where the stores tried to persuade them to buy merchandise and durable goods for which they could pay by instalments. Other peddlers operated their own walking store.[48] There were also "fake" installment businesses and these gave installment selling generally a bad name, at least in the New York City area. They specialized in selling fake jewellery and used fraud and intimidation to enforce payment.[49]

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48 *Ibid.* at 177-79; Seligman, *supra* note 46 at 19-23.
49 Calder, *ibid.* at 178-79.

There is little doubt that door to door peddling was also a familiar phenomenon in various parts of Canada[50] but there are no reported cases of their having included "fake" peddlers. Such Canadian litigation involving instalment sales as occurred in the last quarter of the 19th century and before the First World War seems largely to have revolved around the buyer's liability to pay the balance of the price where the goods had been repossessed for non-payment or disputes between the seller and a third party claiming to have acquired the goods in good faith without prior knowledge of the seller's retention of title. Late 19th century conditional sales legislation in Canada and the US imposed registration requirements on sellers as a condition of the seller's entitlement to assert his title to the goods before they had been paid for.[51] The early Acts also frequently contained modest provisions protecting the buyer's equity in the goods after they had been repossessed by the seller's on the buyer's default and these were equally modestly expanded in the next century.[52]

II. Second Period: 1919 – 1945

The second phase in the evolution of consumer credit in Canada was marked by the following features. Between 1919 and the beginning of the Depression period, installment sales continued to grow vigorously, especially in relation to automobiles.

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[50] The author had a friend in Saskatoon, a furrier, who started his career around 1939 peddling fur coats and other clothing from door to door in smaller Saskatchewan communities.

[51] See Jacob S. Ziegel, "Uniformity of Legislation in Canada: The Conditional Sales Experience" (1961), 39 *Can. Bar Rev.* 165.

[52] *Ibid*., and Jacob S. Ziegel, "Retail Installment Sales Legislation: A Historical and Comparative Survey" (1962) 14 Univ of Toronto L.J. 143 at 148. See also J. S. Ziegel, "The Legal Regulation of Consumer Credit" in Jacob S. Ziegel & R.E. Olley, eds., *Consumer Credit in Canada* (University of Saskatchewan, 1966), p.70.

Also, sales finance companies were established and became an important factor in the financing of durable goods, particularly motor vehicles.[53] The introduction of financial intermediaries for the financing of sales was a mixed blessing from the consumer's perspective since it gave rise to 'holders in due course' and related problems. They became especially troublesome after 1945 because of the sales finance companies' use of promissory notes and cut off clauses to isolate themselves from buyer-seller disputes involving the quality of the goods and other aspects of the contract.[54] Initially however the installment sales industry had to overcome a moral crisis since influential public figures criticized consumer credit as dangerous for the economy and the welfare of consumers, and referred to it pejoratively as "consumptive credit" in contrast to credit extended to businesses which was deemed to be for "productive" uses and therefore good for the economy. Professor E.R.A. Seligman, a distinguished Columbia University economist, was commissioned by GMAC to conduct an independent study of installment selling. His two-volume report, published in 1927,[55] showed the criticisms to be unfounded and restored public confidence in installment sales. Prof Seligman also argued persuasively that there was no inherent distinction between productive credit and

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[53] The largest of them, General Motors Acceptance Corporation, was established during this period and also established a Canadian subsidiary as, later, did other major US sales finance companies. The leading Canadian sales finance company was the Industrial Acceptance Corporation (IAC). Interestingly Henry Ford Sr. did not believe in consumer credit and insisted on selling his vehicles for cash. Calder, *supra* note 35 at 191.

[54] A leading decision in the early period of installment sales was *Killoran v. Monticello State Bank*, (1921), 61 S.C.R. 528. In the post-1945 period, the problem was ultimately resolved by an amendment to the federal Bills of Exchange Act and amendments to the provincial consumer protection legislation. For the details see B. Geva, *Financing Consumer Sales and Product Defences in Canada and the United States* (Carswell Legal Pub. 1984).

[55] *Supra* note 46.

consumer credit: both could be good or bad depending on the use to which the credit was put.

Obviously the Depression period had a dampening effect on installment selling although Mr. Calder tells us that those who had purchased automobiles and other durable goods were remarkably conscientious in maintaining their payments. In Canada, the Prairie provinces of Alberta and Saskatchewan saw things rather differently. Both adopted moratorium legislation allowing debtors to suspend payment on bonds and other loans (much of which was later struck down by the courts as unconstitutional) and also adopted restrictions with respect to the enforcement of conditional sales debts.[56] One of the Alberta restrictions was particularly significant because it was later copied by other provinces (but not by Ontario). This provided that where the buyer was in default under a conditional sale agreement the seller was put to its election: it could repossess the goods or sue for the balance of the price, but could not do both.[57]

A third feature of the interwar period worthy of mention is the belated introduction of the federal Small Loans Act in 1939. This was designed to facilitate the making of small loans to low income consumers at a legal rate sufficiently high to encourage American consumer loan companies to establish subsidiaries in Canada. So far as the available statistics show, one result *not* engendered by the Depression years was an explosion in the number of consumer insolvencies, voluntary or otherwise. The reasons why it did not happen have not been adequately explored. Presumably, they were based on a combination of the facts that few consumers could afford the cost of a bankruptcy,

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[56] For the details see Goode & Ziegel, *supra* note 44 at 14, note 35.
[57] This statutory provision is usually referred to as the “sue or seize” restriction.

that a strong stigma attached to bankruptcy, and that consumers were very cautious about entering into credit commitments.

III. Third Period: 1946 To Present Time

Not surprisingly, from the perspective of this paper, the post-World War II period is the most important in the evolution of consumer credit. Three aspects of that period are particularly important. They are: 1. the renewed and rapid growth of installment credit; 2. the introduction and impact of multipurpose credit cards; and 3. the expansion and growing importance of alternative credit markets to serve the needs of low income consumers.

1. Installment Credit

The switch from a war time economy to a civilian economy and the pent up demand for durable goods of all description, and especially motor vehicles, also provided a need for sales financing services which were met by Canada's sales finance companies and, later the chartered banks, who introduced lines of credit for their more credit worthy customers. The abolition of interest ceilings on bank loans in 1967, and the profitability of consumer loans, gave the banks an added incentive to enter the market still more strongly with the result that the roles of the sales finance companies declined steeply after about 1980. In their roles as financers of consumer sales, the sales finance companies, banks and other financial intermediaries made use of consumer notes and "cut off" clauses to insulate themselves from buyer-seller disputes involving the sale of the goods. The buyer complaints became so prominent that Canadian courts felt obliged to intervene and did so starting with Justice Kelly's seminal decision in *Federal Discount Corp. Ltd.*

v. St Pierre,[58] which was decided in 1962. The federal Parliament also intervened in 1970 by adding Part V to the Bills of Exchange Act, the effect of which was to deny holder in due course status to transferees who received the notes with notice of its character.[59] The rapid expansion of consumer credit of all types also led to the 'truth in lending' controversy, which engaged the attention of Canadian and US legislatures for much of the 1960s and 1970s. Consumer advocates argued that, to enable consumers to compare the cost of credit among competing credit grantors, the cost of credit should be stated as an effective annual rate of interest as well as in dollars and cents. Though strongly resisted by sales finance companies and other elements of the consumer credit industry, the controversy was eventually resolved in favour of disclosure at both the provincial and federal levels.[60]

2. *Multipurpose Credit Cards*[61]

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58 (1962), 32 D.L.R. (3d) 86 (Ont. C.A.).

59 For further details see Jacob S. Ziegel & Benjamin Geva, *Commercial and Consumer Transactions: Cases, Text and Materials* (Toronto: Emond Montgomery, 1981) at ch. 16.

60 For the details see *ibid*. at 1187 *et seq*., and Goode & Ziegel, *supra* note 44 at 56-60. Canada was one of the first countries in the Western hemisphere to adopt truth in lending disclosure requirements. As the result of work done in the Consumer Measures Committee, created under the Agreement on Internal Trade*,* the provinces and the federal government also agreed in 1998 on a revised set of disclosure requirements. See Canada, Consumer Measures Committee, *Consultation on Cost of Credit Disclosure January 2005* (Ottawa: Industry Canada, 2005), online: Industry Canada <http://www.ic.gc.ca/epic/site/cmc-cmc.nsf/vwapj/costofcreditjan05.pdf/$FILE/costofcreditjan05.pdf>.

61 Surprisingly, there appears to be no comprehensive text on the legal or non-legal aspects of credit cards in Canada; the scholarly periodical literature is equally thin. Wikipedia.com has a good overview on credit cards under "Credit Card". However, Google's website on Canadian credit cards is disappointing and is largely filled with advertisements of various descriptions. Prof. Ronald J. Mann's book, *Charging Ahead: Growth and Regulation of Payment Card Markets* (Cambridge: Cambridge University Press, 2006) contains significant statistical data on Canadian credit cards from a

Credit cards are usually divided into two categories: multipurpose credit cards that can be used at any merchant outlet accredited by the card issuer and retail credit cards that can only be used at the issuer's own retail outlets. The following discussion focuses on multipurpose credit cards. As a concept, credit cards were first conceived of in a late 19th century novel. The concept was first given practical expression in metal disks issued to corporate customers by large retail outlets in New York and other large North American cities to enable the customers' employees to obtain goods from the stores without having to pay cash. The Diners Club is usually credited as being the first card issuer in North America

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comparative perspective. The other leading (non-comparative but controversial) US monograph on credit cards is by Robert D. Manning, *Credit Card Nation: The Consequences of America's Addiction to Credit* (New York: Basic Books, 2000). The Canadian Bankers' Association publishes annual statistics on credit card usage in Canada. Detailed information about the terms and conditions of credit cards available in Canada is published by the Financial Consumer Agency of Canada, *Service Fees on Credit Card Transactions* (Ottawa: 2006). However, FCAC does not report complaints involving credit cards unless they appear to involve a violation of federal law. Similarly, FCAC does not track delinquency rates in credit card payments or the role of credit card debt in consumer bankruptcies (see Financial Consumer Agency of Canada, *Commissioner's Decisions*, online: Financial Consumer Agency of Canada <http://www.fcacacfc.gc.ca/eng/industry/CommDecisions/DecisionResult.asp?PRODUCT_SERVICE_ID=4>. However, Ellen Roseman column in the *Toronto Star* quite often deals with complaints involving credit cards. See e.g., *Toronto Star,* April 12, 2008, B3, January 16, 2008, B3, Dec 23, 2007, A21, Nov 11, 2007, A21, Oct 14, 2007, A13, Oct 7, 2007, A21, Sept 23, 2007, A21, Sept. 8, 2007, B3, August 8, 2007, B6, August 4, 2007, B2, August 1, 2007, B6, March 19, 2007, D1, Oct 7, 2006, D3, Sept 30, 2006, D3, Aug 5, 2006, D3.

The only official inquiry into credit cards in Canada appears to be Canada, House of Commons, *Credit Cards in Canada: Report of the Standing Committee on Finance and Economic Affairs* (Ottawa: March 1987). The Report deals primarily with the cost of credit in credit cards and disclosure of the rate of interest and other charges, and recommends that the provinces and the federal government adopt common disclosure requirements.

to issue a multipurpose card, and this occurred in 1960. Visa and MasterCard did not make their appearance till the early 1970s.

There can be little doubt that multipurpose credit cards have exerted a major influence on consumer credit usage in Canada since the introduction of VISA and MasterCard cards in the mid-1970s, and can be expected to continue to do so in the future. Table 3 shows just how rapid that expansion has been. Between 1977 and 2006 the number of issued VISA and MasterCard cards increased 320%, from 8.2 million to 26.4 million. Even more strikingly, the net dollar value of transactions escalated from $4.04 billion to $243.01 billion, an increase of 6,000.15%.

(see next page for Table 3)

TABLE 3: CREDIT CARD STATISTICS – VISA AND MASTERCARD, 1977 – 2006[62]

Credit Card Statistics - VISA and MasterCard

Fiscal Year Ended Oct. 31	Number of Cards in Circulation (1a) (Millions)	* No. of Accts with balances (Millions), including those that are paid off every month (1b)	Net Retail Volume (2) (Billions)	Net Dollar Volume (2)(4) (Billions)	Gross Sales Slips Processed (2) (Millions)	Average Sale	% Delinquency 90 days & over (3)(7)	# of Cards Reported Lost or Stolen (2)	Number of Cards Fraudulently used (2)	$ Amount of Fraudulent Accounts written off (6) (Millions)	Merchant Outlets (5)	VISA/MCI Principal Issuers
1977	8.2		$3.61	$4.04	118.8	$30.46	1.3%	-	-	-	271,150	-
1978	9.0		$4.90	$5.44	150.8	$32.50	1.3%	-	-	-	290,692	-
1979	9.9		$6.64	$7.32	185.8	$35.72	1.2%	-	-	-	322,115	-
1980	10.8		$8.82	$9.44	218.4	$39.47	1.3%	-	-	-	347,845	-
1981	12.0		$10.59	$11.51	249.6	$42.43	1.0%	-	-	-	371,831	-
1982	11.6		$13.83	$13.38	274.9	$50.30	1.7%	259,028	-	$15.88	382,206	-
1983	12.1		$14.84	$14.85	297.6	$49.88	0.9%	275,754	19,200	$17.39	419,610	10
1984	13.1		$16.92	$17.10	325.2	$52.05	0.7%	299,152	21,332	$16.79	442,928	10
1985	14.0	7.3	$19.35	$20.42	372.9	$51.90	0.7%	330,380	21,026	$17.54	527,042	10
1986	15.5	7.9	$23.01	$23.57	417.2	$55.15	0.8%	378,239	22,326	$18.61	571,771	10
1987	17.6	8.8	$26.37	$26.90	450.7	$58.52	0.7%	408,571	23,913	$15.78	642,429	12
1988	19.4	9.5	$30.33	$31.20	490.0	$61.90	0.7%	460,348	25,773	$15.63	646,844	13
1989	20.4	10.3	$36.10	$36.90	546.7	$66.00	0.9%	522,204	30,919	$19.20	709,674	14
1990	23.2	11.1	$38.60	$42.48	591.8	$67.22	1.8%	520,716	32,851	$28.90	786,288	14
1991	24.3	11.8	$40.45	$44.00	617.8	$67.40	1.3%	623,946	53,968	$44.60	857,159	14
1992	24.4	12.2	$43.10	$46.90	639.9	$69.30	1.0%	650,088	61,234	$63.50	896,365	14
1993	25.0	12.4	$47.90	$52.80	695.8	$70.50	0.7%	674,988	63,442	$75.20	904,689	13
1994	27.5	13.2	$55.10	$61.10	778.1	$72.40	0.9%	731,052	63,635	$70.60	955,993	13
1995	28.8	13.6	$61.26	$68.12	840.0	$74.51	0.9%	648,824	66,109	$72.64	981,851	13
1996	30.2	14.1	$67.70	$75.10	896.6	$77.80	1.0%	794,996	77,740	$83.60	1,076,694	15
1997	31.9	15.0	$76.00	$84.30	949.5	$82.50	0.9%	858,625	89,982	$88.08	1,106,141	17
1998	35.3	16.0	$84.10	$93.90	1,001.1	$89.96	0.9%	895,817	126,384	$104.80	1,143,110	19
1999	37.7	17.3	$94.30	$106.00	1,076.4	$90.35	0.9%	823,934	132,836	$134.10	1,139,228	18
2000	40.1	18.5	$109.87	$125.18	1,184.7	$95.57	0.7%	805,580	112,070	$156.38	1,187,745	19
2001	44.1	19.6	$121.82	$138.63	1,226.6	$99.16	0.8%	813,624	116,139	$142.27	1,206,779	19
2002	49.4	20.8	$135.69	$154.57	1,390.6	$100.51	0.7%	796,371	136,598	$128.42	1,265,157	23
2003	50.4	22.2	$150.49	$172.18	1,524.8	$102.00	0.8%	932,915	146,310	$138.60	1,187,384	23
2004	53.4	23.2	$168.78	$192.17	1,664.8	$104.00	0.8%	1,070,547	177,081	$163.18	1,128,410	23
2005	56.4	24.6	$190.60	$216.04	1,839.7	$106.00	0.8%	1,253,781	244,457	$168.60	1,137,849	23
2006	61.1	26.4	$214.70	$243.81	2,017.8	$109.00	0.8%	1,096,182	258,581	$185.45	1,150,779	23

Source: Canadian Bankers Association, Table includes data from all VISA & MASTERCARD Issuers.

(1a) As at last day of the fiscal year-end
(1b) As at last day of the fiscal year-end, including accounts with balances paid off every month.
(2) Reported total for the fiscal year.
(3) Percentage of outstandings as at fiscal year-end.
(4) Total of Net Retail Volume ($ sales) and cash advance volume ($).
(5) Merchants accepting VISA and/or MASTERCARD. Note that merchants accepting both cards have been reported by each plan. To estimate # of merchant outlets accepting VISA or MASTERCARD, divide Merchants Outlets by 2 and multiply by 1.1
(6) Includes total cardholder and merchant fraud for the fiscal year.
(7) Effective October 31, 1991, a new interpretation of "90 days & over" was adopted. This resulted in a one-time reduction in the delinquency ratio of approx. 0.2%.

Credit cards obviously have great appeal to Canadian consumers, just as they do to American, British and Australian consumers. They can be used at home or outside Canada at any accredited outlet for any amount up to the approved limits; they can be used to pay for goods or services in a foreign currency; and they can be used to obtain cash advances in Canadian dollars or a foreign currency. However, the very flexibility of credit cards also makes them a fatal temptation for insolvent consumers. We have noted

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[62] Canadian Bankers Association, *Credit Card Statistics October 2007*, online: Canadian Bankers Association <http://www.cba.ca/en/content/stats/DB038%20-%20Visa%20%20MCI%20Statsb%20-%20Updated%20for%202007.pdf>.

previously the close correlation found by analysts between the number of consumer bankruptcies and the increase in the volume of credit card balances. In her recent study of the incidence of bankruptcies among middle aged and senior Canadians,[63] Prof. Janis Sarra also noted the important role of credit cards among the types of debt held by this class of bankrupts. She found that more than 85% of the bankrupts had credit card debts and that credit card and mortgage debts accounted for the largest source of financial pressure on the debtors. Counter-intuitively, her data also showed[64] that senior bankrupts (75 years or older) carried a higher amount of median credit card debt at the time of bankruptcy ($15, 640) than did the debtors in the 55-59 age range ($13,338)[65] and that credit card debt accounted for 75 per cent of the total indebtedness among the seniors.[66]

These statistics raise the moral, if not legal, question whether credit card companies have an obligation to discourage excessive use of credit cards, and this is discussed in a later section of this paper. Credit card companies have also been accused, especially by US based critics, of other abuses, including the following:

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63 *Supra* note 4 at 793.

64 *Ibid*. at 794, Table 1. Professor Sarra also notes that the senior debtors were carrying large amounts of debt even though they were not receiving employment income. She suggests the senior were not adjusting their life styles to match their income and that they were using their credit cards to bridge the gap.

65 These figures should be compared with Richard Archambault's comparative figures showing that in 2003, on average, Canadian bankrupts had a balance of US $7,808 when the bankruptcy files were opened compared to a balance of US$17, 738 for US bankrupts. See "Comparing the Credit Card Balances of Canadian and American Bankrupts in 2003" *OSB Newsletter 2004-6,* p.3. For purposes of comparison, Mr. Archambault converted the Canadian dollar figures into US currency. However, Canadian currency is at the present time (April 2008) substantially at par with US currency so, to make the comparison more meaningful, the Canadian data in Tables 1 and 2 of Mr. Archambault's article should be increased by about 20 per cent. This would reduce the credit card gap between the balances held by Canadian and US bankrupts but substantial differences would still remain.

66 *Supra* note 4 at 798, Table 2.

1. Mailing out by the millions unsolicited applications for credit cards, often with the suggestion that the credit card will be issued as soon as the recipient makes a phone call;
2. Targeting young students with unsolicited credit card offers;
3. Offering teaser rates to encourage card holders to switch to another card company;
4. Raising credit card limits without a request from card holders;
5. Changing credit card rates without prior notice;
6. Imposing heavy penalties where the card holder is in default in making the minimum monthly payment or in making payments to *any other* card issuer;[67]
7. Keeping the required monthly payment to a bare minimum (sufficient to pay the accrued interest, but little more) so as to encourage card holders to continue to carry balances indefinitely;[68]
8. Excessive interest charges.

In North America, these complaints have come mainly from American sources where they have been reiterated in many reports and studies and have been the subject of Congressional hearings.[69] Some of these concerns – perhaps a majority – surely also

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[67] This is known as a 'universal default' clause. However, Citicorp and other US card companies announced at the beginning of 2007 that they were withdrawing this provision from their credit card contracts.

[68] Professor Elizabeth Warren has described this feature, as well as other still more devious credit card practices, as designed to maximize credit card issuers' income from interest rates and fees. See *Testimony of Elizabeth Warren before the Committee on Banking, Housing and Urban Affairs of the United States Senate on Hearing: Examining the Billing, Marketing, and Disclosure Practices of the Credit Card Industry, and their Impact on Consumers,* January 25, 2007.

[69] See, *inter alia*, Center For Responsible Lending, *Risking Homes to Pay Off Credit Cards* (Washington: November 2005);.Center For Responsible Lending, *Subprime*

apply to Canada although there have been no federal or provincial inquiries to match those in the US.[70] There has been surprisingly little litigation in Canada involving credit

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Lending is a Drain on Home Ownership (Washington: March 2007); Center For Responsible Lending, *The Plastic Safety Net: The Reality Behind Debt in America* (Washington: October 2005); Demos Action Network, *Credit Card Industry Practices in Brief* (Washington: October 2005); Christian Weller, Center For American Progress, *Pushing the Limit: Credit Card Debt Burdens American Families* (Washington: 2006); Michael Donovan [Donovan Searles LLC], Senate Committee on Banking, Housing, and Urban Affairs, *Prepared Statement on the Hearing on 'Examining the Billing, Marketing, and Disclosure Practices of the Credit Card Industry, and their Impact on Consumers"* (January 25, 2007); Kathleen Keest [Center for Responsible Lending], House Committee on Financial Services, Subcommittee on Financial Institutions and Consumer Credit, *Oversight Heading on Abusive Credit Card Practices* (June 7, 2007); Robert D. Manning [College of Business, Rochester Institute of Tech.], Senate Committee on Banking, Housing, and Urban Affairs, *Prepared Statement on the Hearing on 'Examining the Billing, Marketing, and Disclosure Practices of the Credit Card Industry, and their Impact on Consumers"* (January 25, 2007); Edmund Mierzwinski [Consumer Program, US Public Interest Research Group], House Committee on Financial Services, Subcommittee on Financial Institutions and Consumer Credit, *Oversight Heading on Abusive Credit Card Practices* (June 7, 2007); and Elizabeth Warren [Professor of Law Harvard Univ.], Senate Committee on Banking, Housing, and Urban Affairs, *Prepared Statement on the Hearing on 'Examining the Billing, Marketing, and Disclosure Practices of the Credit Card Industry, and their Impact on Consumers"* (January 25, 2007).

[70] The FCAC publishes data on credit card complaints received by the Agency but the data is confined to complaints involving non-compliance by credit card issuers with their statutory obligations. The following table shows the credit card complaints received by the FCAC between 2002-2007and the disposition of the complaints. For further discussion, see Part D, IV, 1, (b), below.

*Number and Disposition of Credit Card Compliance Cases Relating to Consumer Provisions Arising From Complaints to FCAC: 2002-2007**

	Type of disposition				Total
Subject Matter of Complaint	Violation	Non-violation	Withdrawn	Other**	
General	0	73	6	27	**106**
Disclosure of annual interest rate	0	2	1	0	**3**
Disclosure of changes to cost of borrowing (COB) or credit agreement	1	143	18	11	**173**
Disclosure of COB, interest or fees when issued	9	280	14	21	**324**

cards,[71] but this dearth is probably due to the cost of litigation and not to lack of complaints. This may be seen from the fact that two major Canadian banks are currently the target of class actions in Ontario because of allegedly unauthorized credit card charges or because of violation of the interest ceiling in Section 427 of the Criminal Code.[72]

3. Alternative Credit Market for Low Income Consumers[73]

Disclosure relating to optional services	2	162	8	8	**180**
Provision/receipt of monthly statements	1	155	19	70	**245**
Disclosure in plain language	0	3	0	0	**3**
Disclosure of required information in application forms	2	31	1	3	**37**
Disclosure of required information in monthly statements	3	43	1	3	**50**
Repayments before due date prohibited	0	1	0	0	**1**
Requests to keep a minimum balance	0	2	0	0	**2**
Disclosure of required information in advertisements	0	3	0	1	**4**
Disclosure of COB expressed as a rate per annum	2	18	2	1	**23**
Total	**20**	**916**	**70**	**145**	**1151**

* These numbers reflect the fiscal years 2002 to 2007.
** This includes the following dispositions: addressed at the industry level, non-substantive, not a compliance matter, examination complete and other.

[71] Several computer searches by my research assistant Scott Ollivierre uncovered very little in the way of reported complaints. See however *supra* note 61 with respect to complaints received by Ellen Roseman.

[72] See *Markson v. MBNA Canada Bank* [2007] ONCA 334, and *Casano v. Toronto-Dominion Bank* [2007] ONCA 781

[73] Also often referred to in the US literature as "fringe banking". The leading US monograph is by Caskey, *supra* note 38. For an excellent treatment of the topic from a

An important feature in the evolution of Canadian consumer credit since the early 1990s has been the emergence of a clearly identifiable alternative credit market for low income consumers. Payday loans made by payday loan companies are the most important and conspicuous element in this development, but other funding sources - - pawnshops, check cashing facilities, rent-to-own agreements, title loans and tax rebate discounters – are also relevant parts of the total picture. The common bond linking these facilities is that they are primarily aimed at consumers who do not have a credit card or have lost their credit card privileges and do not feel comfortable in a middle class banking environment or live in neighbourhoods poorly served by Canada's chartered banks.[74]

Payday loan companies originated in the US in the 1980s and expanded into Canada around the middle 1990s.[75] There are currently around 1300 payday loan outlets

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Canadian perspective, see Iain Ramsay, "The Alternative Consumer Credit Market and Financial Sector: Regulatory Issues and Approaches" (2001) 35 Can. Bus. L.J. 325 and the accompanying commentaries in the same issue by Tony Duggan (at 402) and Kathleen E. Keest (at 409). See also the fuller exposition of the US position in Lynn Drysdale and Kathleen E. Keest, "The Two-Tiered Consumer Financial Services Marketplace: The Fringe Banking System and its Challenge to Current Thinking About the Role of Usury Laws in Today's Society" (1999-2000) 51 S.C.L. Rev. 589.

[74] There is an unresolved debate over the extent to which higher income Canadians also make use of payday loan companies. The authors of an Ottawa study expressed the view that "one must reject the hypothesis that the AFS is primarily a market of society's most disadvantaged. We estimate about 15 per cent of the AFC market would fall under Statistics Canada's before-tax Low-Income Cut-off (LICO).See Public Interest Advocacy Centre, Ottawa, *Fringe Lending and "Alternative" Banking: The Consumer Experience* (Nov. 2002). On the other hand, Winnipeg investigators were convinced that payday loans in that city were preeminently a low income phenomenon. See The United Way of Toronto adopted the same position in an important recent report on the financial problems of Toronto's indigent families. See United Way of Greater Toronto, *Losing Ground. The Persistent Growth of Family Poverty in Canada's Largest City* (Nov 2007). The correct answer may make a difference since it may influence the question to what extent payday loans in Canada should be subject to rate regulation.

[75] This is not to suggest that there are no Canadian owned payday loan companies. However, all the large payday loan companies operating in Canada appear to be subsidiaries of US companies. ACORN Canada reports that the Royal Bank of Canada

in Canada with an estimated annual turnover of $2 billion.[76] Many of the outlets are situated in or near low income areas or in strip malls.[77] The typical loan is between $300 and $500 for ten days and costs the borrower between $12 to $18(?) for each $100 segment of the loan, or 305% to 650% on an annualized basis. There is a high rate of rollovers in loans[78] and, as a result, the cost of even a very modest loan can double in a very short period.[79]

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and the Toronto-Dominion Bank hold shares in a number of payday loan companies and criticizes the shareholdings on the ground that they create a conflict between the bank's responsibility to cater to the needs of low income consumers and the incentive to steer such borrowers to the payday loan companies. See ACORN Canada Report, *A Conflict of Interest: How Canada's Largest Banks Support Predatory Lending* (Ottawa: March 2007) at 6 *et seq*. ACORN is an association of community organizations pressing for reform of consumer credit services available to low income consumers.

[76] See Canadian Payday Loan Association, News Release, "Canadian Payday Loan Association Welcomes Legislation" (6 October 2006), online: Canadian Payday Loan Association <http://www.cpla-acps.ca/english/pr_2006_05.php>. The $2 billion figure appears modest compared to the $2,017.8 billion net dollar volume of credit card transactions handled by Visa and MasterCard in 2006. However, it needs to be borne in mind, first, that for a majority of Canadians credit cards are a payment mechanism and not a credit facility and, second, that the average payday loan is between $300 and $500. On this basis, a $2 billion annual turnover would translate into four million loans.

[77] No Canadian city has so far approached the concentration in payday loan outlets found in some US cities, but it may be a harbinger of future developments if the number of low income Canadians continues to grow. For example, Appleton, Wisconsin, a city with a population of 70,000 has 19 payday loan stores compared to 5 McDonald's franchises, 3 Pizza Huts, and 4 Starbucks Shops. See John Leland, "Non-Profit Payday Loans? Yes, to Mixed Reviews" *New York Times* (28 August 2007) online: New York Times <http://www.nytimes.com/>.

[78] According to the ACORN Canada Report, *supra* note 75 at 4, citing an Ernst & Young study, each first time payday loan customer ends up taking out an average of 15 rollover or rewrite loans.

[79] See National Consumer Law Center, *Utilities and Payday Lenders: Convenient Payments, Killer Loans* (June 2007), and *cf*. "Provinces Need the Power to Keep Lenders in Check" *Vancouver Sun* (1 May 2006), online: Vancouver Sun <http://www.canada.com/vancouversun/index.html> reporting on an Ottawa Small Claims Court case involving two payday loans. One of the loans was for $280 and, with interest and penalties, rose to $551 at the end of a month.

Borrowers find payday loans attractive because of the accessibility of the payday loan outlets, the privacy of the transactions, the absence of credit checks, and non-requirement of security for repayment of the loan. However, the borrowers must satisfy the payday loan company that they are gainfully employed or are entitled to regular welfare or pension payments from a reliable source. Borrowers are also required to provide the lender with a postdated cheque for the amount of the loan and interest, which the lender will deposit if payment is not made by the due date or if the loan is not rolled over.

Payday loans have been criticized on a variety of grounds, of which the following are the most important. 1. The borrowing costs are too high and may often leave the borrowers worse off than they were before the loan. 2. There are too many rollovers of loans. 3. Unpaid payday lenders resort to harsh collection practices.[80] The first issue is clearly the most significant and is examined later[81] in the broader context of the regulation of interest rates in consumer credit transactions. So is the related question of the extent to which not-for-profit schemes have been or should be developed to provide low cost loans to indigent consumers in deserving cases.[82]

(a) Section 347 Litigation and 2006 Amendment

It seems that at least thirty class actions are pending at the time of writing (April 2008) against payday loan companies in British Columbia, Alberta and Ontario alleging

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[80] For the most recent review of what are described as "Deficiencies of Payday Loans", see Manitoba. The Public Utilities Board Act. *Maximum Charges for Payday Loans.* Order No 39/08, April 4, 2008, pp 238-240.

[81] *Infra*, Part D.IV.1(b), (c).

[82] See Part D, IV, 1, (c), below.

that the companies have breached section 347 of the Criminal Code and seeking restitutionary and other remedies against the defendants. Section 347 (previously known as s.405.1) was adopted by Parliament in 1981 and imposes a ceiling on the cost of loans as well as for other forms of credit, commercial as well as consumer, of 60 per cent per annum. With a view to facilitating payday loans, Parliament amended s 347 in 2007.[83] The amendment provides that s. 347 is not to apply in a province that has adopted payday loan legislation provides for (a) the licensing of payday loan companies; (b) regulates the cost of loans; and (c) restrict loans to a maximum period of 62 days. The majority of provinces have elected to avail themselves of this option and have adopted, or are in the course of adopting, payday loan legislation.[84]

4. Home Equity and Subprime Mortgage Loans

For historical reasons, Canadian consumer credit legislation (and statistics) often exclude home mortgage loans from their scope, leaving them to be regulated by other legislation. Functionally, however, there is no distinction between credit made available to consumers against the security of mortgages on homes and credit made available

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[83] Stat. Can. 2007, c.9.

[84] For the details of the provincial legislation see S. Ben-Ishai, "Regulating Payday Lenders in Canada: Drawing on American Lessons", Append "A" (in course of publication in the *Banking and Finance Law Review*). Ontario is the most recent province to have introduced payday loan legislation (see Ontario, Bill 48, 2008) and, as of this time of writing (May 2008), the bill has been sent to Committee for public hearings. Quebec is unlikely to adopt payday loan legislation because the province's Consumer Protection Act, ss. 8, 325 prohibits lenders from charging more than 35% interest a.p.r. The constitutionality of Quebec's interest rate cap has not so far been challenged although it appears to be in conflict with s 347 of the Criminal Code and the federal government's exclusive jurisdiction over interest rates. It is not clear what alternative sources Quebec borrowers use in the absence of payday loan companies, though it has been suggested that pawnbrokers and branches of the Caisses Populaires Desjardins may pick up some of the slack.

against the security of automobiles, furniture or appliances. The distinction, if any, rests in the quality of the security and the credit worthiness of the borrowers. The distinction, moreover, has been narrowed over the past ten years or more by the growing popularity of home equity loans and the explosive emergence of subprime mortgage loans. Subprime mortgage loans are discussed separately hereafter[85] because they are such a striking example of the consequences of irresponsible lending practices. Though on a much smaller scale, home equity loans can also constitute a trap for borrowers and therefore merit brief discussion.[86]

Home equity loans are loans made to home owners against the security of the equity in their homes[87] and have become popular over the past decade because of the rapid appreciation in home values across Canada. The availability of the loans is heavily advertised[88] and borrowers are told that the loans are "smart, stress free and safe solutions" to their money problems. Other advertisements tout the virtues of home equity loans to remedy bruised credit, achieve consolidation of debts, make home improvements or enjoy an otherwise unaffordable vacation at an exotic resort. The downside of home equity loans is that they involve substantial set up costs for appraisals, legal and broker's

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85 See Part C, III, 4, below.

86 *Cf*. Federal Deposit Insurance Corporation, "Putting Your Home on the Loan Line is a Risky Business", online: Federal Deposit Insurance Corporation <http://www.fdic.gov/consumers/consumer/predatorylending/index.html>, and Center for Responsible Lending, *Risking Homes to Pay Off Credit Cards* (Washington: November 2005).

87 In the US, home equity loans are also referred to as a "cash-out mortgage" refinancing. In cash-out mortgage refinancings, home owners replace their current mortgage with a loan amount larger than the amount they owe on their home. While they take out all or part of the difference in cash, the funds are often used to pay off other debts. Center for Responsible Lending, *ibid*. at 1.

88 See Wikipedia, "Home Equity", online: Wikipedia <http://en.wikipedia.org/wiki/Home_equity>.

fees, and that the interest rate may be substantially higher than for conventional mortgage loans. Just as important the loan has to be repaid and, if the value of the home declines, the homeowner may even be forced to sell the home to pay off the home equity loan.

A variant of the home equity loan is a "reverse mortgage", a newly conceived financing vehicle, particularly directed at senior home owners.[89] Reverse mortgages differ from home equity loans because the loans are not repayable before the home owner dies or unless the home owner sells or moves out of the home.[90] From the home owner's perspectives, reverse mortgages are even riskier than home equity loans because, in a declining market, the reverse mortgage may absorb most of the value of the home and the senior citizen may be deprived of what would otherwise be her most valuable asset to cover future expenditures. The senior citizen would have been better off to sell the home and to move into a lower cost home or into an apartment.[91]

IV. Overall Conclusion On Evolution Of Consumer Credit

The preceding survey, greatly simplified and truncated though it is, will have shown that consumer credit in Canada has come a long way since its peripheral and modest role in pre-confederation Canada. It is now an economic, social and legal

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[89] In fact, under the existing advertised plans, the home owners must be 60 or older.

[90] See Google sub. "Home Equity and Reverse Mortgage Loans". The entry is largely occupied by many pages of advertisements extolling the virtues of the advertised products. Chestnut Park, "Reverse Mortgages" *Newsletter: Welcome Home* (March/April 2008) 2, sub., notes that interest charges on reverse mortgages are expensive, are compounded twice a year, and that the cost to pay back a $200,000 loan over 15 years would be more than $600, 000. (The article does not explain how this amount is arrived.)

[91] In fairness to Canadian reverse mortgage lenders, it should also be noted that they usually require the home owners to obtain independent legal advice before signing the mortgage.

phenomenon of first ranking importance but one that generates significant costs as well as conferring great benefits. One of the costs is that the ready availability of consumer credit in one of its many forms may lead to the consumer's overindebtedness and the debtor's insolvency. The question for consideration is what responsibility Canadian society – and Canadian legal norms – should impose on the creditor to diminish, if not to avert, this negative consequence and how this goal should be realized. These challenging questions form the substance of the balance of this paper.

D. RESPONSIBLE AND IRRESPONSIBLE LENDING; AND LEGAL SANCTIONS

I. Preliminary Issues

The proposition that a lender owes an obligation to ensure that the consumer can afford the loan and will not overcommit herself, and that the terms of the transaction are fair, is not self-evident. Creditors have argued that they are not responsible for the debtor's welfare and that, as adult members of the community, consumers must be expected to look after their own interests. This line of reasoning is consistent with general common law contract principles applicable to parties bargaining at arm's length and not in a fiduciary relationship towards one of the parties. The traditional rule here is that the creditor's obligation is only to avoid misleading the consumer and to abide by the terms of the contract.[92]

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[92] Cf. the much quoted statement of Jessel M.R. in *Printing & Numerical Registering Company v. Sampson* (1875) L.R. 19 Eq. 462 at 465, also cited in John D. McCamus, *The Law of Contract* (Toronto: Irwin Law, 2005), p.24, note 58.

However, the common law has travelled a long way since these 19th century laissez-faire concepts, based as they were on a simple marketing structure and the absence of a clear consumer constituency. Nowadays, federal and provincial law shows widespread appreciation of the common place observation that there is a wide disparity in bargaining power, knowledge and resources between creditors and consumers.[93] The whole thrust of post-World War II legislation has been to redress this imbalance through a multitude of laws and programs, even though many of them are poorly enforced in practice and often not at all. Canadian courts have endorsed the concept of unconscionability to police bargains between commercial sellers and consumer buyers and between creditors and debtors. Several of the provinces have given statutory recognition to this development by giving the courts broad powers to set aside deceptive or unconscionable transactions.[94]

Consumer credit moreover has a number of distinguishing features that justify legislative intervention and in holding lenders to a higher standard of probity and fair dealing. One is the impact of modern advertising and merchandizing techniques. Pervasive advertising in all the media constantly urges the consumer to buy goods or to subscribe to a service at a "low, low" price and assures the consumer, if cash is a problem, that credit is readily available with a modest or no down payment, and with interest payments that may be deferred for a year or more. And then, as we have seen, the friendly credit card also makes its appearance to make the purchase painless. It may give

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[93] *Cf.* Jacob S. Ziegel, "The Future of Canadian Consumerism" (1973) 51 Can. Bar Rev. 191 at 191.

[94] See e.g., Consumer Protection Act, Stat. Ont. 2002, c. 20, Schedule A, Part III, and Jacob S. Ziegel and A.T. Duggan (eds.), *Commercial and Consumer Sales Transactions*, 4th ed. (Toronto: E. Montgomery Publications, 2002) at 122.

this illusion even though the reality is that the consumer is already fully stretched and should not be assuming further financial obligations.[95]

The related phenomenon involves consumers' cognitive dissonance in dealing with credit transactions. As behavioral psychologists and economists have shown, there is a strong desire among many consumers for instant gratification and a tendency to downplay or ignore the possibility of future events that may impair the consumer's ability to meet their financial commitments.[96] Consequently there is a need for laws to provide relief for overburdened consumers and to impose greater responsibilities on lenders.

There are other reasons as well that justify legislative intervention. Overindebtedness and irresponsible lending practices create externalities (social and financial costs) that affect the debtor's family, the debtor's other creditors, and the community at large.[97] It may also jeopardize a country's financial stability as may be seen from the current subprime mortgage credit crisis. It is these externalities that preclude the creditor from arguing that it should be able to take even large credit risks so long as it is also willing to absorb any losses. The answer to this reasoning is that if the lender is acting irresponsibly, it is not in fact internalizing all the losses.

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95 *Cf*. Ron Harris & Einat Albin, "Bankruptcy Policy In Light of Manipulation in Credit Advertising" (2006) 7 Theoretical Inquiries 431.

96 See *inter alia* Thomas H. Jackson, *The Logic and Limits of Bankruptcy Law* (Cambridge, Mass.: Harvard University Press, 1986) and Jason Kilborn, "Behavioral Economics, Overindebtedness and Comparative Consumer Bankruptcy: Searching for Causes and Evaluating Solutions" (CEGLA Conference Paper, June 2005). Surprisingly, this readily available literature is often overlooked in government reports dealing with the phenomenon of consumer overindebtedness.

97 *Cf*. Harris & Albin, *supra* note 95 at 449, and U.K., Department of Trade and Industry, *Fair, Clear, and Competitive: The Consumer Credit Market in the 21st Century*, CM 6040 (London: 2003) at 57, discussing the requirements of responsible lending [DTI Report].

The fall out from the subprime mortgage calamity currently playing itself out in North America and in overseas countries is such a poignant example of the consequences of irresponsible credit practices that it deserves to be related in some detail.[98] The potential market for subprime mortgages was always huge[99] but it was largely ignored by lenders before 1995. It then picked up speed and accelerated rapidly after the year 2000. By March 2007, 1.3 trillion US dollars was outstanding on subprime mortgage loans. The following factors explained this phenomenal growth. Borrowers were encouraged to borrow because the down payment was low (and sometimes non-existent), because the initial interest rate was equally attractive and made more so with the aid of "teaser" rates, though subject to much higher interest rates that were triggered after the initial period. The rapid escalation in home property values between 2000 and 2005 also encouraged borrowers to think they would be able to refinance the mortgage or sell the home at a profit if they had to. Mortgage brokers also played a critical role in not giving always accurate reports about the borrower's financial profile, so did property appraisers who were willing to place inflated values on homes.

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98 The following summary is based on Wikipedia, "Subprime mortgage crisis", online: Wikipedia <http://en.wikipedia.org/wiki/Subprime_mortgage_crisis>, Souphala Chomsisengphet & Antony Pennington-Cross, "The Evolution of the Subprime Mortgage Market" (2006) 88 Federal Reserve Bank of St. Louis Review 31, and many articles on the subprime mortgage crises appearing in the *New York Times* and the *Globe & Mail* since the summer of 2007.

99 For an analysis of the Canadian position, see Benjamin Tal, "Sub-Prime as Prime Target. The Surging Non-Conforming Mortgage Market in Canada" *Consumer Watch Canada*, (10 October 2006), online: CIBC World Markets <http://research.cibcwm.com/economic_public/download/cwcda-102006.pdf> and compare the same author's later evaluation in Benjamin Tal, "Mortgage Risk – Canada vs. US" *Consumer Watch Canada* (16 March 2007), online: CIBC World Markets <http://research.cibcwm.com/economic_public/download/cwcda-070316.pdf>. It seems the author had a change of heart about the potential for subprime mortgages in Canada in the light of the deteriorating position in the US.

Even more critical was the role of the mortgage originators. They found that, in the low interest environment after 2000, there was a ready market for repackaged mortgaged backed securities (MBS), which enabled them to offload the mortgages to eager buyers in North America and overseas. Most of the leading investment banks were involved in this activity and benefited from the fact that rating agencies had generally given the investment vehicles a triple A rating.

The subprime mortgage market quickly began to unravel in the summer of 2007 because of the rapidly escalating number of mortgage foreclosures, the impact of the adjusted mortgage rates on individual home owners, and the cooling off of the mortgage market. The downturn was also quickly transmitted to the wider financial markets. Overall, about US$200 billion is estimated to have been written off from the value of the securitized assets. The projections are that a further $200 billion may be lost in 2008 and 2009 and that the ultimate losses may be as high as a trillion dollars. Canadian investors of asset-backed commercial paper (ABCP) have also been caught up in this maelstrom to the tune of about C$32 billion. At this time of writing (April 2008), proceedings are pending in Ontario under the Companies' Creditors Arrangement Act (CCAA) to persuade the investors to agree to a restructuring of the issuers' obligations so that the investments can be liquidated in an orderly manner.[100]

The subprime mortgage melt down has also had a very painful impact on US communities. Many thousands of US families are threatened with loss of their homes and mayors in those cities have complained about the psychological impact of the large

[100] See Tara Perkins, "ABCP players to seek bankruptcy protection" *The Globe and Mail* (15 March 2008) A8 and *In the Matter of a Plan of Compromise and Arrangement Involving Metcalfe & Mansfield Alternative Investment II Corp. et al*. Ont. Superior Court of Justice, File No 08-CL-7440, April 24, 2008.

number of vacant homes created by foreclosures and the losses in municipal real estate taxes. Legislation has been introduced in Congress to provide relief for the threatened homeowners,[101] and other bills are working their way through Congress greatly to tighten regulatory oversight of the US mortgage market and the roles of the principal players in the market.[102] Fingers are also being pointed at US regulators for failure to exercise existing powers to prevent the financial crisis[103] and at least one derivative action has been started against officers of a major mortgagors originator.[104]

II. The Meaning of Responsible Lending and Consequences

Earlier in this paper,[105] we adopted as a tentative definition of responsible lending the proposition that a lender acts responsibly if, given what the lender knows or ought to know about the consumer's financial and personal circumstances, including other financial commitments, the lender has reasonably grounds for believing that the consumer should be able to meet the consumer's obligations under the contract. It is now appropriate to discuss some of the difficulties with this test and also to raise the question

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101 See inter alia S.2135 and S.2136 ("Helping Families to Save their Homes"), Dec. 2007 and S. 2452 ("Home Ownership Preservation and Protection Act 2007), Dec. 12, 2007.

102 See Mortgage Reform and Anti-Predatory Lending Act 2007, 110th Cong., 1st Sess., H.R. 3915.

103 Sen. Barack Obama summed up a widespread sentiment when he said in a speech in New York on March 27, 2008, that "when subprime mortgage lending took a reckless and unsustainable turn, a patchwork of regulators were unable or unwilling to protect the American people." Michael Powell, "Obama lays out plans for regulating market" *New York Times* (28 March 2008) online: New York Times <http://www.nytimes.com>.

104 "Judge Says Countrywide Officers Must Face Suit by Shareholders," N*ew York Times*, electronic edition, May 15, 2008.

105 See Part A, above.

whether the test should be extended to other aspects of the lender-borrower relationship or whether it should be confined to the initial granting of the credit.

The difficulty about requiring the lender to conduct inquiries into the debtor's circumstances in every case is that it would fundamentally change current lending practices with respect to pawnshops and payday loans, one of whose key attractions to borrowers is that they do *not* have to answer questions about their credit history or give reasons for wishing to borrow. Further, as we have seen, pawnshops and payday lenders take security for their loans and do not rely on their right to bring suit if the borrowers fails to pay.[106] Would it undermine the purpose of responsible lender requirements to exclude pawnshops and payday lenders or can the exclusion be justified in any case because of the short term character of the loans and the special service they provide to subprime borrowers?

The requirement that the lender must satisfy itself that the borrower will be able to repay the loan also runs into the following difficulties. The lender will have difficulties satisfying the test in the case of many student loans to cover University tuition and living expenses where the loan is not repayable until after the student has graduated or has otherwise completed the course of instruction. Similar difficulties arise where the lender knows that the borrower needs the loan to cover medical expenses, look after an ailing member of the family, or to meet living expenses where the borrower is unemployed – to use some common examples. Presumably, the answer in the first case is that society has such a strong interest in promoting higher education and in equipping young persons for

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[106] This observation needs to be qualified in the case of payday loans since, if the borrower's cheque is dishonoured, the payday lender can, and has been known, to bring action on the cheque.

their future careers that these considerations must trump concerns about the students not being to repay the loans because there is no job market for the qualifications they have acquired with the loans. Public policy must surely also play a role in the second case, particularly where the borrowers resides in a country (like the US) which has no comprehensive medical coverage for its citizens.[107] The second example also raises the question of what responsible lending means in the case of multipurpose credit cards. Is the card issuer under a continuing obligation to satisfy itself that maintenance of the original line of credit is warranted? A reasonable answer would be that the issuer is under no such obligation so long as the card holders are maintaining their monthly payments. One might take a different position if the card holder was chronically delinquent in meeting their minimum payment requirements and the issuer remained passive and allowed the card holder to continue to run up new debts. A more critical view of the card issuer's conduct may well also be taken where the initial credit card was unsolicited or where the credit limit bore no relationship to the card holder's known income and, *a fortiori,* where the card holder raised the limit without the card holder's request, a common phenomenon as we have seen.

Should the concept of responsible lending also be applied to the cost of the credit? Free market economists have long argued that regulating the cost of loans does more harm than good and that market conditions and competition among lenders should determine the appropriate rate.[108] Consumer advocates would respond that, in the fringe

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[107] US statistics show that credit cards are used very often to cover medical expenses and to tide the borrower over where the borrower is unemployed or there has been a significant drop in family income.

[108] *Cf*. Barry Scholnick, "Regulation, Competition and Risk in the Market for Credit Cards" (2000) 26 Canadian Public Policy 171.

banking market, there is no effective competition and that if governments are unwilling to impose ceiling on rates the courts should be free to intervene. Critics of credit card issuer practices would also urge court or legislative protection against exorbitant hidden penalties and fees and other unconscionable practices that drive up the cost of the credit significantly where the card holder is even modestly or only technically in arrears with a payment.

This last example also raises the question whether the concept of responsible lending should be applied to all stages of a credit agreement and all aspects of the creditor's conduct, and who should be responsible for articulating and enforcing the applicable standards. Early proponents of responsible lending[109] focused mainly, if not exclusively, on the formation of the credit relationship. However, they were writing in a period when credit was much less developed than it is now and when there were no multipurpose credit cards. It seems equally clear that creditor abuses can occur at any point in the life of a credit relationship and that the law should be willing to intervene if it appears necessary. In the interests of certainty and predictability, the intervention should preferably come from the legislature (Parliament and the provincial legislatures, in Canada's case), and not be left to the courts to fashion *ex post* in the guise of an unconscionability doctrine. Whether we rationalize the need for more detailed rules of conduct as an expression of the concept of responsible lending or as reflective of the fact that the consumer is vulnerable seems unimportant. What *is* important is recognition of the fact that many facets of the creditor debtor relationship in the consumer credit context

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[109] See e.g., Vern Countryman, "Improvident Credit Extension: A New Legal Concept Aborning?" (1975) 27 Me. L. Rev. 1.

cannot be resolved by effective bargaining between the parties because overwhelmingly most of the chips are in the creditor's hands.

Another important issue also needs to be addressed at this point. Where the consumer is bankrupt, what is the role of the bankruptcy court in policing the lender's conduct? The answer seems to turn on whether the question arises in a unilateral state or in a federal union like Canada's or that of the United States. If we are dealing with a unilateral state it is reasonable to assume that the legislature will have considered the role of the consumer credit rules in and outside bankruptcy and will have taken care to ensure that they blend harmoniously. The same assumption cannot be made of a federal system where, as in Canada's case, legislative responsibility for regulating credit contracts is divided between the federal and provincial governments but where the federal government has exclusive jurisdiction to determine the bankruptcy rules.[110] The question that arises in the latter context is the desirability of the federal government supplementing the provincial rules with provisions in the BIA that would enable the bankruptcy court to disallow or otherwise sanction a creditor's claim where the court is of the view that the lender has acted irresponsibly. The question is addressed in the concluding section of this paper.

III. Comparative Legislative and Other Developments

Canada and the US are not alone in facing the problems of consumer overindebtedness and of lenders' conduct that accentuates the difficulties. The problems have also been receiving an increasing amount of attention in Western European

[110] Constitution Act, 1867 (U.K.), 30 & 31 Vict., c. 3, reprinted in Stat. Can. 1985, App. II, No. 5, s. 91(21).

countries (both within and outside the European Union) and, in particular, in the United Kingdom.[111] In this section of the paper we briefly review these developments with a view to seeing what Canada can learn from them. We also draw attention to the important voices in the US calling for regulation of credit card issuers and credit card practices and reforms in the fringe marketing areas. To this too must be added the important remedial provisions in the subprime mortgage regulatory bills, previously referred to, and currently working their working through the US Congress.

1. England

Consumer credit has expanded rapidly in England since the early 1990s and outstanding household exceeded one trillion Pounds at the end of 2006. The ratio of personal debts to disposable income (140 per cent) is higher than it is in Canada; so, as of September 2005, was the percentage of delinquent credit card payments.[112] Despite the strong stigma still attaching to bankruptcy filings in England and the high cost of such proceedings, the number of insolvency filings has increased fourfold over the past ten years and amounted to [100,000] at the end of 2007.[113]

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[111] Non-Western hemisphere countries are also increasingly facing these challenges. South Korea, Japan and South Africa are some of those countries. For South Africa, see RP Goodwin-Groen, *The National Credit Act and Its Regulations in the Context of Access to Finance in South Africa* (FinMark Trust, South Africa, Nov 2006). For Japan, see Kent Anderson, "Japanese Insolvency Law after a Decade of Reform (2006) 43 CBLJ 2, and for South Korea, see Soogeun Oh, "Personal Bankruptcy in Korea: Challenges and Responses" (2006) 7 Theoretical Inquiries 597.

[112] It was 8.5% in the United Kingdom. See Department of Trade and Industry, *Tackling Over-indebtedness: Annual Report 2006* (London: 2006), p.9.

[113] The number of filed insolvencies in all individual insolvency proceedings was 24, 441 and in 1997 and 2007 in 106,645. See The Insolvency Service, *Individual Insolvencies in England and Wales (Not Seasonably Adjusted)*, online: The Insolvency Service

Welfare offices, citizens' advisory organizations and credit counseling services expressed keen concern over the escalating number of overcommitted debtors turning to them for help. The British government responded with an impressively large number of reports focusing on the problems of overindebtedness.[114] The reports estimate that the percentage of seriously overindebted families is only 7 per cent with perhaps another 6 per cent who have difficulties meeting their financial commitments. The government sponsored reports generally ascribe the debt problems to low incomes, poor budgeting skills, and changes in personal or family circumstances. Poor lending practices by the major lenders in the United Kingdom are not perceived to be a major factor.[115] However, loose credit card practice, hidden fees and high penalty rates for late payments have attracted considerable criticism as have the activities of illegal money lenders and debt consolidators.

The British government has responded to these multiple challenges in an impressive manner. At the non-legislatively level, the government has substantially increased its financial support for debt advisory services and has encouraged the 'High Street' banks to provide financial services to low income borrowers ("excluded borrowers") not meeting the banks ordinary eligibility criteria. The government has also

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<http://www.insolvency.gov.uk/otherinformation/statistics/historicdata/IndividualInsolvencies.xls>.

[114] See *inter alia*, U.K., Department for Business Enterprise & Regulatory Reform, *Tackling Overindebtedness*: *Annual Report 2007* (London: 2007)*;* Department of Trade and Industry, *supra* note 97*;* U.K., Department of Trade and Industry, *Over-indebtedness in Britain: A DTI Report on the MORI Financial Services Survey 2004* (London: 2005); Department of Trade and Industry, *supra* note 112; The Griffiths Commission on Personal Debt, *What Price Credit?* (London, 2005) [Griffith Report]. The Griffith Report was commissioned by the British Conservative Party but its members were drawn from all segments of British society and had no official connection with the Conservative party.

[115] The Griffith Commission appears to take a less benign view. *Ibid* , ch. 4.__.

nudged the major consumer credit associations to adopt codes of responsible conduct and fair treatment of consumers.

The legislative record is equally impressive. Hire-purchase legislation outlawing harsh collection and repossession practices by hire-purchase companies was first adopted in 1938 and was substantially revised in 1964. The hire-purchase legislation was replaced in 1974 by the Consumer Credit Act (CCA 1974), which cast a much wider net than the prewar hire-purchase legislation and, among other features, introduced truth in lending disclosure requirements for lenders and suppliers of goods and services on credit. The 1974 Act was substantially amended by the Consumer Credit Act of 2006[116] (CCA 2006). The CCA, as amended, includes the following cardinal features:

- Comprehensive licensing requirements apply to all professional lenders and suppliers of goods and services on credit;
- The Office of Fair Trading (OFT) has power to attach conditions to licences and to impose civil penalties for infractions of the CCA;
- Updated truth in lending requirements apply to all credit agreements;
- An ombudsman service has been established allowing consumers to lay complaints against creditors without cost; and, not least,
- The English courts are granted broad powers to provide relief from unfair bargains and practices.

The last item warrants special attention. As a general rule, interest rates have not been regulated in England since repeal of the usury acts in 1854. Instead, the British government relied on the money-lenders legislation authorizing the courts to police harsh

[116] (U.K.), 2006, c. 14.

or unconscionable lending transactions. These provisions were placed by ss. 137-140 of the CCA 1974 allowing the courts to reopen 'extortionate' credit transactions.[117] The courts gave a very narrow reading to their powers and only 35 actions were brought under these provisions between 1974 and 2003.[118] Nevertheless, the British government decided against imposing rate ceilings and opted instead to replace the extortionate bargain test with the very broad powers given the court in the CCA 2006 to modify, set aside or order other forms of relief if the court finds that the relationship between the parties was an unfair one.[119] The British government officials have also launched a strong campaign to weed out illegal lenders. They feel that the very broad licensing powers under the CCA 1974 and the 2006 amendments will enable them to lean on lenders who

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[117] *Supra* note 29, s. 137-140.

[118] See further U.K., Office of Fair Trading, *Protecting Vulnerable Consumers: A Note by the Office of Fair Trading in Response to the DTI's Consultation Document on Extortionate Credit* (London: 2003).

[119] Section 140A of the CCA as added by CCA 2006, s. 19, reads as follows:

> (1) The court may make an order under section 140B in connection with a credit agreement if it determines that the relationship between the creditor and the debtor arising out of the agreement (or the agreement taken with any related agreement) is unfair to the debtor because of one or more of the following—
>
> > (a) any of the terms of the agreement or of any related agreement;
> > (b) the way in which the creditor has exercised or enforced any of his rights under the agreement or any related agreement;
> > (c) any other thing done (or not done) by, or on behalf of, the creditor (either before or after the making of the agreement or any related agreement).
>
> (2) In deciding whether to make a determination under this section the court shall have regard to all matters it thinks relevant (including matters relating to the creditor and matters relating to the debtor).
> (3) For the purposes of this section the court shall (except to the extent that it is not appropriate to do so) treat anything done (or not done) by, or on behalf of, or in relation to, an associate or a former associate of the creditor as if done (or not done) by, or on behalf of, or in relation to, the creditor.
> (4) A determination may be made under this section in relation to a relationship notwithstanding that the relationship may have ended.

are the targets of complaints without the government having to go to court or to threaten to revoke the offending creditor's licence.

2. *European Union*

Because of monetary restrictions by governments and, outside the United Kingdom, consumer credit did not play a major role in most Western European economies before 1980. It then grew rapidly and, from the 1990s onwards, the governments began to be concerned about the growing incidents of overindebtedness among consumers.[120] However, unlike the reaction in some common law jurisdictions, the solution was not perceived to be in liberal consumer bankruptcy laws. Instead, the continental governments focused their attention on improved credit counseling services and long periods of close debtor supervision in those narrow bands of cases where discharge of the debts was regarded as the only solution.[121]

Starting with a Directive in 1987, the European Commission also began to play a role with a view to harmonizing some aspects of the EU members' consumer credit laws. In 2002, the Commission issued Proposals for a revised Directive[122] in light of the many changes in the volume and types of consumer credit since the earlier directive, public

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120 Note however that the level of indebtedness varies widely among EU countries; it is low for example in Italy and Portugal and high in the Netherlands, the United Kingdom, and Sweden. See further Amparo San Jose, European Credit Research Institute, "Briefing on Consumer Credit, Indebtedness and Overindebtedness in the EU" (Paper prepared for the EP Hearing on the Consumer Credit Directive, 29 April 2003).

121 See further Jacob S. Ziegel, *Comparative Consumer Insolvency Regimes: A Canadian Perspective* (Oxford: Hart, 2003), ch 7.

122 European Union, Commission of the European Communities, *Proposal for A Directive of the European Parliament and of the Council on the Harmonization of Laws, Regulations, and Administrative Provision of Member States Concerning Credit for Consumers*, 2002, C 331 E.

dissatisfaction with the earlier directive, and the need for greater harmonization of the consumer credit laws among the member states to permit enhanced competition among providers of consumer credit services. Key features in the proposals included the following provisions:

- Member states' obligation to ensure availability of private or publicly operated data bases to provide information about consumer defaults in credit agreements and obliging creditors to consult the central data base before entering into credit agreements;
- The responsibility of creditors and creditor intermediaries to explain to the consumer the various types of credit facilities offered by the creditor and, similarly, in accordance with "the principle of responsible lending" the creditor's duty to check whether the consumer is in a position to meet the new commitments
- Creditor's duty of full disclosure of all the terms of the agreement, cost of credit and fees;
- Registration (licensing) requirement for persons offering credit facilities or acting as intermediaries for credit grantors.

Reactions to the Proposals were very mixed and the Proposals were amended several times before they were considered by the European Parliament. The Proposals also received a rough ride when they were considered in the European Parliament. Ultimately, however, after much haggling about what changes needed to be made, the Proposals were approved in amended form on January 16, 2008, and received the further approval of the EU Council in April 2008. Importantly, the principle of creditor responsibility in making credit available to consumers was retained as was the creditor's duty to consult relevant data bases before making its decision. Thus, Article 28 of the amended Proposals states that Member states shall take appropriate steps to promote responsible practices during all phases of the credit relationship and that creditors shall not engage in irresponsible lending and give out credits without prior assessment of credit worthiness, and that the Member states shall determine necessary means of sanctioning creditors in the event of their doing so.

Despite the EP's approval of the Directive, observers are skeptical about the result and entertain doubts whether the Directive will lead to a Community wide market in consumer credit.

3. Switzerland

Switzerland is not a member of the EU. Nevertheless, even more than its EU neighbours, it has adopted a strong version of the principle of responsible lending. This came about as the result of a federal law of 2001, *Loi féderal sur le crédit a la Consommation* (LCC 2001).[123] The principal features of the law are the following. Professional credit grantors must be licensed by the federal authority. Before granting credit to a consumer, or issuing a credit card, the creditor must examine the debtor's income and living expenses satisfy itself that, having regard to the debtor's existing familial and other financial obligations, the debtor will have sufficient surplus income to meet the debtor's obligations to the credit grantor. As part of this investigation, the creditor must also consult the new registry established under the Law (*Bureau des*

[123] See further Bernd Stauder, "La Prevention du Surendettement du Consommateur: La Nouvelle Approche de la LCC 2001" in Pierre-Louis Imsand, ed., *La Nouvelle Loi Féderale sur le Credit à la Consommation* (Cediac 2002) .

renseignments) to determine the debtor's existing obligations to other creditors. If the investigation shows that the debtor will not have enough discretionary income to meet the new liability, the credit application must be refused. Regulations issued under the Law may establish different credit eligibility standards for different types of debtor. If the credit is granted, the creditor must report the fact to the credit registry. The creditor must also report payment delinquencies to the registry when ten percent or more of the obligation arising under the contract is in arrear.

A creditor's failure to comply with the Law triggers important sanctions.[124] If the creditor is guilty of a serious breach, the creditor loses the right to recover the credit extended, including the interest, and the debtor is entitled to recover any payments made by him subject to the general civil code provisions on unjust enrichment. If the creditor's infractions are minor, the creditor only loses the right to claim the interest, including expenses (*frais)* due under the contract.

It seems there are no official reports about the operation of the 2001 Law and no reported litigation at first instance.[125]

4. United States

Given everything that has been said in this paper about credit granting practices in the United States, the US must surely appear to be last country in the Western hemisphere which one could expect to adopt the principle of creditor responsibility. This bleak

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[124] Law, art. 32.

[125] Information supplied to the author by the Swiss Ministry of Justice in Berne and by Prof Bernd Stauder. According to Prof Stauder, the 2001 federal Law was requested by the large lenders to overcome the difficulties presented by the multiplicity of laws in effect at the cantonal level.

verdict is reinforced by the US credit industry's long, and eventually successful, fight for the adoption of the Bankruptcy Abuse and Consumer Protection Act 2005 (BAPCPA) and its draconian provisions restricting to the straight bankruptcy provisions in the Bankruptcy Code. In short, the US may appear as the ultimate paradise for credit granting excesses.

However, there is another side to the picture and it is this side I want to draw attention to in this section of the paper. Starting with the late Professor Vern Countryman of the Harvard Law School,[126] many individuals (including attorneys, academics and judges), groups and organizations[127] in the US have fought a battle over many years for recognition of the principle of lender responsibility in the extension of consumer credit and for adoption of laws to give effect to the principle. Up to now their voices have gone unheeded. Creditors' deep pockets have ensured, at least at the federal level, that Congress would not adopt laws seriously inimical to the credit industry's interests. However, the financial crisis engendered by the subprime mortgage melt down may change all this. If either of the current bills before the Congress, HR 3915 or S.2452, are enacted,[128] aiming to remedy the widespread abuses in the subprime mortgage lending market, it will presumably greatly improve as well the prospects for imposing lender responsibility in other branches of the consumer credit market. Professor Elizabeth

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[126] *Supra* note 109. For an earlier article providing strong empirical evidence of loose credit practices in the used automobile industry, see Ronald L. Hersbergen, "The Improvident Extension of Credit as an Unconscionable Contract" (1974) 23 Drake L. Rev. 225.

[127] Significantly, a leading organization espousing this cause is called the Center for Responsible Lending. For some of the Center submissions and publications in the consumer credit area see, *supra* note 69.

[128] Both bills have been reported out of their Committees. See … . See also the excellent U.S., *Report of the Committee on Financial Services on H.R. 3915*, *100th Congress, 1st Sess*. (Washington, D.C.: 2007).

Warren has argued that consumer credit problems are so multifaceted that the traditional fragmentary approach is no longer sufficient. What is needed, in her view,[129] is a Financial Product Safety Commission that will do for consumers in the consumer credit area what the Consumer Product Safety Commission does for them with respect to the safety of consumer products. She could also have used the federal Securities and Exchange Commission (SEC), and its long established role, to bolster her argument.[130] In any event, one must hope her proposal will receive the serious study that it deserves.

IV Lender Responsibility and the Canadian Response

This brings me, finally, to what we should be doing in Canada to redress the imbalance between debtor and creditor responsibilities. Given the size and complexity of the canvas, it is not possible to do more than to sketch the various possible solutions. At the outset, a distinction must be drawn between solutions available before consumers become insolvent and those that should be applied after insolvency. Obviously, prebankruptcy prophylactic measures are of greater importance because, if properly structured and adequately enforced, they should substantially reduce the number of consumer bankruptcies.

1. Prebankruptcy Measures

A complication facing the resort to prebankruptcy measures is the fact that the federal and provincial governments both have substantial constitutional jurisdiction in the

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[129] Elizabeth Warren, "Unsafe At Any Rate" (2007) *Democracy: A Journal of Ideas* 8.

[130] Recall that the SEC was established in 1933 to respond to a crisis strikingly similar to the subprime mortgage market that is currently gripping North American financial markets.

consumer credit area. The federal government derives its jurisdiction from its powers in relation to banks and banking (Constitution Act, s. 91(15)), bills of exchange and promissory notes (s. 91(18), (regulation of interest rates (s. 91(19)), criminal law (s. 91(27)), interprovincial telecommunications (s. 92(10(a)), and interprovincial trade and commerce (s. 91(2)). The main source of provincial jurisdiction rests on the power to regulate property and civil rights within the province (s. 92(13)). This list suggests that the federal government easily enjoys the greater share of powers and it is no doubt true that where federal and provincial legislation come into conflict the federal rules will prevail. Similarly, provincial intervention in a given area may be wholly precluded if the legislation is characterized under a federal head of power. In practice, however, the federal government has not attempted to flex its full constitutional muscle in the consumer credit area and considerable leeway has been left to the provinces.

(a) Scope of Provincial Legislation

Many, and in some cases most, of the important consumer credit provisions are found in provincial consumer protection acts[131] and covers formation of the agreement (including credit card agreements), truth in lending disclosure requirements, rebates for early payment of the outstanding balance, implied warranties and conditions in a credit sale of goods, avoidance of cut off clauses where the credit agreement has been assigned to a third party, restrictions on repossession of the collateral where the debtor is in default as well as more generalized preconditions to the enforcement of the creditor's security

[131] See e.g., Ontario Consumer Protection Act, S.O. 2002, c. 30 as am., and O. Reg. 17/05.

rights under Part V of the provincial personal property security Acts where the debtor is in default.[132]

Of particular significance from the perspective of this paper are the provisions now found in five of the provinces[133] giving the courts broad powers to set aside agreements with consumers brought about by false or misleading representations or by unfair or unconscionable representations by a supplier of goods or services.[134] The provisions in Part III of the Ontario Consumer Protection Act 2002 (supra) are the most recent incarnation of this seemingly open ended approach and illustrate both their strengths and weaknesses.

Section 14(1) of Part III of the Act provides that it is an unfair practice for a person to make a false misleading or deceptive representation. This provision has little relevance for a creditor's conduct that takes advantage of a consumer's ignorance or necessitous circumstances but involves no fraud or deception in the traditional sense. Section 15(1) comes closer to the mark. It declares that "It is an unfair practice to make an unconscionable representation." Subs. (2) then provides that, in determining whether a representation is unconscionable there may be taken into account the fact that the person making the representation or the person's employer or principal knows or ought to know that:

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132 Stat. Ont. 1990, c. P.10. The newly minted provincial payday loan legislation is omitted from this list because it has been discussed earlier. See *supra* note 84.

133 I.e., British Columbia, Alberta, Ontario, Nova Scotia and Prince Edward Island. For the citations, see McCamus, *supra* note 92, ch. 11 at note 275.

134 "Services" is very broadly defined in s 1 of the Ontario CPA, *supra* note 94 and means "anything other than goods, including any service, right, entitlement".

(a) that the consumer is not reasonably able to protect his or her interests because of disability, ignorance, illiteracy, inability to understand the language of an agreement or similar factors;

(b) that the price grossly exceeds the price at which similar goods or services are readily available to like consumers;

(c) that the consumer is unable to receive a substantial benefit from the subject-matter of the representation;

(d) that there is no reasonable probability of payment of the obligation in full by the consumer;

(e) that the consumer transaction is excessively one-sided in favour of someone other than the consumer;

(f) that the terms of the consumer transaction are so adverse to the consumer as to be inequitable;

(g) that a statement of opinion is misleading and the consumer is likely to rely on it to his or her detriment; or

(h) that the consumer is being subjected to undue pressure to enter into a consumer transaction.

These provisions were not originally designed to protect consumers in credit transactions. Nevertheless, subsections (c) and (d) seem capable of being applied to quite familiar credit sales situations.[135] The fact remains that there are few reported cases where they

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[135] As described, for example, in David Caplovitz's classic study *The Poor Pay More: Consumer Practices of Low Income Families* (New York: Free Press, 1967).

have been invoked for this purpose. There are two reasons for this. The first – the less important of the two – is that all of the examples of unfair representations in s. 15(2) hinge on the troublesome proof of a "representation" by the creditor. The second, and still more debilitating, reason is that the type of consumer who needs the protection most cannot afford to litigate. Under the CPA, the Minister and the Minister's officials have broad powers under Part XI of the Act:

- To issue cease and desist orders against the person making the false, misleading of deceptive representation (s. 109);[136]
- to issue a compliance order if a person has engaged in activity that contravenes any provision in the Act (s. 111);
- to accept an assurance of voluntary compliance from a person alleged to be violating the Act (s. 114); and, as an ultimate resort,
- to obtain a court requiring an offending party to comply with the Act (s. 115).

Similar powers appeared in the Ontario Business Practices Act, the predecessor to the OPA, and were little used there.[137] It would be agreeable to think that a new broom sweeps clean but it seems unlikely.

(b) The Federal Role

The federal government is in a preeminent position to play a leading role in the regulation of most types, and many aspects of, consumer credit given the reach of its

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136 As worded, s. 109 is not broad enough to apply to unconscionable conduct not involving false or misleading representations under s. 15 of the OPA.

137 *Cf.* W.A.W. Neilson, "Administrative Remedies: The Canadian Experience with Assurances with Voluntary Compliance in Provincial Trade Practices Legislation" (1981) 19 Osgoode Hall L.J. 153.

constitutional powers, its near total control over the powers and activities of banks and federal incorporated trust and loan and other financial institutions, and its control over the mortgage funds made available to consumer borrowers under the Central Housing and Mortgage Corporation Act.[138]

The federal government's actual record is very mixed. It erred badly in repealing the Small Loans Act in 1981[139] and replacing it with the misconceived and unworkable usury provisions in s. 347 of the Criminal Code.[140] Regrettably, the federal government also abdicated its responsibilities in 2006 in leaving it to the provinces to regulate payday loan companies – a recipe surely for confusion and inconsistencies in rate setting and administration of the newly adopted provincial legislation. The federal government appears also so far not to have exercised its powers to prevent abuses and misleading advertisements with respect to home equity loans (other than in relation to loans made by federally controlled banks) and to make sure, through its control over CMHC, and otherwise, that the abuses of subprime mortgage loans will not secure a foothold in Canada.

On the other hand, the federal government deserves considerable credit for imposing strong disclosure requirements in consumer loan and credit card agreements regulated under the Bank Act,[141] in improving low income consumers' access to retail banking accounts, and in requiring banks to give public notice before closing bank branches and entitling local communities to voice their concerns before a final decision is

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[138] Stat. Can. 1985, c. C-7.
[139] An act to amend the Small Loans Act and to provide for its repeal and to amend the Criminal Code, Stat. Can. 1980, c. 44, repealing Small Loans Act, Stat. Can. 1939, c. 23.
[140] Supra, Section C.III.3(a).
[141] Stat. Can. 1991, c.46, as am. by Stat. Can. 2001(9), Part VIII.

taken.[142] Arguably, the federal government's most valuable contribution in the protection of consumer interests has resulted from the establishment of the Financial Consumer Agency of Canada in 2001.[143] The FCAC was established on the recommendation of the federal Task Force on the Future of Financial Institutions, whose report strongly emphasized the need for better "consumer empowerment".[144] The FCAC has informational, monitoring, research and enforcement functions. It can discharge these functions with considerable effectiveness because it has a substantial annual budget,[145] derived from an annual levy imposed on banks with a paid up capital of more than a billion dollars[146] and therefore not dependent on the vagaries of federal governments. All four of the agency's functions are important but the function that has had the greatest impact are its enforcement powers. The agency will investigate complaints and, if well founded, will oblige the offending financial institution to remedy the violation and provide restitution to affected consumers. The agency also power to impose fines, up to a maximum of $200,000 for corporations, and has exercised it against repeat and, sometimes, first time offenders.[147] In short, given strong leadership, a higher profile, and more public support the FCAC has the potential for realizing in Canada what Professor

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[142] *Ibid*., s.459.2

[143] Financial Consumer Agency of Canada Act, Stat. Can. 2001, c.9 [FCAC Act]; Financial Consumer Agency of Canada Assessment of Financial Institutions Regulations, S.O.R./2001-474 [FCAC Assessment Regulations]; Financial Consumer Agency of Canada Designated Violations Regulations, S.O.R./2002-101.

[144] Task Force on the Future of the Canadian Financial Services Sector, *Change Challenge Opportunity: Report of the Task Force* (Ottawa: September 1998) at 207.

[145] The Agency's total revenue in 2006 amounted to $7, 291,772, of which assessments accounted for $7,291,054; the 2005 total revenue was $7,168, 323, of which assessments accounted for $7,157,400. See *FCAC Annual Report* 2005-2006, p. 55.

[146] See FCAC Act, *supra* note 143, s. 18(3) and FCAC Assessment Regulations, *supra* note 143.

[147] Information about the Commissioner's disposition of complaints is published on the FCAC website and is very detailed.

Elizabeth Warren has proposed for the US: the establishment of a comprehensive consumer credit protection agency.

(c) A Better Solution for the Payday Loans Problem?

The FCAC has no jurisdiction with respect to payday loans but section 459.3 of the Bank Act provides the key for a potentially important, albeit partial, solution to the problem. The short term character of payday loans, the small size of the loans, and the relatively high costs of administration must inevitably mean that the cost of the loans, at least expressed as an annual percentage rate, will always remain high. The solution appears to be the establishment of community oriented not-for-profit loan institutions along the lines of the *montes pietatis* long familiar in continental Europe. Section 459.3 of the Bank Act comes into play here for the following reasons. The section applies to banks with a paid up equity of $1 billion or more and requires the banks to publish annually a statement describing the bank's contribution to the Canadian economy and society.[148] Neither the section nor the accompanying regulations[149] specify the types or amount of contribution that will satisfy the statutory requirement, and it is not clear that the existing provision has significantly altered corporate citizenship in the banking sector. It is suggested that meaningful corporate citizenship would be much more positively advanced if Canadian banks, individually or collectively (or possibly a combination of both) were obliged to do one of two things: (a) to establish a Canada wide network of not

[148] The statement, which is usually referred to as a "public accountability statement"(PAS), was probably inspired by the Community Reinvestment Bank Act 1977 model in the US. See 12 USC 2901. For a recent example of a PAS by a major Canadian bank, see Toronto-Dominion Bank, *Annual Accountability Report 2007*, online: TD Bank Financial Group <http://www.td.com/ar2007/>.

[149] S.O.R./2002-133.

for profit payday loan outlets for particularly indigent borrowers referred to an outlet by a social agency, or (b) to contribute an annual amount to help cover the operating expenses of such a network. In addition, pressure should be brought to bear on provincial governments to ensure that the allowances paid to families on welfare are sufficient to cover basic cost of living expenses and to keep pace with inflation, and that minimum wages are adjusted automatically to reflect an inflation index. It is not suggested that such measures are likely to eliminate the need for profit oriented payday loan companies or the need to regulate their activities. The measures should however assist the most deserving borrowers and will also provide the regulatory authorities with valuable experience in regulating the activities and costs of commercial payday loan companies.

2. *Postbankruptcy Measures*

Since this paper is much concerned with the impact of consumer credit on consumer insolvencies, it is also appropriate to consider what role the BIA provisions could play in encouraging responsible lending practices and penalizing those creditors who behave irresponsibly. As earlier noted,[150] the current BIA provisions are one sided. Section 170(1) requires the trustee to report to the creditors (and to the court if there is to be a hearing) on the causes of the consumer's insolvency, the consumer's conduct subsequent to bankruptcy, whether the debtor has made the required surplus income payments under s. 68, and whether the debtor has attended the mandatory counseling sessions. The trustee is not required[151] to comment on whether any creditor's conduct was

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150 *Supra* Part A.
151 Or even permitted?

wholly or partially responsible for the debtor's financial problems and whether any creditor may have breached any federal or provincial law for protection of consumers.

The picture remains one sided if the trustee or a creditor opposes the debtor's discharge from bankruptcy.[152] As provided in s. 172 of the BIA,[153] if any of the circumstances described in the section apply, the court must refuse the discharge, suspend the discharge, or make a conditional order of discharge. All the circumstances enumerated in the section (no less than fifteen) relate to the debtor's financial condition or the debtor's conduct in relation to the debts. The section contains no reference to the creditors' conduct or whether any creditor's conduct brought about or contributed to the debtor's insolvency.[154]

To redress the imbalance between the treatment of creditors and debtors under the BIA, I suggest the following changes:

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[152] As a result of the 2005 and 2007 amendments to the BIA, the discharge provisions have become much more complex. However, the basic provision remains that in s. 167 basically entitling a first time bankrupt to a discharge after nine months unless the discharge is opposed or the bankrupt has surplus income.

[153] Section 172 reads:

> (1) On the hearing of an application of a bankrupt for a discharge, the court may either grant or refuse an absolute order of discharge or suspend the operation of the order for a specified time, or grant an order of discharge subject to any terms or conditions with respect to any earnings or income that may afterwards become due to the bankrupt or with respect to his after-acquired property.
>
> Powers of court to refuse or suspend discharge or grant conditional discharge
>
> (2) The court shall on proof of any of the facts mentioned in section 173
>
> > (a) refuse the discharge of a bankrupt;
> >
> > (b) suspend the discharge for such period as the court thinks proper; or
> >
> > (c) require the bankrupt, as a condition of his discharge, to perform such acts, pay such moneys, consent to such judgments or comply with such other terms as the court may direct.

[154] I appreciate that the one sidedness in s. 172 is historical and that only a very small percentage of discharge applications are opposed in practice. Nevertheless, the discrimination remains and is objectionable.

1. The trustee's Section 170(1) report, in dealing with the causes of the debtor's bankruptcy, will indicate whether, in the trustee's opinion, a creditor's conduct has contributed to the bankrupt's financial difficulties and, if it has, in what way it has done so.
2. A new class of claims should be added to the BIA and described as "unconscionable claims". An "unconscionable claim" will be defined, inter alia, as a claim against a consumer debtor brought about by improvident credit extended to the bankrupt where the creditor knew, or should reasonably have anticipated, that the debtor would not be able to, or would have serious difficulties, meeting the debtor's obligations under the credit contract, or would not be able to do so without impairing the debtor's obligations to other creditors or to the members of the debtor's family.
3. BIA section 135(2)(a) should be amended to provide that a trustee may disallow "any claim, including any unconscionable claim" as defined in the Act.
4. In dealing with an opposed application for discharge from bankruptcy under s. 173, the court will be required to take into consideration whether, and to what extent, the bankrupt's overindebtedness was brought about as the result of a creditor's unconscionable conduct.
5. Where the Superintendent of Bankruptcy is of the view that a creditor is engaging in a course of conduct resulting in unconscionable claims against bankrupt consumers, the Superintendent may make an order precluding the creditor from filing a claim against bankrupt debtors until, in the Superintendent's opinion, the creditor has ceased engaging in the unconscionable conduct giving rise to such

claims. The Superintendent's order will be subject to the usual rights of appeal to the Bankruptcy Court.

These proposals may appear novel and will no doubt be vigorously opposed by creditors. However, they only reflect the principle of creditor responsibility incorporated in the EU Directive and adopted in the business and trade practices provisions of five of the Canadian provinces. It is desirable to entrench the principle in the BIA provisions to highlight the importance which the Canadian Parliament attaches to responsible lender conduct and because of the prominence of consumer credit claims in most consumer bankruptcies. If there are corresponding provincial provisions imposing responsible lender conduct, the trustee will be able to rely on those as well but it important to ensure that the trustee will have at least one set of statutory norms at the trustee's disposal.

E. CONCLUSION

Consumer credit has come a long way from its peripheral role in early agrarian societies to its major status in sustaining the economies of many advanced industrialized states. However, the attraction of consumer credit to consumers in allowing them to pay for goods and services over a period of time, and its attraction to lenders and credit grantors as a major profit centre, both easily lend themselves to abuse. The thesis of this paper has been that, while in Canada, the potential for abuse by debtors has long been recognized in the insolvency context, the need for lender and credit grantor responsibility in extending the loan or credit is just as important. If there were any doubts about the latter proposition it has surely been put to rest by the subprime mortgage loan debacle. The question is no longer whether lenders and credit grantors should be held responsible but how that principle can best be given legislative expression, both at the time the credit is extended and in the event that its extension leads to the consumer's insolvency.

I have argued however that lender responsibility is not an adequate answer to meet the credit needs of low income Canadian consumers. The challenged here, it has been suggested, is for governments at the various levels, together with the private sector, to devise imaginative solutions to the existing problems. The challenges are all the greater because they involve the least privileged, and politically least influential, members of Canadian society. Nevertheless, all of us will pay a high price if the problems are not adequately addressed.