Calculating the Adverse Impacts of a Reduction in the Qualifying APR

Developed by the Risk Roundtable of the Canadian Lenders Association
June 29, 2022

EXECUTIVE SUMMARY

In calculating the reduction in the qualifying APR, the Risk Roundtable subcommittee notes that any reduction in the maximum allowable rate would negatively impact up to 80% of the entire Non-Prime/Unscorable segment, which accounts for almost a quarter of the Canadian population.

INTRODUCTION

The Federal Government is undertaking a consultation to determine whether a change to the Maximum Rate of Interest in the Criminal Code is allowed under law. The Canadian Lenders Association has conducted research that provides a better understanding of the unintended consequences of reducing the maximum rate of interest to the Canadian consumer and SMB borrowers.

The Canadian Lenders Association's Risk Roundtable, which represents risk officers from across the lending spectrum, has utilized a quantitative methodology to estimate the number of Canadians who would be negatively impacted by a reduction in the maximum allowable rate.

CLA Members are permitted to reference these estimates as part of any representation to the Federal Government provided the appropriate notation is included with their submission.

BACKGROUND

The *Criminal Code*'s effective annual interest rate of 60% is the maximum allowable rate in Canada, which is equivalent to a nominal annual percentage rate ("APR") of ~47%, a measure that is more familiar to consumers when referring to the borrowing cost for nearly all credit products requiring regular repayments.

As of December 31, 2021, there were a total of 26,665,749 Canadians with credit reports according to TransUnion of Canada. Utilizing TransUnion's Credit Vision score, 8,237,031 Canadians or 27.8% of the population are considered Non-Prime while 21,127,327 or 71.2% are considered Prime. A total of 301,481 Canadians or 1.02% of the population are considered Unscorable. Collectively, Non-Prime consumers held $186.6 billion in consumer credit balances consisting of credit cards, lines of credit, auto loans and installment loans while Prime consumers held $661.5 billion and those without a credit score held $2.8 billion.

Table 1 Credit Segmentation of the Canadian Population

Credit Vision Score Band	Credit Segment	# of Consumers	% of Consumers	Sub-Total # of Consumers	Sub-Total % of Consumers	Consumer Credit Outstanding
No Score	**Unscorable**	301,481	1.02%	301,481	1.02%	$2.8 billion
300 - 329	**Non-Prime**	83	0.00%	8,237,031	27.77%	$186.6 billion
330 - 359		1,559	0.01%			
360 - 389		3,190	0.01%			
390 - 419		4,681	0.02%			
420 - 449		46,261	0.16%			
450 - 479		63,553	0.21%			
480 - 509		70,071	0.24%			
510 - 539		146,696	0.49%			
540 - 569		279,912	0.94%			
570 - 599		580,662	1.96%			
600 - 629		1,009,306	3.40%			
630 - 659		1,351,462	4.56%			
660 - 689		1,928,703	6.50%			
690 - 719		2,750,892	9.27%			
720 - 749	**Prime**	3,420,855	11.53%	21,127,237	71.22%	$661.5 billion
750 - 779		3,288,165	11.08%			
780 - 809		4,007,760	13.51%			
810 - 839		4,643,706	15.65%			
840 - 869		3,720,634	12.54%			
870 - 899		1,687,167	5.69%			
900		358,950	1.21%			
			100.00%	**29,665,749**	**100.00%**	**$850.9 billion**

Source: TransUnion, as at December 31, 2021. Balances include those held by co-borrowers.

While most lenders regularly report credit data to the credit reporting agencies, this has not included the APRs of the debts held by consumers.

To help its members better understand the negative impact of a potential reduction in the maximum allowable rate, a team of Risk Officers belonging to the CLA's Risk Roundtable developed a model to quantify the number of Canadians whose access to credit would be affected using information provided by TransUnion and a series of underlying assumptions.

METHODOLOGY

The first step of the analysis was to broadly assign a range of interest rates based on the credit segmentation of the Canadian population. Based on the pricing practices of its members, who would also have knowledge of the range of APRs used by a larger group of financial institutions (as many of these APRs are available in the public domain), the Risk Roundtable assumed that Non-Prime/Unscorable consumers would qualify for APRs between 20% and 47.2% and prime consumers would qualify for APRs less than 20%. Furthermore, in the absence of knowing the specifics of dynamic risk-based pricing strategies of each lender, it was assumed that an equal distribution of the population of Non-Prime/Unscorable and Prime consumers would qualify for these APR ranges.

Utilizing this approach, the Risk Roundtable calculated that for every 1% drop in APR between 20% and 47.2%, approximately 3.7% of the Non-Prime/Unscorable consumer population or 313,916 Canadians would be negatively impacted as lenders opted to either reduce or deny consumers access to credit as a result of being unable to price for higher levels of risk due to a reduction in the maximum allowable rate.

Table 2 Calculation of the Negative Impacts of a Reduction in the Qualifying APR

Credit Segment	# of Consumers	Qualifying APRs	% of Consumers adversely impacted for every 1% drop in Qualifying APR		# of Consumers adversely impacted for every 1% drop in Qualifying APR
Unscorable / Non-Prime	8,538,512	>= 20% and <= 47.2%	1 divided by 27.2 based on an equal distribution of consumers by Qualfiying APR	3.7%	313,916
Prime	21,127,237	< 20%	1 divided by 20 based on an equal distribution of consumers by Qualfiying APR	5.0%	1,056,362

From this, the Risk Roundtable was then able to calculate the number of Canadians that would be negatively impacted for every 1% drop in the qualifying APR. This estimation focused solely on the impact to the Non-Prime/Unscorable population based on the assumption that any reduction in the maximum allowable rate would not fall to APRs below 25% at which point the borrowing activity of Prime consumers would be negatively impacted.

Table 3

Quantification of the Population Negatively Impacted by a change in the Maximum Allowable Rate

APR Maximum expressed as an APR	Number of NonPrime Customers Excluded From Borrowing	% of NonPrime Customers Excluded From Borrowing	% of Canadian Consumers Excluded from Borrowing
47.2%	-	0.0%	0.0%
47.0%	85,215	1.0%	0.3%
46.0%	399,131	4.7%	1.3%
45.0%	798,261	9.3%	2.7%
44.0%	1,197,392	14.0%	4.0%
43.0%	1,596,522	18.7%	5.4%
42.0%	1,995,653	23.4%	6.7%
41.0%	2,394,783	28.0%	8.1%
40.0%	**2,793,914**	**32.7%**	**9.4%**
39.0%	3,193,045	37.4%	10.8%
38.0%	3,592,175	42.1%	12.1%
37.0%	3,991,306	46.7%	13.5%
36.0%	4,390,436	51.4%	14.8%
35.0%	**4,789,567**	**56.1%**	**16.1%**
34.0%	5,188,697	60.8%	17.5%
33.0%	5,587,828	65.4%	18.8%
32.0%	5,986,959	70.1%	20.2%
31.0%	6,386,089	74.8%	21.5%
30.0%	**6,785,220**	**79.5%**	**22.9%**
29.0%	7,184,350	84.1%	24.2%
28.0%	7,583,481	88.8%	25.6%
27.0%	7,982,611	93.5%	26.9%
26.0%	8,381,742	98.2%	28.3%
25.0%	**8,780,873**	**100.0%**	**29.6%**

CONCLUSION AND IMPLICATIONS

The Federal Government's consultation to determine whether a change is required to the maximum allowable rate could have negative impacts on a significant portion of the Canadian population, specifically the Non-Prime/Unscorable Canadian borrowers in the form of reduced or terminated access to credit. A potential reduction in the maximum allowable rate from approximately 47% APR to 35% or 30% would negatively impact between 4.8 and 6.7 million Canadians, or up to 80% of the entire Non-Prime/Unscorable segment, which accounts for almost a quarter of the Canadian population.

A change of this magnitude could have unintended consequences by limiting or eliminating the borrowing activity of millions of consumers, many of whom rely upon credit for essential expenses. With over $186 billion in consumer credit balances, the Non-Prime consumer segment is a significant contributor to the lifeblood of the Canadian economy; they also represent the segment of the population that is most at risk given their inability to qualify for credit at major financial institutions who focus largely on servicing the Prime consumer.

Therefore, any steps to constrain or eliminate their access to various forms of borrowing should be carefully considered given the large number of consumers who would be negatively impacted by a change of this nature.