An Introductory Guide to the Payday Lending Industry In Canada

A Report to the Public Utilities Board of Manitoba

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September 17, 2007
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Introduction

I have been retained by the Public Interest Law Centre of Legal Aid Manitoba to offer my opinion on factors which the Public Utilities Board of Manitoba may wish to take into account in setting the maximum cost of credit that may be charged for payday loans in Manitoba.

I am an associate professor of finance at York University, in the Atkinson School of Administrative Studies. I have a PhD in Finance and I am a chartered accountant and a certified financial planner. I have co-authored a widely used personal financial planning textbook that is the standard university level textbook in Canada, and also exists in French language, US, Chinese and Dutch editions, with Mexican and UK editions in progress. I have published many research papers in financial planning, retirement planning, investment management, corporate finance, accounting, auditing, financial statement analysis and environmental management, and I have taught graduate level courses in those areas. I have extensively studied the payday lending industry in Canada. In May of 2006, ACORN Canada released my report, Regulation of Payday Lending in Canada, in which I recommended a fee structure for payday lenders based upon the evidence available at that time. My understanding is that this report has already been provided to the Public Utilities Board.

One of the challenges in recommending any fee structure for payday lenders is that information relating to key data such as average loan size, volume per store and number of transactions is considered proprietary by many industry players. I believe this regulatory proceeding offers a unique opportunity to put the best possible information on the record in order to achieve an appropriate rate.

In the report which follows, I do not propose a maximum cost of credit for payday loans, rollover loans or repeat loans. Instead, I attempt to highlight key characteristics of the payday lending industry which may assist the Board in fulfilling its mandate. I look forward to the opportunity provided by the regulatory process to gain greater knowledge of the industry in order to assist with my final recommendations.
The Business of Payday Lending

In this section, we will explain how the business works and draw from that explanation important observations that will help us to design appropriate rate structures.

We will build up our understanding from the simplest example to a realistic example of the financial operations and results.

From this process we will see that the payday lending stores have the following characteristics:

- They are very small businesses.
- They have high operating leverage, which means profits change a great deal with changes in volume.
- Most of the costs are the operating costs, and these are largely fixed for the scale of most stores.
- Bad debts affect profits significantly, but are much less important than the operating costs.
- They require little capital.
- They charge very high fees, and the fee schedules are difficult to compare between stores.
- They have engaged in very limited economies of scope compared with most financial institutions. Only two business lines make a significant contribution: payday loans and cheque cashing.
- Money Mart and The Cash Store together have more than half the volume of the business. There are a number of smaller chains and many single stores.
- The size of the business has grown very rapidly in a decade in four ways:
  - Number of stores (growth has slowed in recent years)
  - Volume per store, at least in the large chains (still growing)
  - Average loan size (still growing)

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• Additional lines of business – the original payday lenders were cheque cashers only.
• The payday lending business depends upon repeat customers rather than single time users. The great majority of loans are to regular customers.

\textit{A Simple Example of a Single Transaction}

Ms Juanita Freezin comes into a payday lender on a cold winter day in Winnipeg. She asks how the loans work, and a clerk explains. He has to tell her how much it costs, how she will repay it (with a cheque dated seven days hence) and other conditions of the loan. He has to prepare the loan agreement. She takes out a loan for $100 repayable within seven days. The entire process takes 20 minutes. Suppose the clerk earns $12 per hour, including benefits. Suppose the loan charge is 1\% of the face amount, or $1. If that rate is compounded for 52.14 weeks, it will come close to 60\% per annum, which is the limit under the Criminal Code. The clerk’s time alone costs the store $4, and so it loses three times the value of its revenue on this transaction, before allowing for any other costs\textsuperscript{2} and assuming that the clerk has an uninterrupted stream of customers who all take out loans. Therefore, the clerk didn’t charge her 1\%, he charged her his store’s standard fee of 20\% of the principal, regardless of the time to maturity. In one week she will have to repay $120.

This simple example demonstrates that standalone payday lenders cannot possibly charge interest rates that look anything like those we are accustomed to on more conventional loans, like credit cards and mortgages. The small size of the loan and the time to process it requires that payday lenders charge very high fees. It is possible that if conventional financial institutions would offer such loans, their much greater economies of scale and scope would allow them to charge far lower rates. But our question in this analysis has to be what might be a reasonable rate for the alternative financial institutions or fringe banks to charge.

In order to determine this, we need to learn quite a lot more about how the payday lending business operates, and what its financial results look like.

\textit{An Example of a Single Payday Lender and Cheque Casher}

Imagine now that we have a company with a single store that cashes cheques and makes payday loans. This example is illustrative, to show the characteristics of the business. It does not represent a particular store, nor an average set of values. It does show the business relationships and the interaction of the financial variables realistically.

We will consider some variations in its costs and scale, looking at small, medium, large and very large volumes of business, and two different bad debt rates. The loan fee structure of our imaginary store is quite simple --a fixed percentage of each payday loan, regardless of the length of time to maturity. The small store charges 20\%, the medium store 12\%, the large store 10\% and the very large store 9\%. The bad debt rate alone is probably more than 1\% of total loan volume.
cheque cashing fees are the same for each store: $2.24 per cheque + 2.94% of the face value (drawn from Buckland 2006).

Table 1 shows the summary of the financial results for these combinations. There are seven columns for seven different situations. The small, medium and large stores are repeated for bad debt loss rates of 3% and 4%, while the very large store is shown only with a 4% loss rate.

Let us move down through the lines to understand what makes up this model of a store, and then look at the different profit results. The upper part of the table is a simple income statement, with one additional line, cost of capital, whose importance will be explained. The bottom part is the inputs, which are reasonable values that allow the revenues and expenses to be calculated in the income statement.

Revenues are cheque cashing and payday loans. Since the Board is considering payday loans in this hearing, the emphasis in this analysis is on them, but cheque cashing must be included because it covers part of the fixed costs, and thus allows a firm to charge lower payday loan rates (or make higher profits). Payday loan volume, the first line of the Inputs, is $1, 2, 3 and 5 million for the small to very large stores, respectively. An important statistic is the average loan size, $300, because it determines how many transactions and gives us some idea of how much business a store does and how many staff it will need. The cheque cashing volume comes from the Money Mart 2006 10K averages. The revenues include only the actual receipts – non-paying loan revenue is deducted. The gross revenues are quite small, less than $3/4 million for the very large store. Many of the fringe banks have additional business lines, but the contribution shown in the Money Mart 2006 10K is very small compared with cheque cashing and payday lending, and so we ignore them for this analysis.
Table 1: Model of a Single Store Operation

<table>
<thead>
<tr>
<th></th>
<th>Small</th>
<th>Medium</th>
<th>Large</th>
<th>Small</th>
<th>Medium</th>
<th>Large</th>
<th>Very Large</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Revenues</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Payday loans</td>
<td>$194,000</td>
<td>$232,800</td>
<td>$291,000</td>
<td>$192,000</td>
<td>$230,400</td>
<td>$288,000</td>
<td>$432,000</td>
</tr>
<tr>
<td>Cheque cashing</td>
<td>70,000</td>
<td>140,000</td>
<td>175,000</td>
<td>70,000</td>
<td>140,000</td>
<td>175,000</td>
<td>280,000</td>
</tr>
<tr>
<td></td>
<td>264,000</td>
<td>372,800</td>
<td>466,000</td>
<td>262,000</td>
<td>370,400</td>
<td>463,000</td>
<td>712,000</td>
</tr>
<tr>
<td><strong>Expenses:</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Clerks</td>
<td>36,000</td>
<td>77,760</td>
<td>103,680</td>
<td>36,000</td>
<td>77,760</td>
<td>103,680</td>
<td>151,200</td>
</tr>
<tr>
<td>Owner-manager</td>
<td>70,000</td>
<td>80,000</td>
<td>80,000</td>
<td>70,000</td>
<td>80,000</td>
<td>80,000</td>
<td>90,000</td>
</tr>
<tr>
<td>Rent</td>
<td>36,000</td>
<td>36,000</td>
<td>36,000</td>
<td>36,000</td>
<td>36,000</td>
<td>36,000</td>
<td>48,000</td>
</tr>
<tr>
<td>Services, utilities</td>
<td>30,000</td>
<td>30,000</td>
<td>30,000</td>
<td>30,000</td>
<td>30,000</td>
<td>30,000</td>
<td>40,000</td>
</tr>
<tr>
<td>Supplies</td>
<td>10,000</td>
<td>10,000</td>
<td>11,000</td>
<td>10,000</td>
<td>10,000</td>
<td>11,000</td>
<td>15,000</td>
</tr>
<tr>
<td>Bad debts</td>
<td>33,600</td>
<td>67,200</td>
<td>99,000</td>
<td>43,600</td>
<td>87,200</td>
<td>129,000</td>
<td>214,400</td>
</tr>
<tr>
<td>Depreciation</td>
<td>18,000</td>
<td>20,000</td>
<td>22,000</td>
<td>18,000</td>
<td>20,000</td>
<td>22,000</td>
<td>30,000</td>
</tr>
<tr>
<td></td>
<td>233,600</td>
<td>320,960</td>
<td>381,680</td>
<td>243,600</td>
<td>340,960</td>
<td>411,680</td>
<td>588,600</td>
</tr>
<tr>
<td><strong>Net income</strong></td>
<td>30,400</td>
<td>51,840</td>
<td>84,320</td>
<td>18,400</td>
<td>29,440</td>
<td>51,320</td>
<td>123,400</td>
</tr>
<tr>
<td>Cost of capital</td>
<td>19,500</td>
<td>23,667</td>
<td>28,500</td>
<td>19,500</td>
<td>23,667</td>
<td>28,500</td>
<td>39,167</td>
</tr>
<tr>
<td><strong>Economic Income</strong></td>
<td>$10,900</td>
<td>$28,173</td>
<td>$55,820</td>
<td>$-1,100</td>
<td>$5,773</td>
<td>$22,820</td>
<td>$84,233</td>
</tr>
<tr>
<td><strong>Inputs</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Loan Volume</td>
<td>1000000</td>
<td>2000000</td>
<td>3000000</td>
<td>1000000</td>
<td>2000000</td>
<td>3000000</td>
<td>5000000</td>
</tr>
<tr>
<td>loan fee % of P</td>
<td>0.2</td>
<td>0.12</td>
<td>0.1</td>
<td>0.2</td>
<td>0.12</td>
<td>0.1</td>
<td>0.09</td>
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<tr>
<td>Bad debt rate loan</td>
<td>0.03</td>
<td>0.03</td>
<td>0.03</td>
<td>0.04</td>
<td>0.04</td>
<td>0.04</td>
<td>0.04</td>
</tr>
<tr>
<td>Average loan</td>
<td>300</td>
<td>300</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td># of loans</td>
<td>3333</td>
<td>6667</td>
<td>10000</td>
<td>3333</td>
<td>6667</td>
<td>10000</td>
<td>16667</td>
</tr>
<tr>
<td>Cheque volume</td>
<td>2000000</td>
<td>4000000</td>
<td>5000000</td>
<td>2000000</td>
<td>4000000</td>
<td>5000000</td>
<td>8000000</td>
</tr>
<tr>
<td>Cheque size</td>
<td></td>
<td>400</td>
<td></td>
<td></td>
<td>400</td>
<td></td>
<td></td>
</tr>
<tr>
<td># of cheques</td>
<td>5000</td>
<td>10000</td>
<td>12500</td>
<td>5000</td>
<td>10000</td>
<td>12500</td>
<td>20000</td>
</tr>
<tr>
<td>Cheque flat fee</td>
<td>2.24</td>
<td></td>
<td>2.24</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Cheque % fee</td>
<td>0.0294</td>
<td></td>
<td>0.0294</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Bad debt rate cheques</td>
<td>0.0018</td>
<td></td>
<td>0.0018</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Loan maturity</td>
<td>12</td>
<td>12</td>
<td>12</td>
<td>12</td>
<td>12</td>
<td>12</td>
<td>12</td>
</tr>
<tr>
<td>Clerks $/hr</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Hours open/day</td>
<td>10</td>
<td>12</td>
<td>12</td>
<td>10</td>
<td>12</td>
<td>12</td>
<td>14</td>
</tr>
<tr>
<td>Days/year</td>
<td>300</td>
<td>360</td>
<td>360</td>
<td>300</td>
<td>360</td>
<td>360</td>
<td>360</td>
</tr>
<tr>
<td>Hours open/yr</td>
<td>3000</td>
<td>4320</td>
<td>4320</td>
<td>3000</td>
<td>4320</td>
<td>4320</td>
<td>5040</td>
</tr>
<tr>
<td>Transactions/hr</td>
<td>2.78</td>
<td>3.86</td>
<td>5.21</td>
<td>2.78</td>
<td>3.86</td>
<td>5.21</td>
<td>7.28</td>
</tr>
<tr>
<td># of clerks on duty</td>
<td>1</td>
<td>1.5</td>
<td>2</td>
<td>1</td>
<td>1.5</td>
<td>2</td>
<td>2.5</td>
</tr>
<tr>
<td>clerk hours/yr</td>
<td>3000</td>
<td>6480</td>
<td>8640</td>
<td>3000</td>
<td>6480</td>
<td>8640</td>
<td>12600</td>
</tr>
<tr>
<td>Physical capital</td>
<td>90000</td>
<td>100000</td>
<td>110000</td>
<td>90000</td>
<td>100000</td>
<td>110000</td>
<td>150000</td>
</tr>
<tr>
<td>Depreciation rate</td>
<td>0.2</td>
<td>0.2</td>
<td>0.2</td>
<td>0.2</td>
<td>0.2</td>
<td>0.2</td>
<td>0.2</td>
</tr>
<tr>
<td>Loan capital</td>
<td>40000</td>
<td>666667</td>
<td>100000</td>
<td>40000</td>
<td>666667</td>
<td>100000</td>
<td>166667</td>
</tr>
<tr>
<td>Initial loss</td>
<td>50000</td>
<td>50000</td>
<td>50000</td>
<td>50000</td>
<td>50000</td>
<td>50000</td>
<td>50000</td>
</tr>
<tr>
<td>Cash</td>
<td>150000</td>
<td>200000</td>
<td>250000</td>
<td>150000</td>
<td>200000</td>
<td>250000</td>
<td>250000</td>
</tr>
<tr>
<td>Total capital</td>
<td>1950000</td>
<td>236667</td>
<td>285000</td>
<td>1950000</td>
<td>236667</td>
<td>285000</td>
<td>391667</td>
</tr>
<tr>
<td>Discount rate</td>
<td>0.1</td>
<td></td>
<td></td>
<td>0.1</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Owner salary</td>
<td>70000</td>
<td>80000</td>
<td>70000</td>
<td>80000</td>
<td>70000</td>
<td>80000</td>
<td>90000</td>
</tr>
</tbody>
</table>
The expenses are what you would expect from a small retail outlet. The owner-manager (or franchisee in some cases) works very long hours and a substantial salary is allowed for him/her. Many small businesses would not show such a salary on an income statement, since the owner would simply take the net income, but we need to include the salary in the analysis to allow the owner payment for time worked in addition to business profit. The assumed salary may seem quite large, but it includes all the benefits that an employee in a larger company would expect, and the very long hours the owner-manager will be working. Clerks are paid $12 an hour, all-inclusive of benefits, vacation pay, overtime. Different outlets will have different salary schedules, and may have some full and some part-time employees. The number of clerks on duty during the opening hours increases with the volume of the business.

Rent is a reasonable rate for Winnipeg, but in practice would vary by location. The very large store is assumed to be in a high traffic location that commands a higher rent. Services and supplies are catch-all for all other expenses like energy, office supplies, legal and accounting services, bank service charges, etc.

Bad debts are calculated by applying a percentage to the loan and cheque cashing volumes. The payday loan loss rates are on the high end of those reported in the EY (2004) report. The cheque cashing losses are from the Dollar Financial Group 10K (2006) statistics for Canada.

Depreciation is 20% of the physical capital (mostly leasehold improvements). This is an accounting convention rather than a cash flow, but we use it here to replace capital expenditures. The value is small relative to other expenses.

The total capital is the sum of physical capital, loan capital (calculated by using the average loan maturity of 12 days), initial business loss and cash on hand. The initial business loss is not often considered in such an analysis, but almost any small retail outlet will incur cash losses for the first year while it builds volume, and that is a real investment in the business, just like furniture and loans receivable. The assumed cost of capital is 10%, which is actually quite high, since all these numbers are in real dollars.3

The cost of capital is then deducted from net income as if it were a real cash outlay, even though it is not. This is a critical technique in the analysis, since we will use it again when estimating reasonable fee schedules. Cost of capital does not show on financial statements, except to the extent that a business pays interest or dividends. It is a real cost to the business owner; however, the opportunity cost of using the money in the business instead of investing it elsewhere. When the cost of capital is deducted from net income, the result is the economic income or “rent” from the business. In a fair and competitive economy, the rents from a business that does not possess some unique advantage like a mineral deposit or a patented product should be zero. The payday lending business has no unusual characteristics that should lead to rent formation other than the inability of consumers to distinguish the

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3 Real dollars means dollars with inflation deducted. Table 1 shows a single year, but it is as if that year remains the same in every future year, which it will not if there is any inflation. We can keep it as a constant by treating it as if it were in real dollars, deflated by the Consumer Price Index. Then, any interest rate must also be similarly deflated to be consistent. That is why a 10% real cost of capital is quite high.
rates between them, understand the true cost of their borrowing, and take their business elsewhere. We expect the rents to be zero. Of course, they cannot be precisely zero, since even in the best case the revenues and expenses vary, and we will have to make many approximations and assumptions in the analysis. Negative or positive rents of a few thousand dollars per store are not meaningfully distinguishable from zero.

**Lessons we can learn from this single store model**

Now that we understand how the lines are calculated in Table 1, we need to turn to what the different scenarios tell us about the business. We must remind the reader that this is an example illustrating how the business works. In subsequent sections we will focus more carefully on the details of the costs where public evidence exists. Table 1 illustrates how the business works in general; it does not represent a specific fringe bank. Recall from the start of this section that we posited a number of facts about the business. The single store model illustrates the first five:

- They are very small businesses

  The revenue for the very large store is only $712,000 p.a. Most stores are much smaller. Furthermore, look in the inputs at the line “Transactions/hr.” This is calculated by using the average loan and cheque sizes from other reports, assuming a number of hours open per day and a 360 day year (holidays are Christmas, Rosh Hashanah, Yom Kippur, Eid al Fitr and Earth Day). This is just completed loans and cheques cashed, it does not allow for inquiries that do not produce a sale, follow-ups for defaults, etc. However, it gives us an idea of the scale of the operations. The number of transactions per hour ranges from 2.78 for the small store to 7.28 for the very large store with normally three clerks or two clerks and the manager on duty. This is indeed a small business.

- They have high operating leverage, which means profits change a great deal with changes in volume

  This factor is also called returns to scale. The payday lending business has high fixed costs relative to total costs. Once it falls below/above covering its fixed costs, the profits become negative/positive and decrease/increase rapidly with volume changes. Table 1 illustrates this effect by assuming fees that decline as the size of the store increases. The small store charges 20% of the principal, the medium store 12%, the large store 10% and the very large store 9%. Despite the declining fee revenue per loan, each size store still earns positive economic income for a 3% bad debt rate (first three columns) and only the small store has negative economic return with a 4% bad debt rate. The reason is obvious from the expenses. Within the scale of a fringe bank, the rent, owner-manager salary and most other operating costs except wages increase very little with even substantial increases in business. In fact, considerable changes in volume will affect costs very little. Since these stores are so small, the rent and other space costs don’t change. The store has to have one or two clerks to serve customers all the time. For example, make $1000 per day of additional loans in the small store, and revenue increases by 1000 X .2 X 360 = $72,000 p.a. The only costs that increase are bad debts of $10,800 and cost of capital, and so the owner gets a very large increase in profit.
• Most of the costs are the operating costs, and these are largely fixed for the scale of most stores. The store has to have someone on duty all the time. The costs are those required to open the doors and stay open, regardless of how busy the staff are. Bad debts, depreciation, and cost of capital are about 1/3 of the total revenue in each column.

• Bad debts affect profits significantly, but are less important than the operating costs.

Table 1 uses bad debt rates of 3% and 4%, which are in fact higher than many payday lenders experience. The industry often cites bad debts as the reason why such high fees are necessary, and of course they do contribute significantly. Bad debts reduce the revenue line by the amount of the uncollected fee, and the bad debt expense line is the bad debt rate times the loan volume. The bad debts for cheque cashing are far smaller. The total bad debts are always more than 10% of revenue in Table 1 and are a higher percentage of revenue for the larger firms, since the fee percentage is lower for the larger firms, but the bad debt rate is the same. Nonetheless, labour costs are always a greater proportion of revenue than bad debt costs. We will discuss bad debts and the business risk of a payday lender or cheque casher in more detail in a later section.

• They require little capital

The total capital is calculated close to the bottom of the Inputs section of Table 1. The total capital is always considerably less than one year’s revenue, which is totally atypical of a mainstream financial services firm, whose capital is several times the annual gross revenue. There are two reasons. First, the fringe banks rent their branches, they do not own them. Second, the loans are very short term and hence the firms need much less capital to finance them than do traditional banks or other lenders, whose loans are outstanding for much longer terms.

Looking at Real Data in More Detail in Payday Lending

How are Fees Calculated?

Payday lenders do not follow the traditional lending model of charging a defined interest rate, compounded monthly or annually, or perhaps some other specified frequency. Indeed, many lenders do not follow this model strictly any more, particularly in the consumer lending field, attaching various fees and charges to their loans, in addition to interest calculated on a time basis. For example, if you go overdraft on your bank account, the bank will charge interest on the amount overdrawn, but it will also charge a fixed “overdraft fee” that is not dependent on the length of time you are in an overdraft, each time it happens. The total cost of the loan is more than just the interest charge, and thus the effective rate of interest is higher than the stated rate of interest, regardless of how you compound it.

Understanding why certain fee patterns are seen requires understanding the basic cost structure of a payday lender. As we have already seen, almost all costs are fixed. The occupancy cost and staffing
are not changed much by the volume of business, since payday lending outlets are quite small. They
are not like a bank branch with thousands of customers and tens of millions of dollars in assets and
transactions per year. They will normally have only one or two staff members on the premises at any
time. The capital cost of supporting the loan balances is a very small part of the cost of the business
because the money turns over so quickly and the balance outstanding at any time is small. The cost of
bad debts is more significant, but still less than the cost of operating the store. Most loans are repeat
loans to an existing customer, by a ratio of 15:1 (EY 2004, pg. 36).

These facts lead to two very important characteristics of the business model:

1. The lender spends much more to set up a new customer. The clerk must get name and address,
evidence of regular employment or government transfer payments, and explain the stores rules
and fees. All stores record this data on a computer file and so subsequent loans require much
less time to process. All the clerk has to do is confirm that the data is still valid. Subsequent
loans also face lower risk of default, since the customer now has demonstrated that s/he will
repay.

2. The time to maturity of the loan and the size of the principal have almost no effect on the cost
to the payday lender. It takes the same amount of clerical time for any loan, and the default
costs and cost of capital are quite small relative to the operating costs of the business.

Payday lenders do not follow a consistent pattern of fees and so each one’s fees must be carefully
documented to determine the cost to consumers and how to regulate the fees. We need to know the
details of how each charge is calculated, not just examples of fees for specific loans. In the following
sections we explain every form of payday lending charge that we have encountered so far. Different
lenders use different combinations of these fees, which has the consequence of making comparisons
between them even more difficult for consumers.

**Regular Loan Charges**

*Fixed percentage of principal*

Many smaller lenders charge a fixed percentage of the principal, regardless of the size of the loan and
time to maturity. This is the easiest calculation method and everyone understands it. Thus, a $300
loan at 20% maturing in 11 days requires a postdated cheque of $360. Cash Money is the largest
Canadian operator using this method and it charges 20%. However, on its contract, it separates the fee
into two parts: interest at 59% and the remainder as a “service charge.”

One variant is a *sliding percentage*. The lender charges a higher rate on the first $x of principal, and a
lower rate on the remainder above that rate. This is a logical way to charge, because the costs for the
loan are mostly invariant to the size, and hence a larger loan should be charged a relatively lower
amount per dollar of principal. We have not observed Canadian companies charging in this fashion,
but the state of Indiana regulates payday lenders as follows: 15% on the first $250 + 13% on the next
$150 plus 10% on the remainder.
Another variant is to lend only specific amounts rather than the customer’s choice, and to charge a fixed dollar amount, which is equivalent to a fixed but sliding percentage. The only company we have observed doing this is Unicash in Ontario around the Golden Horseshoe, and it lends two specific amounts and charges as follows: $21 on $100; or, $22.35 on $152.65 (=14.6% of principal).

Another variant is a fixed percentage of principal, regardless of how large the loan is or how long it lasts, but the percentage is reduced for repeat customers. Mogo, which is the new name for a company previously called Payroll Loans, now charges 20% of principal for the first six loans, and 15% for subsequent loans to the same customer. This is also a logical fee structure, because of the greater cost and risk of the first loan.

The remaining types of fees are all used in combinations rather than alone as the fixed percentage of principal.

*Interest* is charged at a rate that is always claimed to be less than the Criminal Code limit of 60%. Money Mart charges 0.89% per week, and this compounds to an effective annual rate (EAR) of 58.5% and an annual percentage rate (APR) of 46.4%. The EAR is the appropriate method for comparing interest rates that are compounded more frequently than annually. Common public practice is to use the APR, which was also much easier to calculate in the days before handheld calculators and computers with exponential functions. Appendix I explains EAR and APR. Other than Money Mart, all the lenders that charge interest use periodic rates that have an APR of 59%.

*Brokerage fee* is a fixed percentage of the principal that the payday lender charges to find a lender for the customer. There actually is a separate lender somewhere hidden in the background, but of course the effect on the customer is the same as if the payday lender were lending the money and charging a fixed percentage of principal plus an interest charge. The Cash Store charges a brokerage fee, as does its subsidiary Instaloans.

*Loan insurance.* It appears from a review of its standard loan contract that The Cash Store in Manitoba is also selling insurance. We do not know if The Cash Store, or its parent company, RentCash Inc., has an insurance license.

*Fixed fee* regardless of size of loan or time to maturity. These fees are sometimes called processing fees. For example, every Money Mart loan comes due the day before the person’s payday. If the person repays the loan on time, the only charge is the 59% interest. If the person fails to repay, then Money Mart deposits the cheque left as security. This cheque includes third party cheque cashing fees (Money Mart’s original business was cheque cashing; payday lending is a more recent addition to the fringe banking field). A fixed fee is also a logical part of the fee because, as already noted, most of the costs of making a payday loan are fixed regardless of the size and time to maturity. Since payday loans are so small, the fixed fee is a very large part of the total fee. I will not give a separate example, because all the fixed fees are part of a package of fees.

*Initial fee for a debit card or a card with a balance that can be retrieved from an ATM.* Some of the large firms are now issuing their own debit and credit cards. You get your loan from the company as a prepaid balance on the card, and then use it. Money Mart and The Cash Store have both followed this
route. There is a big difference between the two, though. Money Mart says it costs nothing for the credit card or debit card, except of course that you have to prepay the amount on the card immediately. It does provide a credit card for those who can’t get one. Presumably Money Mart makes money from the merchant fees, and it is getting money up front without paying interest for it. It could also make money on a payday loan that provides the cash to load the card.

The Cash Store charges $8 for its debit card, one time only. Thus, a first time borrower has a fixed fee of $8. You cannot get cash from The Cash Store; you must buy the card. This reduces operating costs, since it reduces the cash float each store has to carry, and prevents employee theft.

Transaction fee for using a debit card. All debit cards have usage fees, which generate fees for any company issuing them, but of course there are also costs involved with the operation of the debit card system, and these will be hard to disentangle from payday lending costs. However, since The Cash Store requires the borrower to use its debit card, it has a guaranteed extra source of income, and the fee is $7 per usage.

Let us now put together the two most complicated fee structures that use multiple forms of fees, since they are also the fees charged by the two dominant companies in the business.

Money Mart

Money Mart has changed its fee structures at least twice in the last five years, but the current structure seems to be the same as the one in force when my ACORN report was written. If the customer can repay before payday, then all the cheque-cashing fees are avoided and only interest is payable. This early repayment is likely to be infrequent – the customer has no other source of cash. Therefore, in reality, this is the Money Mart fee:

$2.49 (third party cheque cashing) + interest at 59% EAR + 13.99% of [principal loaned plus interest].

The Cash Store fee

For a first time loan:

$8 (debit card) + $7 (ATM withdrawal fee) + brokerage fee at a rate of 20 – 26% + 59% interest charged at APR.

For a subsequent loan:

$6 (ATM withdrawal fee) + brokerage fee at a rate of 20 – 26% + 59% interest charged at APR.

The Cash Store website says the brokerage fee averages 20%, but I have difficulty relying on this figure. It was originally 22.5%, but it bought Instaloans which charged 25%. I have also been quoted 26%. One possible scenario is that they charge 26% for the first loan and 20% thereafter. Another scenario is that the higher rate for the first loan includes the $8 card fee.
Default Fees

**NSF charge.** Banks charge the payee for every NSF cheque deposited, as well as charging their own customer for issuing the cheque. Most businesses ask for more than the NSF fee because of the extra work entailed. Money Mart charges $35; The Cash Store charges $50.

**Default fee.** Some lenders also charge a default fee in addition to the NSF fee. The Cash Store charges $75.

**Interest while in default.** Three years ago a legal representative of Money Mart told Chris Robinson in a private conversation that they stopped the interest clock on defaults and put them into collection. The loan agreement now in use lowers the interest rate to 26% APR for loans in default. The Cash Store charges 59% in default.

**Rewrites/Rollovers/Extension fees.** This practice is banned by the CPLA. Money Mart and the Cash Store do not do it, but some smaller companies do offer rollovers. Essentially, it means that if you can’t repay the loan, the lender charges the full fee over again to allow you more time to pay. Or the lender collects a small portion of the loan that you can afford, but charges you the entire fee on the remainder as a ‘new’ loan. The mystery shoppers in Buckland et al. found that some Manitoba stores will do rollovers.

The reason for banning it is very simple. The major cost of offering the loan in the first place has already been incurred, and so there is no cost justification for compounding the fee. The debt trap that results is really hard to escape. Let us look at a simple example. Our friend Juanita Freezin from the early example borrows $100, which is 50% of the $200 net per week she earns while caring for her daughter as a single mother, working part-time and going to school to get education to get them out of the debt trap. She cannot repay at the end of the week because her daughter needs new jeans for school and a new backpack. The store obligingly rewrites the loan. Now she has to repay $120 = $144 next week, or just under ¾ of her paycheque. Well, she can’t afford that, her daughter has had to say home sick and she had to stay home with her, losing some of her pay. Once again the kindly payday lender rewrites the loan, which is now, at the end of three weeks, going to cost $172.80, or 86% of her net pay.

Credit card companies and the banks that issue credit cards are often berated for their outrageous interest rates. A common rate is 2%, compounded monthly. Suppose Juanita put that $100 on a credit card and failed to repay even the minimum 5% – 10% for three months. She would then owe the bank or card company $100 = $106.12 after three months, as opposed to owing the payday lender $172.80 after three weeks.

We recommend that rollovers/rewrites/extensions be banned entirely. We do not feel any further evidence is needed to support this recommendation. The lender should be entitled only to collect costs of NSF cheques and a reasonable rate of continuing interest on overdue loans.
What rates do we see in practice in Manitoba?

The following table is replicated from a companion report to the Board: Buckland et al., 2007, *Serving or Exploiting People Facing a Short-term Credit Crunch? A Study of Consumer Aspects of Payday lending in Manitoba.* These rates are consistent with those reported in the ACORN study for all of Canada, which has also been submitted to the Board. These are very high rates by any standard. They are stated for a 12 day loan, which is the average length of loan reported in the EY study, and they become even higher for shorter terms.
Table 3 (Replicated from text). Payday Loan Fees by Firm in Manitoba, Based on Field Research August- September 2007*

<table>
<thead>
<tr>
<th>Firm</th>
<th>Loan Size</th>
<th>Total Repayment</th>
<th>Lump Sum Fee</th>
<th>Annual Percentage Rate, APR** (on 12 day loan)</th>
<th>Effective Annual Rate, EAR*** (on 12 day loan)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Winnipeg Firms</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>A</td>
<td>$250</td>
<td>$300</td>
<td>$50</td>
<td>608%</td>
<td>25511%</td>
</tr>
<tr>
<td>B</td>
<td>$250</td>
<td>$359</td>
<td>$109</td>
<td>1321%</td>
<td>5831073%</td>
</tr>
<tr>
<td>C</td>
<td>$250</td>
<td>$348</td>
<td>$98</td>
<td>1194%</td>
<td>2373886%</td>
</tr>
<tr>
<td>D</td>
<td>$250</td>
<td>$300</td>
<td>$50</td>
<td>608%</td>
<td>25511%</td>
</tr>
<tr>
<td>E</td>
<td>$250</td>
<td>$311</td>
<td>$61</td>
<td>742%</td>
<td>76481%</td>
</tr>
<tr>
<td>F</td>
<td>$100</td>
<td>$124</td>
<td>$24</td>
<td>715%</td>
<td>61305%</td>
</tr>
<tr>
<td>G</td>
<td>no data</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>H</td>
<td>$200</td>
<td>$240</td>
<td>$40</td>
<td>608%</td>
<td>25511%</td>
</tr>
<tr>
<td>I</td>
<td>$250</td>
<td>$300</td>
<td>$50</td>
<td>608%</td>
<td>25511%</td>
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<tr>
<td>J</td>
<td>$300</td>
<td>$360</td>
<td>$60</td>
<td>608%</td>
<td>25511%</td>
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<tr>
<td>K</td>
<td>$250</td>
<td>$300</td>
<td>$50</td>
<td>608%</td>
<td>25511%</td>
</tr>
<tr>
<td>L</td>
<td>$200</td>
<td>$250</td>
<td>$50</td>
<td>760%</td>
<td>88550%</td>
</tr>
<tr>
<td>M</td>
<td>no data</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>N</td>
<td>$250</td>
<td>$294</td>
<td>$44</td>
<td>535%</td>
<td>13753%</td>
</tr>
<tr>
<td>Average Firms in Winnipeg $250***</td>
<td>8 firms @ $250</td>
<td>$64</td>
<td>778%</td>
<td>1049655%</td>
<td></td>
</tr>
<tr>
<td>Other Manitoba Firms Outside Winnipeg</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>A</td>
<td>$250</td>
<td>$307</td>
<td>$57</td>
<td>694%</td>
<td>51556%</td>
</tr>
<tr>
<td>B</td>
<td>$250</td>
<td>$300</td>
<td>$50</td>
<td>608%</td>
<td>25511%</td>
</tr>
<tr>
<td>C</td>
<td>$165</td>
<td>$206</td>
<td>$41</td>
<td>760%</td>
<td>88550%</td>
</tr>
<tr>
<td>D</td>
<td>no data</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Average Other Manitoba Firms Outside Winnipeg $250***</td>
<td>2 firms @ $250</td>
<td>$54</td>
<td>651%</td>
<td>38533%</td>
<td></td>
</tr>
<tr>
<td>Web-based Firms</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>A</td>
<td>$250</td>
<td>$309</td>
<td>$59</td>
<td>718%</td>
<td>63084%</td>
</tr>
<tr>
<td>B</td>
<td>$250</td>
<td>$325</td>
<td>$75</td>
<td>913%</td>
<td>292165%</td>
</tr>
<tr>
<td>Average Web-based Firms***</td>
<td>2 firms @ $250</td>
<td>$67</td>
<td>815%</td>
<td>177624%</td>
<td></td>
</tr>
</tbody>
</table>

In addition, the report of Buckland et al. explains the difficulties that the mystery shoppers and the telephone interviewer had in actually determining the method of calculating fees, and how some of the fees charged seem to be inconsistent with the explanations on the contracts. Chris Robinson, the author of the ACORN report, had the same difficulties with determining some of the fees, particularly with respect to The Cash Store. Accordingly, the sixth point from the opening list of business characteristics is supported:

- They charge very high fees, and the fee schedules are difficult to compare between stores
The remaining business characteristics

The ACORN report contains evidence demonstrating most of the remaining points from the start of this paper:

- They have engaged in very limited economies of scope compared with most financial institutions. Only two business lines make a significant contribution: payday loans and cheque cashing.

- Money Mart and The Cash Store together have more than half the volume of the business. There are a number of smaller chains and many single stores.

- The size of the business has grown very rapidly in a decade in four ways:
  - Number of stores (growth has slowed in recent years)
  - Volume per store, at least in the large chains (still growing)
  - Average loan size (still growing)
  - Additional lines of business – the original payday lenders were cheque cashers only.

- The payday lending business depends upon repeat customers rather than single time users. The great majority of loans are to regular customers.

We would like to comment on this last point. EY (pg. 36) estimates that the average payday lender makes 15 repeat loans for every loan to a new customer. The repeat business is lower for new entrants to the business. Furthermore, EY finds that the cost of processing a first-time borrower is much higher. Thus, as the industry matures, the cost structure will be lower than EY observed, lower than that used in ACORN, and lower than much of what the Board will receive in this hearing. The industry position has often been that it provides a much needed emergency funds service for persons who find themselves in unexpected trouble. The reality is that the industry survives by serving as a repeat lender (and cheque casher) for a core of repeat customers.

We would like to update the material from the ACORN report on all these characteristics, particularly the loan size, volume per store and the volumes of The Cash Store and Money Mart. There have been two sources of this data so far: The EY Report, and the annual and quarterly reports of RentCash Inc. (parent company of The Cash Store) and Dollar Financial Group Inc. (the US parent of Money Mart). If information coming to the Board from other interveners is verifiable and provides us with better information then we can update. Otherwise, we will have to move to the most recent published reports of RentCash and Dollar Financial Group and use them as best we can to proxy for the entire industry.
Towards a Regulated Fee Structure for Payday Lenders

If we combine the findings of this report and the companion report to the Board, along with the evidence provided by EY and ACORN, then we can recommend how to proceed in regulating the fees charged by payday lenders. The Board has a unique opportunity as the first regulator dealing with payday loans to draw in new evidence and use these insights and the tools available to arrive at a just and fair rate.

The first consideration is what level to regulate to in terms of the individual stores. All the evidence shows that smaller stores and stores with only payday lending instead of multiple lines of business are less efficient. Therefore, they will have to charge higher fees than the more efficient multi-line businesses to survive. If the Board sets limits on fees that allow the smallest, least efficient payday lenders, usually single-line businesses, to survive, then the larger and more efficient businesses can charge the regulated rate, and earn substantial excess profits, to the detriment of their clientele, who are disadvantaged to begin with.

The recommended fee levels in ACORN are estimated using only efficient cost structure and store size. The recommended levels are lower than those charged by any payday lenders presently. If the figures used in ACORN are accurate, then the efficient payday lenders could still earn suitable returns and the smaller firms would be forced to sell out to them, or exit the business. The rate that creates that environment is a fair rate, since it allows competitive firms to exist, and prevents excess profits being taken from those members of society who are at a serious disadvantage vis-à-vis the lenders.

One point not made so far is how to think of risk. The payday lending industry is not very risky in the way that we usually think of risk in financial institutions. The lending portfolio is much diversified in the form of many very small loans, and hence the loss rate is reasonably stable. A single corporate default can cost a bank far more in loan losses than the total loan losses of the entire payday lending industry in Canada for a year. The risk for payday lenders comes at the opening phase, as it does for most small businesses. Unless a payday lending store gets enough business to cover its fixed costs and generate a positive margin, it is a losing proposition. Once the clientele is established, which takes about a year, the risk is quite small. We must also remember that the clientele is largely repeat customers, which reduces the risk.

What are the issues the Board will have to address in setting rates? We return to the opening set of characteristics:

1. The considerable economies of scale and scope mean that the board should regulate to rates that are suitable for larger stores and companies that do both cheque cashing and payday lending, and hence both lines of business must be incorporated into the analysis. ACORN only considers payday lending and is thus using arbitrary allocations of expenses between the two lines of business.
2. Bad debts are a significant cost and need to be included in the analysis, but they are not a source of unusual risk, because they are so diversified. The level of bad debts is high, but it is not a fluctuating number that varies greatly, once it is established.

3. Whatever fees are set, the schedule must have three characteristics that will require close attention:
   a. Every possible sort of fee must be spelled out to avoid imaginative ways of hiding charges
   b. A reasonably limited menu of alternatives should be allowed in order that consumers have some possibility of understanding the fees.
   c. The firms must disclose the fees clearly, including not just examples, but the detailed algorithm by which the fees are calculated. This will not help those consumers who are unwilling or unable to make the comparisons, but those who can and will shop around should be able to do so easily.

4. The industry has grown very fast. The aggregated historical cost data is not valid, because too many stores were not at full volume, and hence the costs are artificially inflated. Furthermore, the new customer costs far more to serve than the repeat customer, and not until the business is well-established will the normal ratio of repeat to new customers be established. Finally, larger chains are now established with considerable economies of scale and scope. For all these reasons, the most up-to-date data with considerable detail is required.

5. The Board should consider the merits of making separate fee structures for first-time and repeat borrowers, to more closely approximate the cost function. As it stands, repeat customers subsidize one-time borrowers. A disadvantage of such a fee structure is increased complexity for both consumers and operators. We note that Mogo has recently introduced a program of lower fees after the first six loans.

6. The Board should ban rollover/extension/rewrite fees for unpaid loans. They should continue to accrue interest at a reasonable rate for the risk, perhaps 60% p.a., and the consumer should be expected to pay for any bank service charges the lender incurs.

Because of the data limitations, we are reluctant to recommend fee structure limits without further information and analysis. If the payday lenders provide verifiable data that helps us in redoing the analysis from ACORN, then we would like to have it first. If not, then we will use the most recent public disclosures from Money Mart to update the ACORN analysis to see if different rates emerge. It is almost certain that the new analysis would not change the rates recommended in ACORN a great deal, and that any change would be to lower rates. The Board has received the ACORN report, but the recommended rates are repeated here for convenience:

There are many permutations and combinations of fees and cost structures that are possible. The two that I have found that seem to balance consumer interest with maintaining the industry for efficient producers are:
$10 per loan + 5% of the principal + 60% effective annual interest on the principal, or 12% on the first $250 of principal + 6% on principal exceeding $250.

The first of the two recommended fee structures is my preferred one, since it comes closer to matching the cost function. I estimate a total saving to consumers of $194 million annually. This is an approximation, but it gives a reasonable idea of how much could be saved. Table 9 shows the calculations. These calculations use the new Money Mart fee schedule.

Table 9: Estimate of Savings to Consumers with Adoption of Recommended Fee Schedule

<table>
<thead>
<tr>
<th></th>
<th>Existing fee</th>
<th>Number of stores</th>
<th>Fee reduction per store</th>
<th>Total Company Reduction 000s</th>
</tr>
</thead>
<tbody>
<tr>
<td>Money Mart</td>
<td>59% EAR + 13.99% of (princ + int)</td>
<td>350</td>
<td>$141,931</td>
<td>$49,676</td>
</tr>
<tr>
<td>Cash Store</td>
<td>$6 + 59% EAR + 26% of principal</td>
<td>298</td>
<td>270,164</td>
<td>80,509</td>
</tr>
<tr>
<td>All the rest</td>
<td>20% of principal (assumed average)</td>
<td>652</td>
<td>97,571</td>
<td>63,616</td>
</tr>
<tr>
<td>TOTALS</td>
<td></td>
<td>1300</td>
<td></td>
<td>$193,801</td>
</tr>
</tbody>
</table>

Source: ACORN 2006, pg. 28

This analysis used the same method as Table 1, which is to allow for reasonable costs and scale, and include an estimate of the cost of capital to arrive at economic profit or rent. The aim of a just and fair rate is to provide a zero economic profit to the operator. Robinson arrived at his recommendations by simply trying many different fee schedules to arrive at the recommended ones. The devil is in the numbers, which are already out of date. The major omission is cheque cashing. The costs used in ACORN are all payday lending, but they include some arbitrary allocations to do that. A better solution would be to regulate with all the revenue lines and costs included, but that will require better data from the industry.

Accordingly, we recommend this method be used again to determine a just and fair rate for the fee schedules. Professor Robinson is willing to give the Board access to all his spreadsheets from this report and the ACORN report, along with detailed descriptions of how he did the analysis.

Finally, we wish to comment on the position of the mainstream financial institutions, the credit unions and chartered banks. Buckland et al. (2007) show that payday lenders are concentrated in areas where these institutions have tended to withdraw their services and close branches. This fact was poignantly illustrated in 2006 when ACORN released ACORN (2006) in a media event held on the sidewalk in front of a Toronto Money Mart branch. The Money Mart occupied what had formerly been a bank branch, originally built for a bank many years ago.
The mainstream institutions already have economies of scale and scope that far outstrip anything the fringe banks possess. The mainstream institutions can offer loans secured only by the next payday cheque, which is probably deposited in their branches. More important, they can offer them for fees far less than the payday lenders can offer, and they will encounter less risk in so doing. But they have to accept some social responsibility for serving all the population, not just the most wealthy areas.

The credit unions are already very interested in offering payday loans or convenience loans, which they see as being part of their mission to serve their clientele. Robert Whitelaw, the former president of the CPLA, worked on contract for Alterna Savings in Ontario to develop a convenience loan product, which has not yet been introduced while Alterna works through some unrelated organizational issues.\(^4\) Vancity Savings, the largest credit union in Canada, has also done research on entry into payday lending. Many US credit unions are offering payday loans or are considering doing it, and the industry association of credit union directors is promoting this as a socially responsible action, with rates that are orders of magnitude lower than the payday lenders.\(^5\)

References


Chris Robinson, *Regulation of Payday Lending in Canada A Report to ACORN*, May 24, 2006 [ACORN]

\(^4\) Private conversation between Robert Whitelaw and Chris Robinson

\(^5\) Attendance at the annual conference of US Credit Union directors by Chris Robinson, June 2007.
Appendix I: Converting Short Term Rates to Annual Rates

Interest rate calculations to convert interest rates for short periods into annual rates may follow one of two conventions: effective annual rate (EAR), or annual percentage rate (APR). As long as the reader knows which convention is followed, conversion is simple. However, when trying to determine the economic nature of short-term interest rates, the EAR is much more revealing, and is closer to economic reality.

The APR assumes implicitly that the interest and principal repaid by a borrower is not reinvested at the same rate on a compound basis. Only the principal is reinvested. As a result, the formula for an APR is:

\[ APR = m \times (1 + i_m) \]

where:

\[ m = \text{the number of periods in the year} \]
\[ i_m = \text{the interest rate for the period}. \]

The EAR assumes implicitly that any money received from a borrower, including interest, is reinvested at exactly the same rate of return. Thus, the interest compounds continually during the year. While this is not exactly true, it is reasonably close to reality. Since interest rates do fluctuate, the actual return a borrower receives is somewhat variable over the year. Nonetheless, the EAR is closer to economic reality than the APR, since it does assume that the periodic interest is also reinvested. Even if a lender does not actually reinvest the money, he gets the benefit of receiving it earlier than year end. The formula for an EAR is:

\[ EAR = \left( 1 + i_m \right)^{\frac{365}{m}} - 1 \]

The difference isn’t that large for a typical consumer loan where interest is charged monthly, but it becomes very large for payday loans with their short periods and high rates. Two examples will illustrate this, using a loan of $300 for 14 days (which means 26.14 periods per year, or \( m = 26.14 \) if we want to be very accurate, although accuracy is somewhat superfluous with such large interest rates).

Example 1: A fee of 20% of principal
APR = 20% \times 26.14 = 523%
EAR = (1.2)^{26.14} - 1 = 11,644%.

Example 2: A fee of $10.00 + 60% EAR + 5% X principal
The fee is $10 + $300 \times (1.60^{\frac{14}{365}} - 1) + 5\% \times$300
= $10 + .0182 \times 300 +$15 = 30.46
APR = 30.46/300 \times 26.14 = 265%
EAR = (1 + 30.46/300)^{26.14} - 1 = 1153%.