Criminal interest rate: Canada sets high stakes for high rates

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As it revisits decades-old regulations on what constitutes a criminal interest rate, Canada challenges lenders to remain profitable under substantially tighter margins.

What you need to know

On Dec. 23, 2023, the federal government published the much-anticipated *Criminal Interest Rate Regulations* (the Regulations) in the *Canada Gazette*, inviting public feedback until Jan. 22, 2024.

These Regulations are necessary to implement amendments brought by the *Budget Implementation Act, 2023, No. 1* to section 347 of the *Criminal Code*. The amendments will **lower the criminal annual rate of interest from the current 60 per cent (effective annual interest rate) to an annual percentage rate (APR) of 35 per cent.** They will also narrow the types of agreements and arrangements to which this criminal offence applies. Though not yet in force, the Regulations aim to combat predatory lending practices and reform Canada's framework for consumer financial protection and regulation.

These changes could introduce significant compliance challenges for lenders, especially in high-risk credit markets. This shift is particularly impactful for non-prime and non-bank lenders, who must now navigate tighter interest rate margins. Such alterations are set to reshape risk assessment strategies and the availability of credit.

The current regime

Under the existing section 347 of the *Criminal Code*, it is an offence to enter into an agreement or arrangement to receive interest, or in fact collect interest, at an effective rate exceeding 60 per cent annually. The effective rate must be determined by taking into consideration all related fees, fines, and charges associated with the agreement. This applies to virtually all Canadian credit agreements including not only loans, but other agreements and arrangements as well, including agreements where a monetary value of any goods, services or benefits is advanced. An example from the Supreme

Court of Canada shows that contracts, like those for natural gas sales imposing a five per cent late payment penalty, can trigger this prohibition.

Legal consequences for violating section 347 vary. For indictable offences, the penalty can be imprisonment for up to five years. If prosecuted summarily, the penalty can include a fine of up to $25,000, imprisonment for a term of not more than two years less a day, or both. The Crown exercises discretion in how these cases are prosecuted.

Background: Tracing the criminal interest rate reforms

The recent amendments represent the first significant update to the criminal interest rate regime in over four decades. Initiated in 2021, these reforms stemmed from the minister of Finance's commitment to tackle predatory lending, as outlined in their mandate letter, and included extensive consultations with stakeholders from both the lending sector and consumer advocacy groups. These changes build on the foundations established by the 2007 amendment to the *Criminal Code*, which notably exempted certain payday loans from the application of the criminal rate.

The newly introduced Regulations, as stated by the government, aim to alleviate the impact of high-cost loans on vulnerable populations. They strive to strike a careful balance, protecting borrowers while maintaining the operational viability of lending.

The proposed criminal interest rate exceptions

The new criminal rate offence will continue to apply to all agreements or arrangements to receive interest, except those provided for by regulations. As a consequence, the draft Regulations propose to exempt certain lending practices from the offence, as they fall outside of the federal government's policy intent to address predatory lending. The exemptions include:

- **Commercial loans**: Loans between $10,000 and $500,000 are exempt if the APR is below 48 per cent. Loans over $500,000 are completely exempt.
- **Pawnbroking loans**: Exempt only if certain conditions are met, including a credit advanced lower than $1,000 and an APR not exceeding 48 per cent.

Payday loans: Cap on borrowing cost

The Regulations also introduce a nationwide cap on the cost of borrowing for certain payday loans in Canada. The specifics of these limits are as follows:

- **National interest limit**: The Regulations set a national cap for payday loans, limiting the total cost of borrowing to 14 per cent of the loan amount. This limit excludes any additional charges specifically authorized by provincial laws, such as fees or penalties that are $20 or less, or fees for default of payment. This new cap will have the effect of lowering the maximum total cost of borrowing allowed for payday loans in certain provinces.
- **Fee cap for dishonoured cheques**: The Regulations will also set a nationwide cap of $20 on the one-time fee that payday lenders can charge for dishonoured

cheques. This cap is part of a broader effort to regulate additional costs associated with payday loans.

Implementation schedule and effective dates

Once in effect, the Regulations will be applicable to all loans (including payday loans) that are entered into on or after the date the Regulations came into force.

The proposed Regulations are set to take effect three months following publication of the final Regulations in the *Canada Gazette, Part II*, and aligning with the coming into force of the amendments to the *Criminal Code* to lower the criminal rate of interest.

Implications: Navigating the new lending landscape

As currently drafted, the Regulations focus on creating exemptions applicable to certain loan agreements. However, it is unclear if these exemptions will also apply to other types of agreements caught within the ambit of section 347 of the *Criminal Code*. Such uncertainty will likely create risks for businesses charging fees that may be captured within the definition of "interest" in the *Criminal Code*.

This regulatory shift will also introduce significant compliance challenges for lenders, especially in high-risk credit markets. This is particularly impactful for non-prime and non-bank lenders, who must now navigate tighter interest rate margins. Such alterations are set to reshape risk assessment strategies and the availability of credit. In response to this evolving landscape, lenders should prioritize:

- Strategically reassessing their lending models;
- Adjusting new lending agreements to align with the reduced criminal interest rate;
- Conducting thorough reviews of new credit agreements to address potential criminal rate issues; and
- Utilizing the exemptions for certain loan types, which offer the potential to maintain flexible yet compliant lending practices, subject to a thorough understanding of the regulatory nuances.

As legal advisors with a comprehensive understanding of these amendments, we are well positioned to guide lenders in adapting their operations to meet the new legal requirements, ensuring both compliance and operational viability.

Preparing for future regulatory changes: Contact us

With the government contemplating a further reduction of the criminal rate below 35 per cent APR, the lending sector must stay informed and adaptive. Keeping abreast of these changes is essential for lenders to successfully prosper in this evolving regulatory environment.

For proactive strategies and tailored advice on managing compliance challenges for lenders, including about the criminal rate of interest in Canada, please reach out to the key contacts listed below or any lawyer from BLG's Banking & Financial Services Group.

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