

Lowering the ceiling: the new reality for interest rate provisions in credit agreements

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On April 20, 2023, the Government of Canada introduced Bill C-47, the *Budget Implementation Act, 2023, No. 1*, an act to implement key commitments put forward in Budget 2023. The bill includes amendments to the criminal interest rate provision under section 347 of the *Criminal Code*.

Although past private members' bills have sought to change the criminal rate of interest, this is the first bill introduced in the House of Commons to amend the *Criminal Code* by moving from an effective annual rate (EAR) to an annual percentage rate (APR).

In Budget 2023, the federal government proposed to lower the criminal interest rate to 35% APR while also adjusting the payday loan exemption to cap interest charged. The federal government will also launch additional consultations on whether the criminal rate of interest should be reduced even further.

Under the *Criminal Code*, "criminal rate" is defined as "an effective annual rate of interest calculated in accordance with generally accepted actuarial practices and principles that exceeds sixty per cent on the credit advanced under an agreement or arrangement". Consequently, the move toward APR will result in the maximum allowable rate of interest to an equivalent APR of about 47%. A reduction to 35% APR will align with Québec's existing cap on interest rates for consumers.

The federal government intends to adjust the *Criminal Code*'s payday lending exemption by requiring payday lending operators "to charge no more than \$14 per \$100 borrowed". This cap would be in line with Newfoundland and Labrador, which currently has the lowest cap among provinces under consumer protection legislation except for Québec. The federal government will also launch consultations on additional revisions in respect of the payday lending exemption.

Anticipated impacts

A reduction in the maximum allowable rate of interest could have significant consequences for both borrowers and lenders. The lowering of the criminal rate of interest may impact non-traditional lenders, such as non-prime consumer lenders who typically operate at a higher average interest rate or have less scale in their operations. Further, this could eliminate access to credit for many borrowers, clearing a path to more expensive sources of borrowing or other illegal loan sources.

Currently, the gap between the Bank of Canada's overnight rate and the criminal rate is 30.5%. Assuming continued hikes in the Bank of Canada's policy interest rate, the gap

permitted by law will continue to tighten.

Should the ceiling continue to lower, lenders and practitioners would be well advised to pay special attention to provisions addressing payment of interest. Most credit agreements today contain mechanics to reallocate payments of interest exceeding the maximum allowable rate of interest permitted by law to the repayment of outstanding commitments, or to reduce fees or other amounts owed to lenders constituting interest under the *Criminal Code*. These provisions may become unenforceable if they create an obligation to pay interest in an amount or a rate exceeding 35% APR.

If you or your business require assistance in determining the potential impact of a lower criminal rate of interest, please feel free to contact the authors of this article.