



Memorandum

To: All members of the Canadian Institute of Actuaries and other interested parties

From: Edward Gibson, Chair
Actuarial Standards Board

Kelley McKeating, Chair
Designated Group

Date: January 11, 2024

Subject: **Notice of Intent to Revise Section 4600 of the Practice-specific Standards for Actuarial Evidence – Calculation of Criminal Rate of Interest**

Comment deadline: **January 31, 2024**

Document 224004

Introduction

The Actuarial Standards Board (ASB) has established a Designated Group (DG) to revise Section 4600 of the *Standards of Practice* to address a change to the definition of “criminal rate” in [Section 347 of the Criminal Code](#) (Part 4, Division 34) which received Royal Assent on June 22, 2023 but has not yet come into force.

For agreements or arrangements entered into after the legislative change comes into force, the criminal rate of interest will no longer be defined as “an effective annual rate of interest calculated in accordance with generally accepted actuarial practices and principles that exceeds 60 per cent on the credit advanced”. Instead, the criminal rate of interest will be defined, under the Criminal Code, as “an annual percentage rate of interest calculated in accordance with generally accepted actuarial practices and principles that exceeds 35 per cent on the credit advanced”.

The draft regulations set out certain exceptions to the above definition:

- The 35% annual percentage rate of interest (APR) threshold will apply if the borrower is an individual (not a company).
- An APR of 48% will apply to commercial loans (where the borrower is a company) over \$10,000 and up to (and including) \$500,000.
- Commercial loans over \$500,000 will be exempt from the Criminal Code provisions.

The draft Regulations provide for other minor exemptions, changes to the exemption related to provincial payday loans, etc.

Background

The introductory paragraphs of the government's [Regulatory Impact Analysis Statement](#) make it clear that the change from “effective annual rate” to “annual percentage rate” is intentional:

Predatory lenders take advantage of some of the most vulnerable people in our communities, including low-income Canadians, newcomers to Canada, and those with limited credit history—often by extending very high interest rate loans. The current criminal interest rate under the *Criminal Code* of 60 per cent effective annual rate – equivalent to approximately 48 per cent on an annualized percentage rate (APR) basis – can trap people in a cycle of debt that they cannot afford nor escape.

The *Budget Implementation Act, 2023, No. 1*, amended section 347 of the *Criminal Code* to lower the criminal interest rate (also referred to as “the criminal rate”) to 35 per cent APR. These amendments will come into force on a day or days to be fixed by order of the Governor in Council.

Public policy debates regarding possible changes to the definition of “criminal rate” have been ongoing for ten or more years. Those discussions revealed that some members of the public and some policy makers find the results of an “effective annual rate” (EAR) calculation to be not intuitively sensible. For example, if someone borrows \$100 and has to repay \$110 in a week’s time, a lay person might be disbelieving of an interest rate of more than 14,000%.

The DG’s understanding is that the primary policy motivation for the change from EAR to APR is to produce a measure of interest cost that makes more intuitive sense to the public than does EAR. We understand that there was also a desire to adopt terminology that is used in the loan context in other jurisdictions. The DG is of the opinion that it is in the public interest for the *Standards of practice* (SOP) formula for APR to be aligned with the first of the above policy goals. The formula envisaged by the DG, as presented on the following page, would result in an APR of 616% under the above example.

There is no definition of “annual percentage rate of interest” (APR) in the *Standards of Practice*. APR is a term that is not commonly used in actuarial science. There are varying definitions of APR in use across Canada and internationally. The formula most commonly used in provincial payday loan legislation in Canada (in British Columbia, Alberta, Saskatchewan, Manitoba, and Ontario, for example) can only be applied to relatively simple loan structures. For example, payday loan APR definitions in most provinces require that:

1. The “interest calculation periods” be of exactly equal length (in days, weeks, months or years), and
2. The amount of interest to be charged in each period be clearly defined.

The commonly used provincial payday loan APR formula does not distinguish between obviously different loans. Consider these examples:

1. \$1,000 loan. Pay interest of \$30/month for 12 months and \$1,000 at end of year.
2. \$1,000 loan. No payments during year, pay \$1,000 plus \$360 interest at end of year.
3. \$1,000 loan. Pay interest of \$360 at the end of one month, no further interest payments, pay \$1,000 at end of year.

Under the commonly used provincial APR formula, all three of these examples result in an APR of 36% despite the very different patterns of borrowing costs.

It is the DG's view that the "provincial APR" formula would not be appropriate in the context of a criminal rate calculation that must address loan structures of varying complexity and that should differentiate between loans with obviously different patterns of borrowing costs. However, one advantage of the "provincial APR" formulas is that the resulting interest rates generally make intuitive sense to members of the public.

After consultation with the Actuarial Evidence practice area regarding various possible responses to this legislative change, consideration of the background material that is publicly available, and discussions with Finance Canada representatives to clarify elements of the publicly available background material, the DG's recommendation, subject to comments received as a result of this notice of intent, will be that APR be defined as "f" in the following formula:

$$f = [(1 + i)^{1/12} - 1] \times 12, \text{ where } i \text{ is the effective annual rate (EAR) as determined using the current paragraph 4630.01}$$

The factor of 12 determines the overall monthly effective rate of interest underlying the loan and converts it into an equivalent nominal annual rate, excluding compounding. Monthly (one-twelfth of a year) was selected because it corresponds to a commonly used period in many consumer loans. It also produces an APR (using the above formula) that is very close to the provincial payday loan APR for typical consumer loans.

The proposed formula for APR is actuarially sound because it:

- Properly recognizes the time value of money
- Correctly distinguishes between different loan structures and borrowing cost patterns
- Works for both simple and complex loans
- Produces a single result for any given loan structure (interest and repayment pattern)

In addition, the proposed formula for APR produces results that make intuitive sense to the public and policy makers. It should also be noted that, for typical consumer loans, the proposed formula produces results that are close to provincial payday loan APR results.

For the three examples above, the APR determined in accordance with accepted actuarial practice would be as follows:

1. APR = 36.00%
2. APR = 31.15%
3. APR = 43.45%

For example 1, which is a typical consumer instalment loan, the "provincial APR" formula and the DG's proposed formula produce the same result. However, the proposed formula produces different results for examples 2 and 3, correctly distinguishing the different underlying borrowing cost patterns of the three loans.

Note that, for a \$100 loan and using the proposed APR formula above, the maximum amount repayable in one week which would not violate the 35% maximum APR is \$100.66. This repayment amount would result in an APR under the "provincial formula" that is marginally below 35%.

Minor changes to some parts of Section 4600 may be required to align with the legislation which will use the old definition of "criminal rate" for agreements entered into before the legislative changes come into force and the new definition for agreements entered into after that date.

Mandate of the Designated Group

The ASB's mandate to the DG is as follows:

1. Update Section 4600 of the *Standards of Practice* to address a new, unproclaimed change to section 347 of the *Criminal Code* that would redefine "criminal rate" as "an annual percentage rate of interest calculated in accordance with generally accepted actuarial practices and principles that exceeds 35 per cent on the credit advanced" by adding a definition and/or formula to Section 4600 for "annual percentage rate of interest".
2. Update Section 4600 in any other way necessary to address the legislative change, including the establishment of clear transition rules that can be understood by both actuaries and the public.
3. Communicate with representatives of Finance Canada as needed to best ensure that the changes to the *Standards of Practice* are implemented harmoniously with the legislative changes' coming into effect.

Timeline

Draft regulations pertaining to the legislative amendment were released on December 23, 2023. The Department of Finance has proposed bringing the amendments to the Criminal Code and the proposed regulations into force three months following publication of the final regulations in the Canada Gazette, Part II. While timelines are not finalized, we anticipate that this could occur by the middle of 2024. Time is therefore of the essence with respect to updating Section 4600 so that a disparity in actuarial practice does not develop. The ASB and DG believe that having a definition for APR in the SOP before the legislative amendments come into force is in the public interest.

Given the urgency of effecting a change to the SOP, the tentative timeline is as follows:

1. Issue notice of intent mid-January with two-week comment period (deadline: January 31, 2024)
2. Consider comments received and develop exposure draft in February 2024
3. Issue exposure draft late February with one-month comment period (deadline: March 31, 2024)
4. Consider comments received and finalize the Section 4600 revisions with an effective date of May 1, 2024.

This timeline incorporates consultations with the affected practice committee (the Actuarial Evidence Practice Committee), as required by ASB's due process. Depending on the comments received, the timeline may have to be revised.

Desired Feedback

The DG and ASB are soliciting feedback on this notice of intent from members of the CIA, government representatives, and any other interested groups.

Please send comments to [Kelley McKeating](#) and [Chris Fievoli](#) by **January 31, 2024**.

A discussion of the legislative amendments and possible responses from the actuarial profession occurred at the October 2023 Actuarial Evidence Seminar, where many actuaries from the affected practice area were present. No other in-person forums for discussion are planned.

It is the responsibility of the ASB to make decisions regarding revisions to the Standards. The ASB expects to make final decisions regarding the Section 4600 revisions in accordance with the ASB's due process.

The members of the DG are Kelley McKeating (Chair), Greg Gillis, Jay Jeffery, Jamie Jocsak and Marshall Posner.

The ASB's due process was followed in the development of this notice of intent.

EG, KMCK



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