



**Canadian  
Institute  
of Actuaries**

**Institut  
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**Subject: Consultation on Fighting Predatory Lending by Lowering the Criminal Rate of Interest**

The Canadian Institute of Actuaries (CIA) is pleased to provide our comments on this consultation. We have commented on the sections of the paper relevant to the actuarial profession and have included additional relevant comments.

Actuaries have a unique interest in the criminal rate of interest as defined in section 347 of the *Criminal Code of Canada*. The criminal rate of interest is defined as an effective annual rate of interest calculated in accordance with generally accepted **actuarial** principles. Actuarial Standards of Practice specify the formula for calculation of an effective rate of interest. The professional discipline process of the CIA ensures that actuaries comply with those standards. An actuary's certificate is sufficient to establish whether a rate is a criminal rate.

**Consultation questions**

1. *Should the criminal rate of interest be set at a fixed level or linked to prevailing market conditions? Please provide your rationale.*

**Floating vs. fixed**

A fixed-level rate has the advantages of clarity and simplicity. As noted by many people, prevailing rates have changed significantly over the years and the criminal rate has not.

If the criminal rate of interest is linked to prevailing market conditions, then the legislation should specify what date or dates are to be used in choosing that rate.

- a) Would the criminal rate be set as of the date the loan agreement starts? And would the criminal rate be level for the entire term of the loan?
- b) If the criminal rate is a rolling rate based on what the market was over the course of the loan, those rates could only be known after the fact when the loan is fully repaid or in default.

- c) If the criminal rate changes over the term of the loan, then the law would need to specify how compliance is to be measured. Would compliance need to be measured separately on each sub-period when a different rate is applied? Would it be acceptable to calculate a single effective average rate over the term of the loan and compare that to a single average criminal rate over the same term? Either approach would add to the complexity of the calculations and make the process less transparent for borrowers.
- d) If the criminal rate is allowed to change over the term of the loan, then the legislation could potentially put an end to fixed-repayment loans. In other words, it would no longer be possible to agree in advance that a person can borrow \$X and make monthly payments of \$Y for a set term. Any lender entering such a contract would be exposed to possible criminal violation if prevailing interest rates fell enough over the term of the loan.

### **Method of interest calculation**

The current legislation defines the interest rate calculation in terms of generally accepted *actuarial* principles. That definition provides a clearly documented mathematical basis for the calculation. The application of the formula is enforced by the existing professional discipline process of the CIA.

Other interest definitions are not clearly defined and are therefore open to possible abuse or selective re-interpretation by lenders. For example, one common practice is to define the annual rate of interest as being twelve times the monthly rate. But that practice ignores compounding of interest. A rate of 5% per month works out to an effective annual rate of 80%, not 60% (=12 x 5%). A rate of 1% per week works out to an effective annual rate 68%, not 52%. We believe the law should avoid such possible vagueness.

### **Small amounts and short durations**

There is some minimum administrative cost in any lender making a loan. For shorter-term, smaller loans, that cost necessarily translates into a larger percentage than the same cost spread over a longer-term, larger loan. The current legislation makes no allowance for this fact.

If new legislation lowers the criminal rate but makes no allowance for shorter-term, small loans, they will become uneconomical for lenders. The result will be that many lenders will impose their own minimum terms and/or durations.

### **CIA comments**

Our additional comments are as follows:

- a. It would be reasonable if the criminal rate varies to reflect prevailing market rates.
- b. If the rate can vary, some care is needed in deciding how frequently it should change. Market rates are generally available daily. But it may be more workable for lenders

and borrowers to have the rate set once a month or once a quarter based on the market at that time, then held level until the next month or quarter.

- c. The law should allow the criminal rate to be fixed as of the start of the loan. If that option is not available, the law might effectively be putting an end to fixed-payment, fixed-term loans. Even if fixed-payment loans continue to be available, the calculation of whether the loan violates the criminal rate would be more complex and therefore less transparent to borrowers if the rate can change over the term of the loan.
- d. The criminal rate could be allowed to vary over the course of a loan if the interest being charged on the loan also varies. This option would allow continuation of loans similar to a line of credit. The point is, as with (c) above, the legislation should avoid situations where the criminal rate can change but the lender has no freedom to adjust the interest rate charged.
- e. We believe the legislation should continue to define the interest rate calculation in terms of generally accepted *actuarial* principles. Other definitions can be vague about how often interest is calculated and whether or how often it compounds.
- f. We believe it is reasonable and fair that larger interest rates or a specified dollar amount be permissible on shorter-term, smaller loans to reflect the basic economics of those loans.
- g. In some court cases, actuaries have been asked to provide opinions on the effective interest rate resulting from early payment discounts or late payment penalties from retailers and utilities. Because of the short time frames involved, it is mathematically possible that the effective interest rate exceeds the current 60% limit and would likely exceed any new limit being considered. If early payment discounts and late penalties are not intended to be covered by legislation, the legislation should include some statement to that effect for clarity.
- h. Most matters involving allegations of a criminal rate are civil suits where the allegation of a criminal rate is raised as a reason to void an entire contract. There are some, but few, criminal cases. We suggest that the *Criminal Code* is not the best place for controlling maximum interest rates.

Consultation questions 2 through 7 are outside the scope of actuarial expertise.

The CIA appreciates the opportunity to provide feedback on these issues, and we would welcome further discussion with you throughout this process.

If you have any questions, please contact Chris Fievoli, FCIA, Actuary, Communications and Public Affairs, at 613-236-8196 ext. 119 or [chris.fievoli@cia-ica.ca](mailto:chris.fievoli@cia-ica.ca).

Sincerely,

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President, Canadian Institute of Actuaries



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