THE GREAT RATE ESCAPE: COMMERCIAL LOANS NO LONGER CRIMINAL

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On December 23, 2023, the federal government proposed new regulations[1] (the “**Regulations**”) which represent a significant step in the ongoing transformation of the criminal rate of interest regime. The Regulations provide needed clarity on the federal government’s proposed changes to the *Criminal Code* (Canada) (the “**Criminal Code**”) relating to loans that pose a risk of trapping Canadian consumers in a cycle of debt. The Regulations allow for a more precise approach to reducing consumer debt cycles while leaving the commercial and pawn loan market undisturbed.

Background

The criminal rate of interest regime is intended to prevent consumers from falling into a vicious cycle of high-interest debt that becomes increasingly difficult to escape. The current criminal rate of interest pursuant to Section 347 of the Criminal Code[2] is 60% effective annual rate (“**EAR**”) or roughly 48% on an annualized percentage rate (“**APR**”) basis.

However, over the last few years, the federal government has expressed concern about predatory lending practices that target vulnerable individuals, including low-income Canadians, newcomers, and those with limited credit histories for high-interest loans (even though the interest rate may not have breached the current “criminal” threshold).

As noted in our update in July 2023, *Interesting Changes to Interest Rates*, in the *Budget Implementation Act, 2023, No. 1*[3] the federal government proposed two notable changes to the Criminal Code: (1) changing the criminal rate of interest from EAR to APR; and (2) lowering the rate of interest that is considered “criminal” from 60% EAR to 35% APR (collectively, the “**Proposed Changes**”). The Proposed Changes are significant and impactful as they represent the first major update to the criminal rate of interest regime in over 40 years. They apply to practically all credit arrangements, other than payday loans which were excluded from the legislative regime in 2007. The Proposed Changes will come into force by order of the Governor in Council, a day for which has not yet been set.

Refining the Intended Changes

The Proposed Changes, in and of themselves, are overly broad and could limit the availability of credit to commercial borrowers that prefer "expensive" financing to no financing at all. While it is difficult to quantify the number of borrowers that access financing through high-interest rate loans, it is important to note that the Criminal Code broadly defines "interest" to include essentially all fees, charges and expenses paid to the lender. As such, the criminal rate of interest regime has a broader scope than one might anticipate.

In the Regulations, the federal government acknowledged that the Proposed Changes could negatively impact lending practices for commercial loans and pawn loans, both of which are not viewed as trapping Canadians in a cycle of debt. The Regulations emphasize that the objective is to crack down on predatory lending practices while avoiding any "cooling" of the commercial lending market.

In order to refine the focus of the Proposed Changes, the Regulations propose three notable exclusions:

1. Commercial loans above $500,000 will not be subject to the criminal rate of interest regime or any other rate cap (which aligns Canada with international regimes, including those found in the United Kingdom, Ireland, Australia, New Zealand and certain US states);
2. Commercial loans between $10,000 and $500,000 will remain subject to the criminal rate of interest regime, although the "criminal" rate threshold will be adjusted to 48% APR; and
3. Pawn loans under $1,000 where the only recourse on a default by the borrower is the seizure of the pawned property will remain subject to the criminal rate of interest regime, although the "criminal" rate threshold will also be adjusted to 48% APR.

Commercial loans are defined as loans made where (i) the borrower is not a natural person; (ii) the borrower is using the arrangements for a business or commercial purpose and either (iii) (a) the amount advanced is between $10,000 and $500,000; or (b) the amount advanced is over $500,000.

Setting aside pawn loans, the Regulations clarify that only loans under $10,000 will be subject to the Proposed Changes, which lower the rate of interest considered "criminal" to 35% APR. This is welcome news to stakeholders who had expressed concerns that the Proposed Changes would prevent access to necessary credit, and limit the availability of venture capital, private equity and automotive floor financing, none of which would appear to raise concerns about trapping consumers in cycles of debt.

Next Steps and Key Takeaways

There is a 30-day consultation period for the public and other stakeholders to provide comments on the proposed Regulations. Once the window for comments is closed, there will be a period of three months following publication of the final Regulations before they come into force, which will align with the timing of the coming into force of the Proposed Changes. This three-month transition period is intended to allow lenders to adjust their operations, including IT systems, signage, and marketing to align with the new requirements.

Note that there is some indication that the criminal rate of interest threshold may be lowered even further in the final version.

Typically, Canadian credit agreements, or credit agreements that have a Canadian entity involved, contain provisions relating to Section 347 of the Criminal Code to ensure that the rate of interest does not breach the criminal rate of interest. Once the Regulations are in force, the Canadian market may adjust its usage of such provisions or stop using them altogether for loans over $500,000.

Should you have any questions regarding this newsletter or require further information, please contact one of the authors or a member of McMillan's Financial Services group.

[1] Canada Gazette, Part I, Volume 157, Number 51: Criminal Interest Rate Regulations.
[2] Criminal Code, RSC 1985, c C-46, s 347(1).
[3] Bill C-47, An Act to implement certain provisions of the budget tabled in Parliament on March 28, 2023, 1st Sess, 44th Parl, 2023, cl. 610(1).

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A Cautionary Note

The foregoing provides only an overview and does not constitute legal advice. Readers are cautioned against making any decisions based on this material alone. Rather, specific legal advice should be obtained.