

Proposed Amendments to the *Interest Act*



FINAL REPORT OF THE WORKING GROUP

PRESENTED BY

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Overview of Presentation



- 1. Origins of Act
- 2. What's so “interesting” about the Canada Interest Act?
- 3. Function of *Interest Act* and overview.
- 4. Background to Final Report.
- 5. Recommendations of Working Group.

1. Origins of *Interest Act*.



Federal jurisdiction over matters relating to interest pursuant to s. 91(19) of *Constitution Act 1867*.

- Provisions of the Interest Act first enacted in between 1880 and 1900.
- No comprehensive review leading to substantive overhaul of legislation
- “hopelessly dated”; “functionally dead”

2. What's so “interesting” about the *Interest Act*?



- Important to understand whether the *Interest Act* still has a role to play.
- How relevant is the *Interest Act* to modern lending practices?
- Drafters of *Interest Act* could not have anticipated:
 - modern lending practices such as short term mortgages with long amortization periods or credit cards.
 - Emergence of provincial legislation
- Emergence of provincial legislation dealing with:
 - cost of credit
 - consumer protection
 - Unconscionability

2. What's so “interesting” about the *Interest Act*?



- At very early stage the Working Group concluded that *Interest Act* remained relevant to modern commercial and consumer lending practices.
- The Final Report that we recommend amendments to various provisions to improve the legislation rather than repeal.
- Before examining specific amendments, the presentation will provide an overview of the legislation.
 - What is purpose of Act?

3. Function of *Interest Act* and Overview



- s. 2 freedom of K principle
- s. 3 default rate of 5%
- s. 4 disclosure regime for non-mortgage transactions
- s. 6 a disclosure regime for mortgages
- s. 8 prevents mortgage lenders from increasing the rate of interest on default.
- s. 10 provides individual mortgagor with repayment rights to repay their mortgage after five years

4. Background to Final Report.



Preliminary Background Paper, 2007

- Paper describes the present state of the law and the purposes of the various parts of the Act as initially conceived by drafters
 - comparison the commercial reality of today.
- Paper examined extensive case law and demonstrated that many areas of the Interest Act jurisprudence remained unsettled.
- Paper also concluded that some aspects of the Interest Act have never the subject of a reported or unreported case.

4. Background to Final Report



Working Group Preliminary Report, 2008

- Preliminary work: to consider whether the provisions of the *Interest Act* were duplicated in provincial or territorial legislation
- Comprehensive review of all territorial and provincial legislation that dealt with
 - interest rates
 - Cost of credit disclosure
 - Unconscionable transactions
- Preliminary Report 2008:
 - Does not recommend repeal.
 - Recommends retention of provisions with certain amendments
 - Repeal of s 6 only if provincial legislation strengthened
 - Consult on operation of s. 10

4. Background to Final Report



Working Group Consultation 2009

- Consultation letter sent to 99 organizations including
 - Banks,
 - organizations representing financial institutions,
 - branches of the CBA, consumer groups,
 - credit counseling organizations, government ministries.

- **3 responses received**

5. Working Group's Final Report



- Propose a Draft Model Amending Act which attached as Appendix A to our Report
- Recommendations take into account
 - Consultations
 - Study of Interest Act jurisprudence
 - Provincial and territorial legislation

Working Group's Final Report



Current Provision

Amendment: Yes/No

- s.2: freedom of K
- **s.3: default rate**
- **s.4: disclosure non-Mtg**
- **s.6: disclosure Mtg**
- **s.8: penalties**
- s. 10 mtg repayment right

- s. 2: No
- **s. 3: Yes**
- **s. 4: Yes**
- **s. 6: Yes**
- **s. 8: Yes**
- s. 10: No

Section 2: No Change



- Section 2 permits parties to stipulate any rate of interest
- Section 2 embraces principle of Freedom of Contract
- Principle is subject to any other restrictions found in Interest Act or any other law
- Represents the antithesis of usury legislation which seeks to cap interest rates
- Section represents an important principle:
- **Recommendation: No Change**

Section 10: No Change



- In 1880 common practice was long term mortgages that matched amortization period.
- Borrowers paid significant penalties if they wanted to repay early
- s. 10(1) enacted to enable a borrower to repay at end of five years by tendering principal and interest and 3 months interest.
- Problem of how to deal with current practice of short term mortgages resolved by *Potash v. Royal Trust*, [1986] 2 S.C.R. 351.
- *Potash* has been adopted as the standard practice in residential real estate.
- **Recommendation: No Change**

Section 3: Amendment



- Current provision provides a default rate of 5% wherever interest is payable by an agreement or by law.
- Rate established in 1900 as reflective of economic conditions at turn of the century.
- Working Group concluded that default rate should be tied to a market rates.
- **Recommendation: amend s. 3 to include a defined market rate using language used in a number of federal regulations.**
- **Recommendation: amend s. 3 to specify that default mode of calculating interest will be simple interest rather than compound interest.**

Section 4: Amendment



- **Disclosure regime for non-mortgage loans**
- Current provision provides that where interest is payable for a period of less than 1 year
- *E.g. 2% per month; 2% per week.*
 - No interest exceeding default rate of 5% shall be charged
 - ✦ Unless the contract contains
 - ✦ “express statement of the yearly rate....”
 - ✦ Purpose: prevent lenders charging interest on a weekly or daily basis without disclosing annual rate

Section 4: What must be Disclosed



- Current version of s. 4 does not indicate what form of annual interest rate must be disclosed
- Problems: what must be disclosed?
 - Effective rate of interest 2% per month = 26.8 per cent?
 - Nominal rate 2% per month = 24%?
- Jurisprudence divided on this point
- **Recommendation:**
- Addition of s. 4(2) to require lenders to disclose effective rate of interest when s. 4(1) applies to transaction.

Section 6 Amendment



- Original provision added in 1880 to deal with deceptive mortgage transactions.
- Where mortgage is being re-paid on 1 of 3 repayment types:
 - Lender must disclose the amount of principal and the rate of interest chargeable on the money, calculated yearly not in advance.
 - Without proper disclosure lender not entitled to any interest.

Section 6



- Repayment plans
 - Sinking fund
 - An allowance of interest on stipulated repayments
 - Blended payments

No clear judicial interpretation of first two plans

- **Recommendation:**
 - Eliminate
 - ✦ Sinking fund
 - ✦ An allowance of interest on stipulated repayment

Section 6



- **Revised Scope of s. 6**
 - Restrict s. 6 to blended payment type mortgages
 - As case law has left meaning of blended payments ambiguous we recommend clarifying meaning of blended payments in s. 6
- **Revised Penalty**
 - Current penalty will deprive lender of all interest for non-disclosure
 - Courts have been reluctant to impose this penalty
 - **Recommendation: Lender be restricted to interest at the annual rate in mortgage, compounded yearly**

Section 8 Amendment



- Applies only to mortgages and can be traced to 1880
- Provision prevents a lender from increasing rate of interest on default.
 - E.g. Contract provides 10% annual rate and on default this is increased to 15%
 - Borrower also had an obligation to pay \$800 fine on default
- Pre dates consumer transactions as well as unconscionability doctrine and unconscionability legislation
- Tension between protecting borrowers and enabling parties to freely negotiate mortgage transactions

Section 8 Amendment



- Should s 8 apply equally to consumer and commercial borrowers?
- If the commercial lender has adequately disclosed to a commercial borrower
 - the increased rate of interest after default
 - and there is no allegation of inequality of bargaining power
 - should s. 8 stand in the way of the transaction?

Section 8 Amendment



- **Commercial borrower** may have diversified commercial portfolio of property and will be better informed.
- **Recommendation:** s. 8 should no longer apply to this type of transaction.

- **Borrower giving a mortgage over a principal residence.**
 - May be sole asset, the principal residence, to charge with mortgage
 - Inability to diversify risk; inequality of bargaining power
 - **Recommendation:** s.8 should be restricted to a mortgage on a principal residence