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Interest Rate Restrictions on Credit for Low-income Borrowers

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on behalf of the Social Finance Foundation

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Contents

Acronyms 4
Definitions 5
Executive Summary 7
Section 1: Introduction 13
Section 2: Methodology 15
Section 3: Moneylending in Ireland 16
3.1 A brief history: from the 19th Century to 1933 16
3.2 A changing landscape: 1950 – 1988 17
3.3 Current legislation and regulations 18
3.4 Supervision and Authorisation 20
3.5 The moneylending market in Ireland 23
3.6 Customer profile and borrowing patterns 24
3.7 Why is moneylending so popular? 25
3.8 Areas of concern 26
3.9 Alternatives 29
3.10 Cost components of credit provision 34
3.11 Section Summary 36
Section 4: High-cost credit in Europe 37
4.1 Development and types of high-cost credit 37
4.2 Home credit 38
4.3 Section Summary 40
Section 5: Interest rate restrictions in the EU 41
5.1 EU countries with IRR 48
5.2 EU countries with recent changes in IRR 50
5.3 EU countries considering IRR 64
5.4 EU countries with no IRR 65
5.5 Section Summary 66
Section 6: Interest rate restrictions in non-EU developed countries 67
6.1 Japan 67
6.2 Australia 71
6.3 Canada 72
6.4 United States of America 73
6.5 Section Summary 74
Section 7: Potential impacts of an interest rate restriction policy 76

7.1 Social impacts 76
7.1.1 Consumer protection 76
7.1.2 Access to credit 77
7.1.3 Over-indebtedness 78
7.1.4 Illegal moneylending 80
7.2 Economic impacts – supply of credit 81
7.2.1 Cost of credit 81
7.2.2 Competition 82
7.2.3 Convergence at the level of the cap 82
7.2.4 Displacement to alternative credit sources 83
7.3 Regulatory impacts 83
7.3.1 Circumvention by credit providers 83
7.3.2 Opportunity cost of other policy options 84
7.4 Addressing the demand for credit 84
Section 8: Potential barriers to policy change 87
Section 9: Conclusions and Recommendations 92
References 96
Appendix 1: Terms of Reference 105
Appendix 2: List of stakeholders consulted 109
Appendix 3: Trends on interest rate ceilings in developing countries 111

Acronyms

ADB	Asian Development Bank
AFM	Autoriteit Financiële Markten
APR	Annual Percentage Rate
ASIC	Australian Securities and Investments Commission
CCD	Consumer Credit Directive
CFA	Consumer Finance Association
CIB	Citizens Information Board
CNB	Czech National Bank
EU	European Union
EU – SILC	EU Survey on Income and Living Conditions
FCA	Financial Conduct Authority
IPF	International Personal Finance
IRR	Interest Rate Restriction
IRRL	Interest Rate Restrictions Law
MABS	Money Advice and Budgeting Service
ODCA	Office and Director of Consumer Affairs
OFT	Office of Fair Trading
PMC	Personal Microcredit Scheme
PWC	Price Waterhouse Coopers
SACC	Small Amount Credit Contract
SFF	Social Finance Foundation
SMS	Short Message Service
UCC	University College Cork
UK	United Kingdom
US	United States

Definitions

Consumer credit	Credit provided for personal, household or domestic purposes.
Consumer protection	Ensuring that the best interests of consumers are protected, with regulated firms focused on delivering the right consumer outcomes.

[Source: paraphrased from the Central Bank of Ireland Strategic Plan 2016 – 2018]

Default interest rate	The interest rate with which the amount of money concerning capital due after default is calculated (i.e. charges for non-compliance, late payment or interest charged on overdue payment).

[Source: iff/ZEW 2010 report]

Interest rate restriction	Absolute or relative rate ceilings (fixed administratively, by statute or court rulings); Laws designed to prevent exploitation and unfair competition with effects on credit cost; Capped default interest rates and early repayment fees; Restrictions on the compounding of interest and the use of variable rates; Other forms of restrictions to the level or rate of interest including moral consensus; Anti-Trust regulation.

[Source: iff/ZEW 2010 report]

Financial inclusion	Financial inclusion means that individuals and businesses have access to useful and affordable financial products and services that meet their needs.

[Source: World Bank 2017]

Financial exclusion	Financial exclusion means that people encounter difficulties accessing and/or using financial services and products that are appropriate to their needs
Legal interest rate	The interest rate provided by statute to be used when no contract or agreement exists between the parties. Sometimes referred to as the statutory interest rate

[Source: iff/ZEW 2010 report]

Moneylender	A moneylender is defined as a person who carries on the business of moneylending or who advertises or announces

	himself or holds himself out in any way as carrying on that business, but does not include: any pawnbroker in respect of business carried on by him in accordance with the provisions of the Pawnbrokers Act, 1964 (as amended by Part XV); a society which is registered as a credit union under the Industrial and Provident Societies Acts, 1893 to 1978, by virtue of the Credit Union Act, 1966; a registered society within the meaning of the Friendly Societies Acts, 1896 to 1977; a credit institution; a person who supplies money for the purchase, sale or hire of goods at an APR which is less than 23% (or such other rate as may be prescribed); a mortgage lender. [Source: Consumer Credit Act, 1995]
Moneylending agreement	A credit agreement into which a moneylender enters or offers to enter, with a consumer in which one or more of the following apply: 1. The agreement was concluded away from the business premises of the moneylender or the business premises of the supplier of goods or services under the agreement; 2. Any negotiations for, or in relation to the credit were conducted at a place other than the business premises of the moneylender or the business premises of the supplier of goods or services under the agreement; 3. Repayments under the agreement will, or may, be paid by the consumer to the moneylender or his representative at any place other than the business premises of the moneylender or the business premises of the supplier of goods or services under the agreement; or 4. Where the total cost of credit to the consumer under the agreement is in excess of an APR of 23%., or such other rate as may be prescribed. [Source: Consumer Credit Act, 1995]
Usury	Lending money at excessively high rates of interest

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Executive Summary

Background

The aim of this report is to examine the extent and variety of interest rate restrictions within the EU and further afield with a view to assessing the appropriateness of introducing such a restriction in the Irish market given its specific circumstances and financial environment. Moneylending is a form of lending which is legislated for and is subject to authorisation and regulation within the boundaries of the relevant legislative provisions. All licensed moneylenders in Ireland are currently subject to a restriction on their maximum APR and total cost of credit. They are currently licensed to charge up to 188.45% excluding collection charges and up to 287.72% including collection charges. It is important to note the distinction between interest rates and annual percentage rates (APRs). The latter shows the true cost of the loan as it includes both the interest and any fees and charges. It is important to note also that the shorter the term of the loan the higher the APR. Convenience and ease of access are often cited as the reasons why consumers engage with moneylenders, despite the high cost of moneylending credit. However, while it is convenient for the individual, there is a higher than necessary cost for the individual, their family and the wider community. The overall remit of policy, legislation and regulation should be to widen existing alternatives such as credit unions and the Personal Microcredit Scheme.

It is in this context that the appropriateness of continuing a legislative provision that, from a customer viewpoint, allows extremely high interest rates and charges to be levied on those who can least afford to pay them can now be questioned. It is acknowledged that the success of any legislative change requires an accompanying infrastructure that will serve as the mainstream alternative to the moneylending sources of credit. The overall remit of policy, legislation and regulation should be to encourage and support existing alternatives, such as credit unions, which are currently the only and practical alternative.

Moneylending industry in Ireland

There are 39 licensed moneylending firms in Ireland, 31 of which are categorised as home collection credit firms. Currently, these licensed moneylending firms provide high-cost credit to about 7% of the Irish population, have outstanding loans currently valued at about €153

million and hold a market share of 1.7% for consumer credit. Most commonly, loans are offered over 9 months with an APR of 125%. Average loan size is €566. The main feature of the business model involves calling to the customers' homes on a weekly basis to collect loan repayments. There are an estimated 330,000 customers of moneylenders in Ireland, the majority of whom are female, in the lower socio-economic group and between 35 and 54 years of age. Almost 50% of the customers of moneylending organisations are customers of catalogue companies. Catalogue companies typically have lower APR then home credit companies with rates in the region of 43% - 72%.

Customers report satisfaction with the convenience and ease with which they can borrow from and repay moneylenders. However, there is reported dissatisfaction with the interest rate charged. Other concerns surround the assessment of credit-worthiness, practice with regard to top-up loans, and repeat borrowing.

It should be noted that the Central Bank of Ireland (Central Bank) has not granted a licence to any "payday" type lender, who typically charge APRs in the thousands and for whom some of the price caps/IRRs in other juristrictions have been specifically introduced (e.g. UK).

Interest rate restrictions

Globally, interest rate restrictions have become more prevalent in both developed and developing countries in recent years. In Europe, there has been a clear trend towards the use of interest rate restrictions as a policy tool to control high-cost credit. Today, 21 of the EU 28 member states now have some form of interest rate cap on credit. These include the 3 largest economies in the EU (post Brexit) – Germany, France and Italy. In some cases, this is directed at bank lending, such as instalment loans, overdrafts or credit cards. In other cases, it is directed at non-bank lending such as payday/SMS loans or home credit. The latter accounts for much of the recent increase in IRR as a policy tool in EU member states. Other catalysts have been the transposition of the EU Consumer Credit Directive into national law, as well as public and parliamentary concerns about the detrimental impacts of specific products on consumer welfare. Some countries have tightened their existing IRR legislation in recent years, either in response to the expansion of payday/SMS loans and home credit, or to curb attempts to circumvent existing legislation. In addition, a number of Eastern European and Scandinavian countries, along with the UK, have also changed their policies on interest rate

restrictions over the last ten years. Ireland is now in the minority of countries in Europe that has no formalised interest rate restriction on high-cost credit. It should be noted that the Department of Finance is the appropriate authority for consideration of IRR. The Central Bank is the competent authority for implementing the legislation that provides for lenders of this type, rather than the policy-making authority.

One of the main barriers to placing an interest rate restriction on legal moneylending is the fear that it will drive people to use illegal moneylenders. While it must be acknowledged that illegal moneylenders are one possible alternative credit source, they are not the only or preferred alternative. Research has shown that many of those who use moneylenders in Ireland already use other sources of legal credit (Byrne, McCarthy & Ward, 2005). In addition, as evidenced by the recent impact of an interest rate and price cap on high cost credit in the UK, a migration to illegal providers is not an inevitable consequence of an interest rate restriction. Furthermore, the Personal Finance Research Centre (2013: vii) states that, in their survey of 1,451 customers of high-cost credit providers, "using an illegal lender was not an option that the vast majority of customers would consider" in light of a restriction of credit from legal suppliers of high cost credit". The research work on our behalf by iff/ZEW, and additional evidence from countries such as Japan and Slovakia, has indicated that the often-quoted assertion that IRR leads to an increased market in illegal lending is disputable.

Introducing restrictions on interest rates and limiting the total cost of credit can help protect the public interest by ensuring that a fair and reasonable price for credit is provided for all. While users of moneylenders can come from all segments of society, they are more likely to be from lower socio-economic groups and thus least able to afford high-cost credit. A restriction on interest rates and the total cost of credit will force moneylending firms to re-examine their business model. While this may result in some people no longer being able to access credit, there is a high probability that some of these people would not pass a rigorous affordability check and may already be over-indebted. Some restriction in access to credit might, in fact, offer some benefit in this case, particularly as there is no clear evidence to suggest that people will turn to illegal moneylenders where access to legal moneylenders is restricted. Furthermore, in the Irish case, PMC is emerging as a credible and affordable alternative to moneylending for social welfare recipients. In addition, those creditworthy customers previously served by moneylending firms should be capable of being served by the

Irish credit union sector. That assumption is predicated on a clear commitment from the credit union sector to service these customers as their needs arise but always subject to creditworthiness.

The research has highlighted many downsides that arise from doorstep moneylending. In the UK, 52% of home credit users believed that using this form of credit had trapped them into a cycle of borrowing (Personal Finance Research Centre, 2013). Repeat usage is a concern in terms of how much income is being spent on high-cost credit, especially given that 14% feel trapped by their use of moneylenders (Central Bank 2013). Many experts in European countries highlighted the fact that high-cost lending is particularly targeted at people on low incomes, leading to a spiral of increased indebtedness and an inability to maintain payments for essential items such as rent and utility bills.

The research has highlighted the possible link between financial exclusion and the existence of a thriving moneylending sector. By comparison with developed EU countries, most with very low single digit figures, Ireland has a high level of financial exclusion measured in the EU-SILC survey (2008) at 16%. This provides the fertile ground for moneylending firms to operate. The leading moneylending firm in Ireland and the U.K. - Provident PLC - has expanded into new markets in the last 20 years and has focused on (mainly East European) countries where the percentage of people with no bank account is far greater than 14%.

Germany is an example of relevance to Ireland. Most banks in Germany offer free bank accounts that include a free debit card and free online banking as standard. Financial exclusion (close to zero) is mitigated through the role of the Sparkassen banks, which serve a regional and social mission. The German Supreme Court has established a very strong presumption that interest rates that are over double the relevant market rate are contrary to good morals. The maximum permissible APR is twice the market rate calculated by their Central Bank (BaFin). It could be argued that the credit union movement is the equivalent sector in Ireland as it has national coverage within a “common bond” structure and has a social mission. The German Supreme Court view raises the question of the moral legitimacy and social justice of charging excessive interest rates for access to credit, which often targets the most vulnerable and financially excluded consumers. Other examples in the EU include

Spain, where an interest rate of 24% was deemed “excessive” and Finland, where an interest rate of 118% was seen as “unconscionable”.

Consumer credit plays a key role in the economy. However, it must be moderated to protect consumers from any imbalance of power between a credit provider and a consumer. The findings from this study recommend the actions below to enhance consumer protection and financial inclusion for Irish consumers of high-cost credit. Further work is needed to understand how greater financial inclusion can be embedded in policy and financial service provision together with building the capacity of individuals. The latter includes the need for longer-term financial educational initiatives, through the community, through social marketing campaigns and as part of MABS.

Recommendations on interest rate restrictions:

1. Government to adopt a policy that prohibits usurious rates of interest in the interests of fairness to the most vulnerable in Irish society by the introduction of a restriction on interest rates and charges.
2. Such a policy to be conditional on the credit union movement in Ireland committing to and being enabled to serve the community currently serviced by the moneylending firms, subject always to adherence to prudent credit guidelines.
3. In consultation with the credit union sector, the Department of Finance consider increasing the 1% monthly cap on interest rates for credit unions as per Section 38 (1)(a) of the Credit Union Act, 1997, for this type of lending to cater for the significantly greater costs associated with such small lending.
4. Ensure interest rate restriction is coupled with a limit on other fees and charges and a limit on the total cost of credit, with the rules carefully designed to avoid circumvention through the introduction of other ‘innovative’ fees and charges.
5. Consider reducing the permissible interest, fees and charges on second and subsequent loans taken out by consumers.
6. Ensure that resources are provided to enforce the interest rate restrictions and price caps as well as existing lending practices.

Recommendations to supplement the above recommendations, so as to optimise the outcomes of policy change:

7. Ensure moneylenders engage in responsible lending practices.
8. Introduce other policy measures, including actions to promote financial inclusion, which includes financial education initatives, to complement the above measures.

Section 1: Introduction

The purpose of this report is to present the findings of a research study on the extent and variety of interest rate restrictions on high-cost consumer credit used to achieve the joint policy goals of financial inclusion and consumer protection. The research was funded by the Social Finance Foundation and the Central Bank , with the Centre for Co-operative Studies in University College Cork commissioned to independently conduct the research[1]. The context and terms of reference of the study are contained in Appendix 1.

The report examines the presence or absence of interest rate restrictions in other countries, with a particular focus on the EU, in order to consider the appropriateness of such restrictions for the Irish market. Section 2 outlines the methodology that was adopted in completing the research. Section 3 gives an overview of the moneylending industry in Ireland, with a brief history of its development, current legislation and regulations, the size of the market, customer profile and borrowing patterns, areas of concern and alternatives available to consumers. Section 4 gives a short overview of high-cost credit in Europe and demonstrates how moneylending is one of many types of high-cost credit available to consumers in the EU. Section 5 outlines the global situation on interest rate ceilings and the current trends of its use as a policy tool for consumer protection. Section 6 focuses on EU member states, considering countries with and without interest rate ceilings, as well as examining some recent trends and changes. Section 7 discusses recent approaches to interest rates in some non-EU developed countries, namely Japan, Australia and Canada. Section 8 assesses the impacts of an interest rate restriction, considering the possible social, economic and regulatory impacts of a policy change. Section 9 outlines the barriers to policy change and determines the policy change that is most appropriate to the Irish context. Section 10 details the report's conclusions on interest rate restrictions, summarising the actions that are deemed most appropriate to achieving the joint policy goals of consumer protection and financial inclusion.

This study raises the question of the moral legitimacy and social justice of charging excessive interest rates for access to credit, which often targets the most vulnerable and financially excluded consumers. Legal moneylenders in Ireland are currently licensed to charge up to

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188.45% APR excluding collection charges and up to 287.72% APR including collection charges, whereas a majority of EU member states have in place interest rate restrictions far below this level. In fact, some member states have ruled on the excessive nature of these higher rates. For example, in Spain, a rate of 24% was deemed “excessive” (Herrero, 2017) and in Finland, a rate of 118% was seen as “unconscionable” (Vilijanen, 2017). This study considers interest rate restrictions in the context of high-cost credit provision in Ireland.

Section 2: Methodology

In 2016, the Social Finance Foundation approached University College Cork to carry out an independent study of the extent and variety of interest rate restrictions in the EU, with an assessment as to the appropriateness of such restrictions in the Irish market. The parameters of the research were jointly agreed and the services of the Centre for Co-operative Studies were engaged to independently conduct and objectively analyse the findings from the research.

The research methodology consisted of two main parts. The first part consisted of a literature review of existing material in order to provide an analysis and overview on the current state of research on interest rate restrictions and their impact on consumers. It examined relevant reports, journal articles, newspaper articles, websites and speeches from public, private and civil society sources. The second part consisted of collecting evidence and opinions from key stakeholders, mainly in European countries, to update the legislative position across the EU and establish the consequences of the introduction of interest rate regulations. To inform this part of the research, the German organisation Institut Für Finanzdienstleistungen was contracted to facilitate the collection of information in nine European countries .[2] A list of all the stakeholders consulted as part of the study and who provided information is included in Appendix 2.

[2] Institut Für Finanzdienstleistungen e.V. (iff) is an organisation that conducts research in the field of sustainable financial services and advice. It was one of the main authors of the 2010 report for the EU Commission *Study on interest rate restrictions in the EU.*

Section 3: Moneylending in Ireland

3.1 A brief history: from the 19th Century to 1933

Moneylenders, along with shopkeepers and pawnbrokers, were key sources of credit for low-income households in the late 19th and early 20th century in Ireland. In 1914, George Russell (AE) gave a memorandum to the committee on agricultural credit in Ireland that stated that when the Irish Agricultural Organisation Society began its work from 1894 on, the country was 'overrun by private moneylenders' (Mc Laughlin, 2009).

In the mid 19th century, the United Kingdom repealed usury laws that had been in place, in varying forms, for many centuries. Subsequent to this repeal, there was public outrage about the practices of moneylenders in the late 19th century. However, the Government's Moneylending Committee rejected the re-introduction of price controls on moneylending in 1898 because 'interest rates may not be the best measure of the cost of small loans, different conditions are applicable to different types of loans and ceilings would be circumvented'. Instead, the 1900 Moneyenders Act conferred broad powers on judges to hold an agreement to be unconscionable (Ramsay, 2014).

After the formation of the Irish state, the 1900 Act was replaced by the 1933 Moneylenders Act in Ireland. On the issue of usury, Article 17 of the 1933 Act set out a definition of excessive interest as being an interest rate greater than 39%:

> "Where ... it is found that the interest charged exceeds the rate of thirty-nine per cent. per annum, or the corresponding rate in respect of any other period, the Court shall conclusively assume for the purposes of section 1 of the Moneylenders Act, 1900, that the interest charged is excessive and that the transaction is harsh and unconscionable, but this provision shall be without prejudice to the powers of the Court under that section where the Court is satisfied that the interest charged, although not exceeding thirty-nine per cent, per annum is excessive."

In the UK, the position on interest rates altered in 1927, when a presumption was introduced that a loan was unconscionable if it exceeded 48%. However, the courts did not use this as a

price ceiling, allowing lenders to include other fees and charges unless there was evidence of advantage taking (Ramsay, 2014).

With the introduction of the 1974 Consumer Credit Act, the UK abolished the 48% limit and price controls on consumer credit did not feature in the UK again until 2015. In Ireland, the reference to a 39% interest rate ceiling no longer featured once the 1995 Consumer Credit Act came into force.

3.2 A changing landscape: 1950 – 1988

While the 1933 Act limited the interest rate that could be charged, the legislation did not prohibit collection charges and the prevalence of moneylenders continued in Irish society. Having witnessed the daily effects of unemployment and the consequent growth in moneylending activities in the 1950's, Nora Herlihy, a teacher in Dublin, became one of the founders of the credit union movement in Ireland, promoting an alternative system that would give people command over their own resources and facilitate the elimination of moneylenders in the community (Mc Carthy, 1996).

Almost 30 years ago, a study on moneylending and low-income families in Ireland traced the experience of 99 people who were in debt to moneylenders in Ireland, interviewing people from Dublin (Clondalkin, Ballymun/Finglas, Darndale/Coolock/Kilbarrack, inner city), Cork, Waterford and Newcastle West in Limerick. The report found that borrowing from moneylenders was not only extensive but was also a regular pattern in respondents' lives, with a minimum of two loans at a time being the norm and continuous loans being held by most people. IR£346 was the average debt to moneylenders for the total survey sample. 28% of respondents said that unlicensed moneylenders supplied their credit, with 39% of providers falling into the category of unidentifiable moneylender. The most common APR was between 200 and 299%, with over a third of loans charged at this rate. When asked for the reasons why they used moneylenders, 43% said it was their only credit option, 28% cited accessibility/ease of getting money, 12% said a relative/friend suggested it, 7% said a moneylender offered money, 6% said it was tradition in the family and the remaining 4% gave other reasons or incomplete information (Daly and Walsh, 1988).

3.3 Current legislation and regulations

In 1995, the 1933 Moneylending Act was replaced by Part VIII of the 1995 Consumer Credit Act 1995. This Act details the provisions relating to moneylending and sets out the requirements on a number of areas including: licensing requirements, instructions on the maintenance of records, prohibition of default charges and charges for expenses on loans, collection time restrictions and a ban on selling goods while collecting repayments. The Act also requires that the Central Bank maintains a register of moneylenders which includes up to date licensing information and any other particulars that may be prescribed by the Minister of Finance. Under the revisions to the 1995 Consumer Credit Act, a person guilty of an offence under the Act is liable on summary conviction to a fine of €3,000 or imprisonment for up to 12 months or both; if liable on conviction on indictment, a person will be liable to a fine of up to €100,000 or imprisonment for up to five years or both.

Article 47-1 of the 1995 Act states that a consumer or person acting on their behalf may apply to the Circuit Court for a declaration that the total cost of credit provided for in an agreement is excessive. However, unlike the 1933 Act which stipulated an interest rate greater than 39% as excessive, there is no declaration in the 1995 of what is deemed an acceptable limit. The Central Bank, which took over the licensing of moneylenders from the Officer and Director of Consumer Affairs (ODCA) in 2003, does not have the remit to define the term 'excessive' in its regulation of moneylenders. The maximum APR charged in respect of specific loans ranges from 23% to 188.45% APR, excluding collection charges, and up to 287.72% APR when collection charges are included. These rates have remained largely unchanged since 2013.

The 2008 Consumer Credit Directive (2008/48/EC) introduced a number of consumer protection measures and aimed to increase harmonisation of consumer credit across EU member states. The Directive includes articles on standard information to be included in advertising, pre-contractual information requirements, obligations to assess creditworthiness, database access, information to be included in credit agreements, right of withdrawal and early repayment. On the obligation to assess the creditworthiness of the consumer, Member States are required to:

> "ensure that, before the conclusion of the credit agreement, the creditor assesses the consumer's creditworthiness on the basis of sufficient information, where appropriate obtained from the consumer and, where necessary, on the basis of a consultation of the relevant database."

There is also a requirement that if the parties agree to change the total amount of credit after the conclusion of the credit agreement, the creditor updates the financial information at their disposal concerning the consumer and assesses the consumer's creditworthiness before any significant increase in the total amount of credit. The European Directive was transposed into Irish national law by the European Communities (Consumer Credit Agreements) Regulations 2010.

The Consumer Protection Code for Licensed Moneylenders came into effect in 2009. It includes a number of provisions to protect consumers including: provision of information to the consumer, preservation of the consumers' rights, knowing the consumer requirements, suitability, unsolicited contact, disclosure requirements, errors, handling complaints, consumer records, unsolicited credit facilities, arrears and guarantees, and debt collection. As part of its ongoing monitoring of existing codes, the Central Bank are planning to review the Consumer Protection Code for Licensed Moneylenders in 2017 to determine if the existing protections need to be enhanced (Central Bank , 2009).

In 2011, a fitness and probity regime for moneylenders came into effect. Prior approval by the Central Bank is now required before an individual can be appointed to a Pre-Approval Controlled Function in a moneylending organisation. Firms must also comply with the Criminal Justice (Moneylaundering and Terrorist Financing) Act 2010, as amended by the Criminal Justice Act 2013.

The Central Bank is in the process of establishing a Central Credit Register - a national mandatory database of personal and credit information. From 31 March 2018, licensed moneylenders will begin submitting data to the Register in respect of loan agreements of €500 or more. Firms who have begun to submit data may also request credit reports after this date. From 30 September 2018, moneylenders must have reported existing and new credit agreements back-dated to 31 March 2018. Moneylenders must also check credit information

on the Register when considering loan applications of €2,000 or more (Central Credit Register, 2017).

To improve transparency, all moneylending loan agreements must include the amount lent; date of loan; amount, number and timing of repayments; details of collection charges; rate of interest; total amount payable; date that the loan ends; details of how to repay early and the associated rebate for early repayment. A borrower must also receive a repayment book that records repayments and the remaining balance due. If a moneylender is planning to take legal action as a result of missed payments, the moneylender must give the borrower a notice in writing that they are planning to take legal action, at which point the borrower has 21 days from the receipt of the notice to pay the arrears of the instalments due. If a borrower consistently fails to pay instalments on time, the moneylender may ask a court to waive the need to give this notice. However, in practice, moneylenders rarely take legal action against a borrower for non-payment of loans (FLAC, 2007).

The legislation and regulations introduced have strengthened the protection of consumers and the industry is now more regulated than it has ever been. The increased compliance costs are likely to be especially challenging for smaller moneylending firms.

3.4 Supervision and Authorisation

Supervision of moneylending firms is carried out by the Central Bank , mainly through reviews, reports, themed inspections and individual inspections where compliance concerns arise. Since 2011, there have been two themed inspections on licensed moneylenders. An inspection in 2011 focused on whether consumers were being charged in accordance with moneylenders' authorised APRs and costs of credit as set out in the moneylenders' licence. It also examined whether firms had their licences on display and if they indicated the high-cost nature of loans on loan documentation issued to consumers. Overall the inspections found a high level of compliance with the requirements and consumers were charged in accordance with moneylenders' authorised APRs and costs of credit. The 2013 inspection also focused on APRs and costs of credit and found that firms were broadly in compliance, though there were

concerns about a small number of firms. Reports by the Financial Regulator (2007) and the Central Bank (2013) on the moneylending industry have also been issued. The findings from these reports are discussed further in Sections 2.6, 2.7 and 2.8 below.

All moneylenders must apply on an annual basis for a renewal of their licence. This involves completing an application form, giving details of the firm, district court areas in which they operate, background to the firm (principals, shareholders etc.), regulatory background information, compliance and product details (type of loan, amount of loan, period of loan, interest charge, collection charge, any other charge, total cost of loan, APR, APR including collection charge, weekly/monthly repayment amount, cash cost for each €100 borrowed and % cost per €100 borrowed). Firms are also required to disclose the financial details of their turnover, total expenditure, surplus/deficit of income over expenditure, bad debts written off and balance sheet provision for bad and doubtful debts. Firms must also provide details for the previous year on the number of loans advanced, the total value of the loans advanced, the number of consumers with amounts outstanding, the total value of amounts outstanding on all loans and details of any complaints received (Central Bank , 2017).

Interest rate restrictions are just one of a number of measures that are implemented to protect consumers. The following table summarises the measures that are included in the legislation, regulations or the code for moneylenders in Ireland to ensure responsible lending.

Measure	Details of measure	Applicable to moneylenders in Ireland?
Market entry requirements	Requirement to register with the Central Bank	Yes
	Licensing system	Yes
Fitness and probity	Prior approval by the Central Bank for Pre-Approval Controlled Function roles	Yes
Sanctions for breaches	Fines and/or imprisonment for breaches of legislation	Yes
Transparency	Standard information to be included in advertising	Yes

	Pre-contractual information requirements	Yes
	Contractual information - Information to be included in credit agreements	Yes
	Right of withdrawal	Yes
	Early repayment	Yes
	Promotion of financial literacy	No
Consumer affordability/ suitability	Obligations to assess creditworthiness	Yes
	Credit limited to % of net or gross income	No
	Specific requirement to obtain and consider bank statements or other records	No
	Requirement to carry out credit bureau checks	Not yet (partially from 2018)
	Ban on top-up loans/rolling over	Yes
Cost of credit	Cap on total cost of credit	Yes
	Limit of default fees	Yes (no default fees permitted)
	Limit on other non-interest fees	Partial (collection charges allowed)
Other protection measures	Limit on the number of unsuccessful attempts firms can seek payment using continuous payment authority (in use in UK)	No
	Restrictions in place on advertising high-cost financial products	Yes

Table 1: Status of responsible lending policy measures applicable to moneylending in Ireland

3.5 The moneylending market in Ireland

In 1988, there were 127 licenced moneylenders in Ireland, with the Revenue Commissioners acting as the licensing authority (Daly and Walsh 1988). In 2005, the figure stood at 52 licensed moneylenders, charging an average APR of 126.29% excluding collection charges (Byrne, McCarthy and Ward 2005). In that same year, the number of customers was about 300,000 and ten years ago there were 400 agents operating door-to-door throughout the country, issuing new loans and collecting existing loans (Central Bank , 2007).

As of February 2017, there are 39 licensed moneylenders in Ireland, of which three are licensed for payment collection only. The majority of firms (31) fall into the category of home collection credit firms (commonly referred to as doorstep lending) which offer cash loans provided in the home and repaid through a weekly home collection service. The remaining firms consist of "remote" firms that provide cash loans but collect repayments through remote methods (e.g. direct debit), "retail" firms involved in the provision of goods on credit with repayments being made by a variety of methods (e.g., cash, direct debit) and "others" who either operate on the basis of running accounts (e.g., catalogue companies, insurance premium finance companies) or who are authorised only to collect on moneylending agreements previously entered into, but not to grant further credit.[3]

Of the 36 firms actively offering credit, 16 are registered with business addresses in Dublin and 26 are licensed in all court districts, although this does not mean they operate in all court district areas (Central Bank , 2017). The number of customers increased to around 360,000 in 2014 but since then has fallen to about 330,000.[4] This equates to about 7% of the population of Ireland.

[3] Central Bank of Ireland
[4] ibid

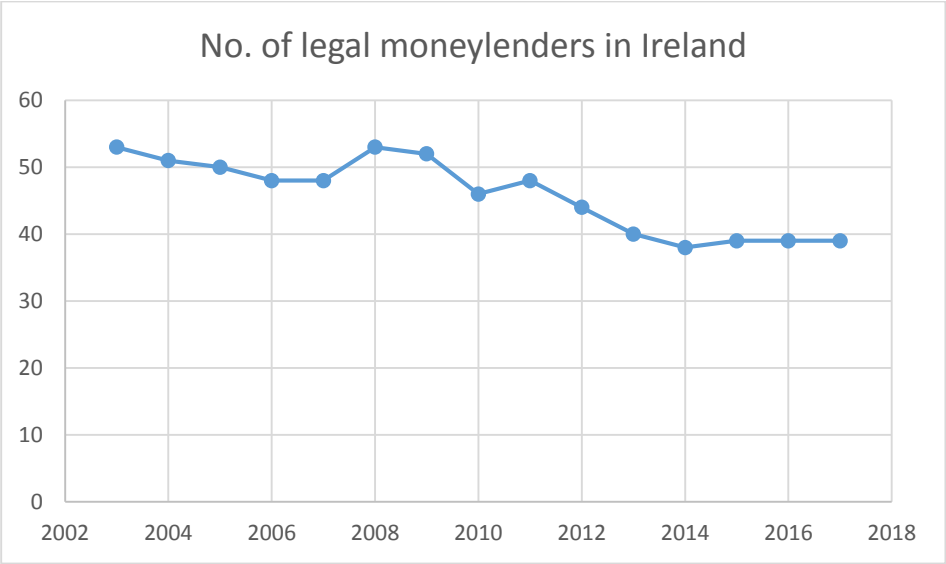


Figure 1: Number of legal moneylenders in Ireland from 2003 – 2017 (Source: Central Bank Moneylending Unit)

Today, moneylending is a multi-million euro business in Ireland. Outstanding loans currently amount to about €153 million (down from €200 million in 2013).[5] Total outstanding consumer loans in Ireland amounted to €11.6 billion in October 2014, which indicates that the moneylending sector accounted for 1.7% of the consumer credit market in that year (Central Bank , 2015).

3.6 Customer profile and borrowing patterns

The majority of moneylender customers in Ireland fall in the age range of 35-54, are more likely to be female and in the lower-socio-economic group. The most frequent term offered is approximately 9 months with an APR of 125%. The average loan principal offered by those who charge collection fees is €566. To put this sum in context, it is the equivalent of three times the standard weekly social welfare payment for an individual (€188 a week).[6] The most common reasons for borrowing are primarily to purchase personal items (goods/clothes) and to cover the costs of family-related occasions (Central Bank , 2013).

[5] ibid
[6] Department of Social Protection Standard Jobseekers Allowance and Jobseekers Benefit rate for unemployed

Compared to personal loans with financial institutions, utility companies, credit cards and mortgages, the number of active debts with moneylenders reported by clients of the Money Advice and Budgeting Service (MABS) is relatively low (MABS, 2016). However, it is important to note that moneylending firms have a repayment advantage over other lenders, due to the fact that their business model involves calling to a customer's home on a weekly basis. In some cases, this means that a customer may pay their moneylender even if they cannot then afford to pay their rent, as indicated by one MABS agent.[7] Moneylenders are also likely to re-negotiate their repayments with their customers.

3.7 Why is moneylending so popular?

In 2007, the Financial Regulator commissioned a report on the licensed moneylending industry, which was followed by a similar study by the Central Bank in 2013. The 2007 study, which involved interviews with 333 customers, asked customers why they use licensed moneylenders as opposed to other lenders. 30% said it was the convenience of home collection, 16% said family tradition/recommendation, 14% were drawn by the immediate availability of credit, 14% cited their existing relationship with the moneylender, 6% said because they had been refused credit elsewhere/had no other credit source/not aware of other companies, 5% said the interest was good or cheaper and 15% gave other reasons including privacy, customer service and preference (Financial Regulator, 2007).

In 2013, the reasons given were ease of availability (26%), convenience of good selection (25%), convenience of home collection (25%), join sports club (10%), existing relationship with moneylender (7%), refused credit elsewhere (5%), family tradition/recommendation (7%), general convenience (4%) or another reason (15%) (Central Bank , 2013).

Daly and Walsh (1988) asked a similar question in their study almost 30 years ago. Whereas their report is heavily influenced by peoples' experience of illegal moneylenders (and different methodologies and questionnaires were used compared to both the 2007 and 2013 surveys), it is worth noting that while in 1988 the main reason people gave for using moneylenders was because it was their only credit option (43%), it is now the ease and convenience factor that is given as the main reason for using licensed moneylenders.

[7] Interview with MABS Officer in Galway on 1 March 2017

According to a Central Bank report, customers' satisfaction with legal moneylenders is high, with an average customer satisfaction rating of 83%. While some customers feel under pressure to make repayments on time (if they miss a repayment), the majority of customers feel that they are treated fairly and most are comfortable to engage with the moneylender to manage arrears. It is also worth noting that 84% of customers reported that they understand the cost of credit (Central Bank , 2013).

The results of a study of customers of short-term, high-cost credit (home credit, pawnbroking and payday lending) in the UK are more telling about the rate of satisfaction. 94% of customers reported they were very satisfied or fairly satisfied with their home credit provider *overall*, the main reasons being the 'customer service' provided and the 'convenience' offered. However, of these 94%, only 6% stated they were satisfied with the 'cost of borrowing/APR' and 1% were satisfied that the service 'did exactly what it said it would/expected/no hidden/extra charges'. Furthermore, 52% of home credit users believed that using this form of credit had trapped them into a cycle of borrowing (Personal Finance Research Centre, 2013).

Apart from this individual impact, there is also a wider household and community impact. Palmer and Conaty (2002:23) highlight that there is a 'huge transfer of resources and potential assets from poor communities to the directors and shareholders of loan companies'. They cite research in the US which found that low-income house owners are stripped of approximately $9.1 billion a year through the practices of the 'alternative credit sector'. They cite research in the UK, carried out by ACE Credit Union Services, which found that in three streets with a total of 40 households, Stg£240,000 was being paid each year to high-cost lenders. The same research indicated that the average weekly income of the households surveyed was just Stg£230.

3.8 Areas of concern

From a consumer protection perspective, the main areas of concern appear to be the high-cost of credit, creditworthiness assessments, top-up loans and repeat borrowing.

Cost of credit: the most common reason for dissatisfaction with moneylenders was the high interest rates charged/cost of credit (Central Bank , 2013).

Creditworthiness assessments: in 2013, it was reported that 50% of customers did not recall whether their moneylender assessed their creditworthiness before their most recent loan. After a series of inspections on nine selected moneylenders in 2013, the Central Bank noted creditworthiness assessments as one area requiring greater attention by moneylenders. In a letter to moneylending organisations, the Central Bank stated that a firm must consider all existing loans and any arrears a consumer may have when assessing creditworthiness. It also stated that where a consumer is in arrears, the firm must give additional consideration to creditworthiness and should have strong evidence of a consumer's ability to repay before advancing a new loan (Central Bank, 2013). The importance of creditworthiness assessments is highlighted in the 2013 survey, which found that more than one in five customers were reported to have loan agreements with more than one moneylender and a quarter of customers reported difficulties meeting repayments to their moneylender, creditworthiness assessments (Central Bank , 2013).

Top-up loans: a borrower can have two active loans with a moneylender at the same time (FLAC, 2007). However, under Section 99 of the Consumer Credit Act 1995, loans or other credit must be advanced in full.In 2013, it was found that almost a quarter of customers were offered additional credit before the balance of their previous loan had been fully repaid. Again, this issue was highlighted by the Central Bank after its inspection of moneylenders in 2013 (Central Bank , 2013).

The issue received media attention in June 2015 when the Financial Services Ombudsman Bureau (Ombudsman) found that two borrowers in Donegal had been sold a number of top-up loans by a licensed moneylender. The Ombudsman found that sums had been deducted from new loans to repay earlier loans. Although the Act does not say that such loans are unenforceable and that the amounts borrowed must be written off, the Financial Services Ombudsman directed in its decision that the outstanding amounts that remained to be paid on the loans in question must be written off. It also awarded each of the complainants a further sum of €450 each in compensation (FLAC, 2015). The issue of top-up loans has persisted for decades. In 1988, 40% of alterations from original loan agreements were due to loans being topped up (Daly and Walsh, 1988).

Repeat borrowing: repeat borrowing by moneylending customers is strong, with 38% having a relationship with their moneylender for five years or more, and 47% of customers having a relationship with their moneylender for one to five years. Repeat usage is a concern in terms of how much income is being spent on high-cost credit, especially given that 14% feel trapped by their use of moneylenders (Central Bank , 2013).

There are areas of overlap between the issues faced by the Irish consumer and those expressed by high-cost short term credit users in the UK. A 2013 study of customers using short-term credit (home credit, pawnbroking and payday lending) found that the main issues associated with short-term credit were the cost of credit, affordability assessments, financial difficulty (for people using pawnbrokers and payday lenders), multiple and repeat borrowing from short-term lenders, and loan renewal (University of Bristol, 2013).

Case study: Provident Personal Credit Ltd.

Provident Personal Credit Ltd. is a wholly-owned subsidiary of Provident Financial plc (a FTSE 100 company) which, together with its subsidiaries, forms Provident Financial Group. It is reported to be the largest home credit moneylending firm in Ireland. The annual report for Provident Personal Credit Ltd. includes both its UK and Ireland activities. In 2015, profits after tax came to £61.8m. Figures for Ireland alone are not available. However, the overseas tax charge (the company is incorporated and domiciled in the UK) for 2015 was £0.7m. Based on a simplistic calculation on the assumption of a corporation tax rate of 12.5%, this suggests a taxable profit for the year in the region of £5.6m from its business in Ireland (Provident Personal Credit Annual Report, 2015).

Country	Sample loan amount	Period of loan	APR	Collection charge per €1 borrowed	Cost of loan per €100 borrowed (%)	Total cost of this loan

Ireland	€100	26 weeks	187.2%	0	€30	€30
UK	£100		535.3%	0	£56	£56
Ireland	€100	52 weeks	157.3%	0	€56	€56
UK	£100		299.3%	0	£87.20	£87.20

Table 4: Provident Personal Credit's APRs and costs of credit in Ireland and the UK (Source: Provident Ireland and Provident UK websites)

The total value of Provident Personal Credit's loan book at year end was £550.1m and the currency profile of amounts receivable from customers in Euro was £55.1 million. This suggests that about 10% of the revenue in 2015 came from its activities in Ireland. Based on the company's average loan size of £500, it can be surmised that there was approximately 110,000 loans made in Ireland in 2015. The company had 895,000 customers in both the UK and Ireland in 2015, down from 1,050,000 in 2014. The average period to maturity of the amounts receivable from customers was 6.3 months. The average effective interest rate for 2015 was 114%. The ratio of impairment to revenue was 20.7% and the revenue yield was 103.1%. The risk-adjusted margin (calculated as revenue less impairment as a percentage of average receivables) was 81.7%. Over the last three years, the company has gone through a business restructuring which has involved staff redundancies and the ongoing deployment of technology in both the UK and Ireland (Provident Personal Credit Annual Report, 2015).

3.9 Alternatives

Research by Byrne et al (2005) showed that 65% of those borrowing from a moneylender also borrow from mainstream sources. 70% of those using moneylenders also borrow from mainstream sources, including 55% who borrow from credit unions.

It is reported by the Central Bank (2013) that the majority of customers do not consider alternative financial service providers before securing their moneylender loan. Almost a third

have borrowings from another credit provider, typically a bank/building society or credit union. While 23% of customers reported being refused a credit union or bank loan, the majority believe they have the ability to access credit elsewhere. When asked where they would borrow if their current moneylender ceased operating, the majority of respondents said they would either source funding from other legal sources or would no longer require credit. 24% would seek funds from another moneylender or do not know where they would source credit.

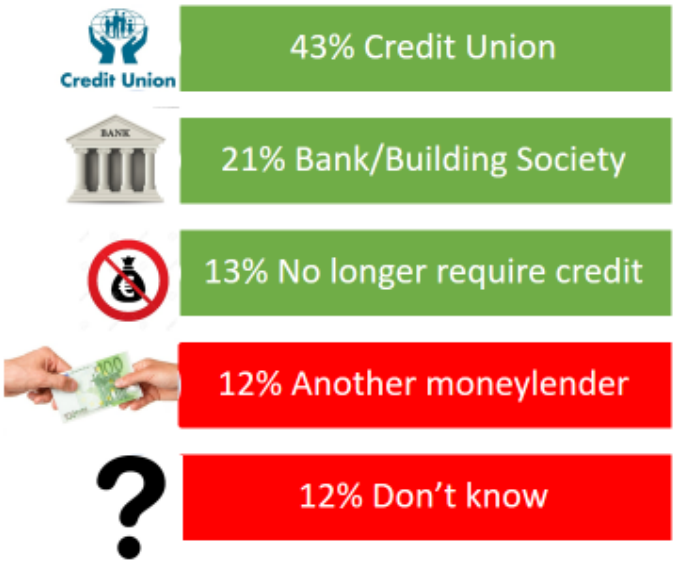


Figure 2: Response from borrowers when asked what alternatives they would use if their current moneylender ceased operating (Source: Central Bank Report on the Licensed Moneylending Industry 2013)

This suggests that more than 75% of moneylending customers believe they have an alternative to moneylenders or would no longer require credit if their moneylender ceased operating.

Credit unions in Ireland (and elsewhere) were set up to give people access to affordable credit. Credit unions can charge a maximum of 1% per month (12.67% APR) on the reducing balance of a loan to a member. Many are active in encouraging their members to consider the credit union as a much more affordable alternative to moneylending. Most notably, Tralee Credit Union Ltd. established an initiative, which they termed as 'Keeping the Wolves from the

Door' to provide information to members of the local community on the cost of a credit union loan as compared to a typical moneylending loan. This initiative was rolled out to some other credit unions, facilitated by the Irish League of Credit Unions and was particularly promoted at Christmas time.

More recently, a targeted lending initiative has been rolled out. In November 2015, Personal Micro Credit (PMC) pilot initiative was launched in 30 credit unions across the country. Branded the 'It Makes Sense Loan', its aim is to prove that credit unions can offer a loan product that matches the convenience and ease that moneylenders offer and addresses the rates of interest charged by them while remaining within prudential lending guidelines.

Specific objectives of the initiative are:

- To facilitate financial inclusion and to offer an alternative to moneylenders
- To encourage education amongst the target member segment and to move sectors of the community from financial exclusion to financial inclusion and sound money management
- To create a useable credit history for members to ultimately enable them to access normal financial services and products
- To create a path to becoming a mainstream credit union member through relationship building.

The "It makes sense" loan is offered by participating credit unions across Ireland, providing loan amounts of between €100 and €2,000 for a maximum loan period of two years. Loans can be granted within a maximum of 24 business hours from making the application. Potential borrowers must be able to demonstrate a capacity to repay (It Makes Sense Loan, 2016).

Credit provider	Loan amount	Period of loan	APR	Weekly repayments	Interest charged	Total repaid
Sample moneylender loan	€500	26 weeks	187.2% (fixed)	€25	€150	€650
Credit union "It makes sense" loan	€500	26 weeks	12.68% (variable)	€19.84	€15.84	€515.84

Table 2: Comparison of costs: sample moneylender v. "It makes sense" credit union loan

The solution involves many stakeholders who have come together under a common mission to deliver an offering that avoids individuals having to resort to moneylenders charging interest rates of in excess of 180%. These stakeholders include individual participating credit unions, the Department of Social Protection, the Citizens Information Board, the Social Finance Foundation, the Irish League of Credit Unions, the Central Bank , An Post, the Department of Finance, MABS, St. Vincent de Paul, the Credit Union Managers' Association and the Credit Union Development Association.

The Government endorsed the scheme in its Program for Government 2016 stating that, *"We specifically support the rollout and extension of the Personal Microcredit (PMC) Scheme, which is providing simple microloans to members and helping to combat the use of moneylenders."*

For social welfare recipients, the PMC solution is uniquely placed to assist in tackling the ease and convenience of moneylenders by enabling them to make a loan deduction prior to receiving their payments.

An external evaluation of the PMC pilot by Amarach Research found that 52% of pilot PMC borrowers had previously used moneylenders, while 22% had considered going to a moneylender before taking out this loan. More than 90% of borrowers rated the overall credit union service as good or very good and would like to borrow from a credit union again. The scheme received an "off the scale" Net Promoter Score of 82% (this represents the propensity to recommend to family and friends). 47% stated that the loan scheme has had an impact on how they manage money. Most importantly and most impressively, all focus group participants scored their experience as a nine out of ten (or greater) in terms of the positive impact on their lives.

Following the successful pilot, the initiative is being rolled out across the country. As at May 2017, there are 105 live credit unions representing 225 sites around the country. It is anticipated that most credit unions will sign up to the scheme over the coming 12-18 months. When this position is reached, it could be said that a sustainable and credible alternative to the licensed moneylending firms clearly exists in Ireland.

Although they share some of the same customers, credit unions and moneylending firms differ significantly in terms of their business models, typical loans and key performance indicators.

Area	Details	Typical credit union	Provident Personal Credit***
Business model	Distribution channel	Branch (311 branches in Rep. of Ireland)*	Door-to-door Online
	Source of funds	Members' savings	Parent company loan
	Focus of regulation	Prudential – security of funds	Consumer protection
	Trends	Mergers	Restructuring - staff redundancies & technology deployment
Typical loan	Amount	€3,250**	£500
	Average repayment period	1.5 - 2 years**	6 months
Key performance indicators	Average effective interest rate	Approx. 9.5%	112%

	Arrears	9.69%*	38%
	Capital	16.48%*	54%
	Return on assets	1.22%*	47%

Table 3: comparison of credit unions and moneylender Provident Personal Credit (Source: Central Bank Financial Condition of Credit Unions: 2011 – 2016 (*), ILCU Head Office Dublin (**), Provident Personal Credit Annual Report 2015 (***)

In 2016, credit unions in Ireland issued over 113,000 loans of less than €500 and more than 284,000 loans of between €500 and €2,000 in value.[8] As we've seen above from the case study of Provident, this puts credit unions in a strong position in the market segment that provides relatively small personal loans.

Byrne et al (2005) suggest that, in order to develop a viable business model in this segment, risk-based pricing needs to be applied. A number of authors (Ellison & Davies, 2008; Jones, 2013) have highlighted the difficulty for credit unions in meeting the needs of low-income and high-risk customers with the normal low rate of interest charged by credit unions and they advocate for risk-based pricing for such lending. Best practice indicates that unless this approach is taken, the service will not develop (Byrne et al (2005)).

Another potential alternative credit provider in Ireland in the near future is peer-to-peer lending platforms. Although peer-to-peer lending is currently not regulated by the Central Bank, there are already a few companies providing business lending and the first personal (consumer) lending platform is due to launch in Ireland in 2017 (Irish Times, 2016).

3.10 Cost components of credit provision

The ADB (2016) deconstructs the cost of credit into four main components: the cost of funds, operating expenses, risk premium/loan loss provisions and profit margin/mark-up. Davel

[8] Information received by email from ILCU Monitoring team on 10 April 2017

(2016) cites Schierenbeck's analysis of a credit providers' costs, shown graphically in Figure 3 below. The first component is the credit funds rate or cost of funds, calculated by using the prevailing market rates. The second component is the operating costs, which includes inputs such as personnel, marketing and administration/processing costs. The third component is the expected loss, calculated using the expected default probability and the expected recovery rate. The fourth component is the unexpected loss, i.e. losses that exceed the expected loss and which must be covered by equity reserves. The fifth and final component is the mark-up or profit of the credit provider. The market rate/cost of funds, operating cost and risk pricing elements gives a minimum credit rate percentage. The clients' credit rate percentage is the minimum credit plus the credit providers' mark-up or profit.

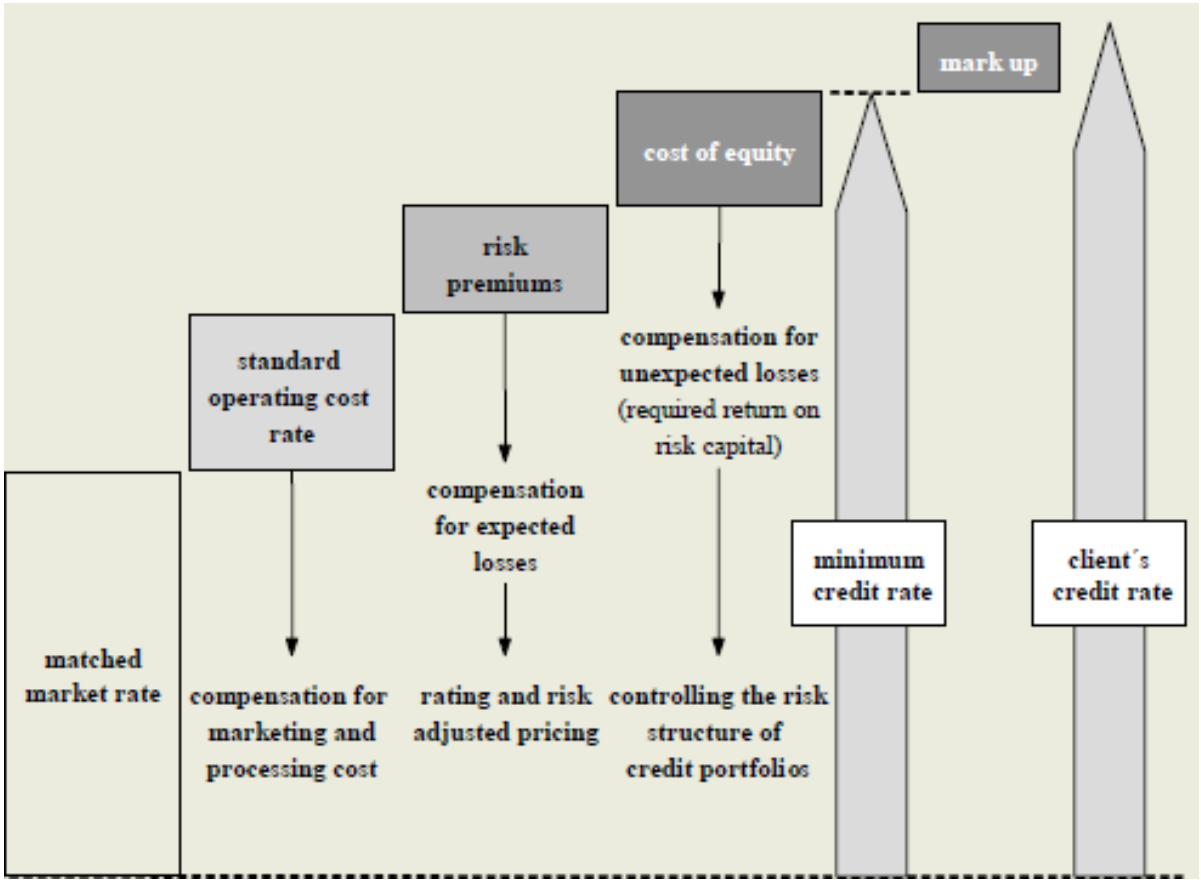


Figure 3: Cost components of credit provision – the theory of setting interest rate limits (Source: Schienrenbeck, 2003 cited by Davel, 2016)

Any consideration of interest rates to be charged needs to be congnisant of these various cost components.

3.11 Section Summary

This section has examined the current position of moneylending in Ireland. There are currently 39 licensed moneylenders in Ireland, 31 of which are deemed to be home collection credit firms. Moneylending firms operate under the Consumer Protection Code for Licensed Moneylenders 2009 and are supervised by the Central Bank . Licensed moneylenders are currently permitted to charge up to 188.45% APR excluding collection charges and up to 287.72% APR incuding collection charges. There are an estimated 330,000 moneylending customers in Ireland at present with outstanding loans of about €153 million, accounting for an estimated 1.7% of consumer credit. The average loan size is €566 over 9 months at an APR of 125%. Moneylending customers are said to value the convenience and speed of loan approval offered by moneylenders. There is evidence to suggest, however, that customers are much less satisfied with the cost of credit. Other concerns include the extent to which moneylenders conduct creditworthiness assessments, the practice relating to advancing loans or other credit in full, and repeat borrowing. Apart from mainstream banking, credit unions offer consumers a clear and affordable alternative for personal lending. The Personal Micro Credit (PMC) initative, first launched in 2015, enables credit unions to offer a loan product that matches the convenience and ease offered by moneylenders but at a much more affordable interest rate. By law, credit unions can charge a maximum of 1% per month on the reducing balance of a loan. The scheme as been endorsed in the 2016 Programme for Government as "*helping to combat the use of moneylenders*".

Section 4: High-cost credit in Europe

4.1 Development and types of high-cost credit

The level of acceptability of high-cost credit varies between EU member states, as does the range of high-cost credit options available. The UK and Ireland are reported to have the most highly developed sub-prime lending markets in the EU 15 countries (iff/ZEW, 2010).

Highly developed sub-prime market	Somewhat developed sub-prime market	Undeveloped sub-prime market
• UK • Ireland	• Spain • Netherlands • Belgium • Portugal • France • Finland	• Germany • Sweden • Denmark • Norway • Italy • Greece • Austria

Figure 4: state of development of the sub-prime lending market in EU 15 countries (Source: iff/ZEW 2010 report using DataMonitor 2007 data; data on Luxembourg not included in analysis, Norway included although not an EU 15 country)

The types of high-cost credit in use across the EU can be classified as bank credit (over-running on accounts, overdrafts and credit cards) and non-bank credit (payday loans, SMS loans, pawnbroking, auto leasing/hire purchase and home credit). Payday loans are popular in the UK, Netherlands (Flitskrediet) and Latvia. SMS loans have become popular in Latvia, Finland, Estonia, Denmark and Sweden. Pawnbroking is a popular source of credit in Finland, Romania, the UK and the Czech Republic. In 2010, experts from the UK, Poland, Portugal, Romania, Czech Republic, Hungary, Ireland, Slovakia, Latvia, Lithuania and Sweden identified problems with high-cost credit in the non-banking and specialist lending sectors. In addition, experts from the Czech Republic, Slovakia, Slovenia, Ireland, Romania, Poland and the UK highlighted the concern that high-cost lending is particularly targeted at people on low-incomes, leading to a spiral of increased indebtedness and an inability to maintain payments

for essential items such as rent and utility bills. Experts from Estonia and Slovakia reported that high-cost loans have contributed to over-indebtedness generally and not just in low-income groups (iff/ZEW, 2010).

4.2 Home credit

Home credit (also known as licensed moneylending or doorstep lending) is characterised by small-value loans usually repaid in one year or less through weekly instalments collected by an agent from a customer's home. Home credit is relatively widespread in the UK and Ireland and serves unbanked customers in Eastern European countries. The development of home credit in Eastern and Southern Europe can be summarised by examining the evolution of International Personal Finance's business expansion.

COUNTRY	YEAR OF INTERNATIONAL PERSONAL FINANCE / PROVIDENT ENTRY INTO MARKET
POLAND	1997
CZECH REPUBLIC	1997
SLOVAKIA	2001 (CEASED LENDING IN 2016)
HUNGARY	2001
ROMANIA	2006
BULGARIA	2013
LITHUANIA	2013
SPAIN	2015

Table 5: IPF in Eastern and Southern Europe (Source: International Personal Finance: The Big Picture Presentation, October 2014)

With the exception of Spain, IPF's expansion into new markets in the last 20 years has focused on countries where the percentage of people with no bank account is greater than 14%.

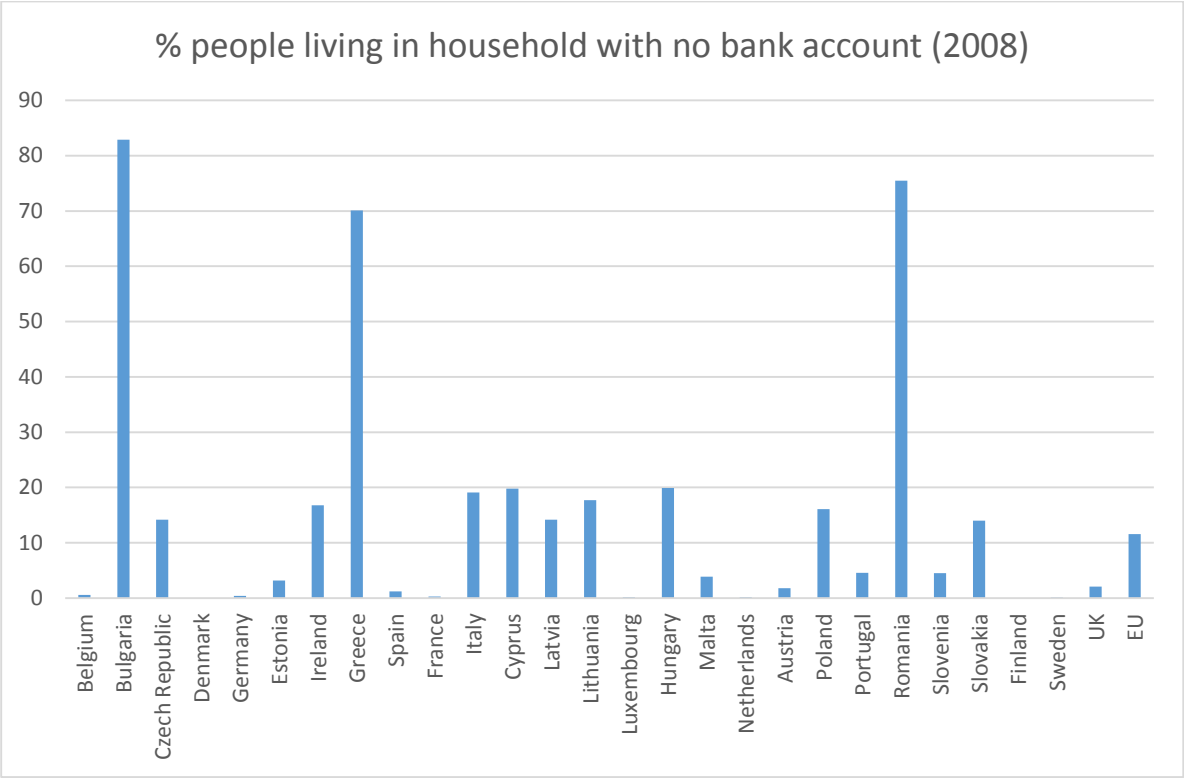


Figure 5: Percentage of people living in household with no bank account (Source: EU-SILC 2008)

Home credit in the UK

Doorstep lending is the largest high-cost credit loan market in the UK. There are 420 home credit businesses in the UK serving an estimated 1.3 million customers (about 2% of the population). Loans typically range in value from £100 to £1,000, although loans of up to £2,000 are offered. The FCA estimates the median loan size to be £500. Based on 2016 customer numbers, the four largest providers of home credit in the UK are Provident (900,000 customers), Morses Club (200,000 customers), Loans at Home (95,000 customers) and Mutual (40,000 customers). Last year, Citizens Advice helped an estimated 23,600 people with unmanageable home credit debts. A third of clients seeking debt advice had been able to take out multiple doorstep loans. A fifth of clients held two doorstep loans. Evidence shows that unmanageable home credit debts in the UK can be caused by high-pressure sales tactics, poor affordability checks and aggressive repayment collection practices. Half of doorstep lending customers are in the lowest earning fifth of adults, the majority of customers are renting and nearly 40% have a long-term illness or disability (Citizens Advice, 2017).

Home credit customers in the UK are more likely than the population as a whole to be female, to be under 35, to have young families, to fall into lower socio-economic groups, to live in a low-income household and to live in housing rented from a local council or housing association. The majority have at least one other credit option, though for some, home credit is the only available source of credit (Competition Commission, 2006).

In 2006, the Competition Commission in the UK found that price competition among home credit lenders was weak and demand was unresponsive to changes in price. The weakness of price competition was, in part, explained by customers' insensitivity to price. This appeared to stem from customers placing greater value on other product attributes and from the difficulties customers had in comparing the prices of home credit loans (Competition Commission, 2006).

Although it is the largest high-cost credit market in the UK, the home credit market is contracting. Provident has reported a 50% reduction in its number of customers over the last six years, from 1.9 million in 2010 to less than half that in 2016 (Citizens Advice, 2017).

4.3 Section Summary

The range of high-cost credit products in use across Europe varies from bank credit such as credit cards and bank overdrafts, to non-bank credit products such as home credit, payday/SMS loans and pawnbrokers. Consumer credit experts from a number of European countries have in the past raised concerns that high-cost lending can lead to a spiral of increased indebtedness, resulting in an inability to maintain payments for essential items.

Research into the home credit sector in the UK in 2006 showed that demand for doorstep credit was unresponsive to changes in price, which was deemed to be a result of customers placing greater value on product attributes other than price.

Section 5: Interest rate restrictions in the EU

Over the last decade, there has been a strong trend towards the use of interest rate restrictions as a consumer protection measure in European countries. In 2010, 14 member states in the EU 27 had some form of IRR and 13 member states had no IRR. Of the 14 countries with some form of interest rate restriction on credit, nine had 'strong' IRR in place (Belgium, France, Germany, Italy, Netherlands, Portugal, Poland, Slovakia, Slovenia) and five had 'weak' IRR in place (Estonia, Greece, Ireland, Malta and Spain) (iff/ZEW, 2010).

Today, 21 of the EU 28 member states now have some form of interest rate cap. Of these 21, 18 apply the restriction to all forms of lending. In some cases, this happened in parallel with the transposition of the EU Consumer Credit Directive into national law. In other cases, it was in response to the expansion of payday/SMS loan products into new markets or due to parliamentary pressure. The situation across EU member states is summarised in Table 6.

Table 6: Summary of IRR status in European countries

COUNTRY	IRR STATUS*	REASON FOR INTRODUCTION	NON-BANK HIGH-COST CREDIT AVAILABLE**	INTEREST RATE CEILING***	% OF PEOPLE WITH NO BANK ACCOUNT****
AUSTRIA	None	-	-	-	N/A
BELGIUM	Introduced in the 1990s	Consumer protection, to prevent excessive rates and to prevent excessive volatility of variable rates	Pawnbrokers	18.5% APR (on personal instalment loans in 2016)	0.6%
BULGARIA	Introduced in 2014	In response to people with low-incomes ending up with huge financial burdens	Moneylenders, SMS/payday loans	50.5% (in 2014) Set at maximum of x 5 (legal rate + 10%)	82.9%
CROATIA	None	-	-	-	N/A
CYPRUS	Introduced in 2011	To penalise usury and combat profiteering	-	9.42% (April 2017) Average bank lending rate plus 5-10%	19.8%
CZECH	Introduced in 2016	To strengthen the position of	Moneylenders	Cap on default fees and	14.2%

REPUBLIC		consumers and protect their rights		early repayments only	
DENMARK	None	-	SMS loans	-	0%
ESTONIA	Introduced in 2009	Consumer protection, the need to control over-indebtedness and mainly to prevent SMS loan providers from collecting unreasonably high interest rates	SMS loans	Set at x 3 average cost of consumer loan	3.2%
FINLAND	Introduced in 2013	To reduce debt related problems in households and make credit available on more reasonable terms	SMS loans	50% (April 2017) Set at bank reference rate + 50%	0%
FRANCE	Introduced in 1935, changed in 1966 and in the 1990s	1935 cap modernised in 1966 to prevent abusive practices due to the market power of banks; to prevent the development of predatory lending to households; to balance the relations between borrower and lender	-	20.27% (for loans of up to €3,000 in Q1 2017) Set at x 1.33 average rate	0.3%
GERMANY	Introduced in 19th Century, removed in 1940 – 1969 period,	A Supreme court ruling in 1981, which started with a media report in 1976 that revealed	Payday loans, pawnbrokers	Set at x 2 average rate or 12% above average	0.4%

	reintroduced in 1970 – 1989 period, changed in 2000 – 2004 period	some specialist instalment banks were selling instalment credit at (old) high prices		rate (APR)	
GREECE	Introduced in 1996	To limit the adverse impact of the liberalisation of the financial market, restrictions on default interest rates were introduced	-	Absolute rate of 6.75% per annum on non-bank credit	70.1%
HUNGARY	Introduced in 2011		Moneylenders	39.9% (Apr 2017) Set at the base rate plus 39%	19.9%
IRELAND	Introduced for credit unions in 1966, introduced for moneylending firms for the period 1933 – 1995 only	For credit unions: for the mutual benefit of members at a fair and reasonable rate of interest; for moneylenders: to avoid excessive interest being charged	Moneylenders, pawnbrokers	12.68% APR for credit unions[9]	16.8%
ITALY	Introduced in the 1990 – 1939 period, changed in the	To prohibit credit where providers can apply excessive interest rates to people with	-	Set at x 0.5 the average credit market price	19.1%

[9] The Irish credit union interest rate limit of 1% per month was inherited from the US model, which in 1913 legislated for 1% interest per month *"in an effort to quantify a 'reasonable rate of interest" (MacPherson, 1999:17).*

	1990s and the 2000 – 2004 period	poor credit histories and thus to counter usury			
LATVIA	None	-	SMS/payday loans	-	14.2%
LITHUANIA	Introduced in 2016		Moneylenders, SMS/payday loans	75% + 0.04% total credit amount; 100% max cost of credit	17.7%
LUXEMBOURG	None	-	-	-	0.2%
MALTA	Introduced in the 19th Century, changed in 1970 – 1989 period	The maximum rate of interest has always been fixed by the Civil Code (1868)	-	8%	3.9%
NETHERLANDS	Introduced in 1900 – 1939 period, changed in 2006	To control illegal financial activities, protect consumers and decrease risk-taking behaviour by credit providers	SMS/payday loans	Legal interest rate + 12% (14% in Apr 2017)	0.2%
POLAND	Introduced originally in 1900 – 1939 period, changed in 2009	To protect borrowers from excessive interest charges	Moneylenders, SMS/payday loans	Set at x 4 the Lombard rate (4 x 2.5% in Feb 2017) plus 25% loan value plus additional	16.1%

	and 2015			cap of 30% per annum; maximum total cost of credit 100% loan value	
PORTUGAL	Introduced in 1970 – 1989 period, removed in 1990s and reintroduced in 2009	Consumer protection for ethical reasons and for protection of the weakest party	Pawnbrokers	Set at x 1.25 market average for loan type or x 1.5 market average of all consumer loan types	4.6%
ROMANIA	None	-	Moneylenders	-	75.5%
SLOVAKIA	Introduced in 2005 – 2010 period, changed in 2015	Excessively high interest rates on consumer credit, which led to problems with repayment	Moneylenders	Set at x 2 average bank rate (27% in 2015)	14%
SLOVENIA	Introduced in 1970 – 1989 period, changed in 1990s	Introduced because of usurious practices by non-bank providers; adoption of the Euro also seen as a reason for revising IRR	-	Set at x 2 average APR; varies based on credit term and amount from 13.2% - 453%	4.5%
SPAIN	Introduced in 1990s	Consumer protection; abuses of financial institutions in a liberalised market,	Moneylenders	Overdraft, default charges and mortgage loans	1.2%

		ineffectiveness of supervisory bodies, violation of consumer rights			
SWEDEN	None	-	SMS/payday loans, pawnbrokers	-	0.1%
UK	Introduced in 2015	Introduced to deal with the payday loan market, to protect consumers	Moneylenders, pawnbrokers, SMS loans, log book loans	0.8% per day; 100% max total cost of credit for payday loans	2.1%

*IRR status excludes countries with restrictions on default interest rate only (Austria, Denmark, Latvia, Luxembourg, Romania and Sweden all have default interest rate restrictions, that is, interest paid on default loans).

**Table excludes high-cost bank credit such as overdrafts and credit cards (financial products which are available in most countries) and sub-prime credit cards (growing popular in the UK); also excludes hire purchase/auto leasing/point of sale.

***The interest rates presented are not intended for comparative purposes. Other costs such as fees and charges may not be included in the interest rate ceiling figures. Other non-interest costs of consumer credit such as default fees, insurance (PPI) fees, guarantee costs, collection charges, speed transfer costs, costs of reminders and direct debit fees can add significantly to the total cost of credit. Furthermore, it should be noted that direct comparisons between countries may be problematic because additional factors may be at play.

**** Data from EU-SILC 2008 study: Percentage of people living in household with no bank account.

5.1 EU countries with IRR

Belgium, France, Germany, Italy, Netherlands, Portugal, Poland, Slovakia and Slovenia have had 'strong' interest rate restrictions in place for several decades (iff/ZEW 2010).

Belgium

In Belgium, usury is regulated in the civil code and the criminal code. There are specific rules on usury in the Belgian consumer credit regulation, which states that interest is not payable by the consumer if the APR exceeds the legally determined APR. The maximum APR is calculated based on the reference rate and is analysed every three months. It varies according to the amount and type of credit (iff/ZEW, 2010). In 2016, the maximum rate for all credit agreements up to €1,250 was 18.5%. This cannot be circumvented through the introduction of guarantees or insurance charges or fees. Short term credits of up to two months with a maximum cost of €4.17 per month are excluded from the consumer credit rules. There is some evidence that illegal credit is sometimes offered on social network sites (Service Public Fédéral, 2017, Swinnen, 2017, Bovy, 2017).

France

In France, Article L.314-6 of the Consumer Code provides that a usury loan is any conventional loan granted at an aggregate effective rate exceeding more than one-third the actual average rate of interest during the previous quarter (Legifrance, 2017). The average rate of interest in the previous quarter is calculated by the Banque de France every three months and varies depending on the credit type and amount. In the first quarter of 2017, the permissable interest rate was 20.27% for loans up to €3,000 (EMN, 2016).

Germany

Interest rate restrictions in Germany are implemented indirectly through jurisprudence rather than explicit caps set by the regulatory authority.

In Germany, the Supreme Court has established a very strong presumption that interest rates that are double the relevant market rate are contrary to good morals. The maximum permissable APR is twice the market rate calculated by the Central Bank (BaFin). A further

ceiling of a maximum of 12 percentage points over average rates is also imposed (Clerc-Renaud, 2017).

Credit offered by banks dominates the credit market in Germany. There are thousands of banks in Germany, which can be grouped into private banks (e.g. Deutsche Bank), co-operative banks (Volksbanken / Raiffeisenbanken), public access banks (Sparkassen) and foreign banks. Financial exclusion is mitigated through the role of the Sparkassen banks which serve a regional and social mission. Most banks in Germany offer free bank accounts which include a free debit card and free online banking as standard. Overall, consumer lending is not as prevalent in Germany as in other EU countries, with only a quarter of households using instalment credit. Overdrafts are an important source of credit, with about a third of households using overdraft credit facilities. Issues with consumer credit in the banking sector in Germany include rolling over of loans and using payment protection insurance as an additional charge on credit. In addition, overdraft rates are quite high for all banks (Clerc-Renaud, 2017).

Some non-bank high-cost credit providers have entered the market in the last few years. In 2015, there were nine payday loan providers registered in Germany. They compete with (and offer comparable rates to) overdraft charges. A common additional charge is an express fee for same day credit delivery. Vexcash was the first payday loan provider to enter the market in 2012. With more than 330,000 customers, they provide loans of between €100 and €5,000 at an effective annual interest rate of 13.9%. Borrowers must have a German bank account and a fixed monthly income of at least €500. In addition, there is a requirement that borrowers must not be over-indebted. A €500 loan for 30 days will cost €5.79 or €44.79 if the funds are required within 24 hours (Kreditrechner, 2016, Vexcash, 2017).

Italy

Similar to France and Germany, Italy also sets an interest rate cap as a coefficient of the average credit market price. The average market price is calculated for different credit types and amounts, with lenders then limited to charging no more than 50% over the average market price. Other countries which use a coefficient of average credit market price to set the interest rate cap are Portugal (1.33 times the market average), Slovakia (2 times the market

average), Slovenia (2 times the market average) and Estonia (3 times the market average) (iff/ZEW, 2010).

The Netherlands, Portugal, Poland and Slovakia have all made further changes to their interest rate restrictions over the last decade. These are discussed in the following section.

5.2 EU countries with recent changes in IRR

UK

In 2010, the UK Office of Fair Trading (OFT) issued a report on high-cost credit in the UK. It noted that high-cost credit is demanded by people on lower-than-average levels of income and people with a poor credit history. It also noted that the high-cost credit market had low levels of competition but it did not consider price controls such as IRR as an appropriate policy measure. However, interest rate caps have since been introduced in the UK, as set out below.

When the Financial Conduct Authority (FCA) took over the regulation of consumer credit from the OFT in April 2014, it focused on products that posed the highest risks to consumer protection. At that time, there was considerable pressure from the UK Parliament to tackle the problem of payday loans. The Financial Services (Banking Reform) Act 2013 gave the FCA a duty to introduce a price cap on high-cost short term credit, to secure an appropriate degree of protection from excessive charges (CFA, 2016). The CEO of the FCA, Martin Wheatley, made the position of the organisation clear in October 2013 when he said:

> "Today I'm putting payday lenders on notice: tougher regulation is coming and I expect them all to make changes so that consumers get a fair outcome" (FCA, 2013).

In April 2014, a number of regulatory measures to protect consumers were introduced for payday loan providers. These included rules on affordability checks, limiting the number of times a loan can be rolled over to two, putting risk warnings on loan adverts and limiting to two the number of unsuccessful attempts firms can seek payment using a continuous payment authority (recurring payments from a customer's bank account).

In January 2015, the FCA's cap on high-cost short term loans (payday loans only, home credit was not included in the definition) came into effect. The cap consisted of three elements: an initial cost cap of 0.8% per day inclusive of interest and fees, a total cost cap of no more than 100% the amount borrowed, and a cap of £15 on default fees. The 0.8% per day cap served to protect all borrowers, the 100% total cost of credit cap served to mitigate debt spirals and the £15 cap on default fees protected borrowers who pay back their loans late (FCA, 2014, CFA, 2016)[10].

The impact of the price cap and the other regulatory measures on the payday loans sector has been significant, as evidenced in the following infographic from the FCA website.

[10] According to the Central Bank, "while there is no comprehansive legislative cap in place in the RoI, the maximum cost of credit permitted is 75%. This cost of credit relates to a five year personal loan offered by one licensed moneylender and is subject to review as part of the annual licence application process." (Correspondence with the authors, 2017)

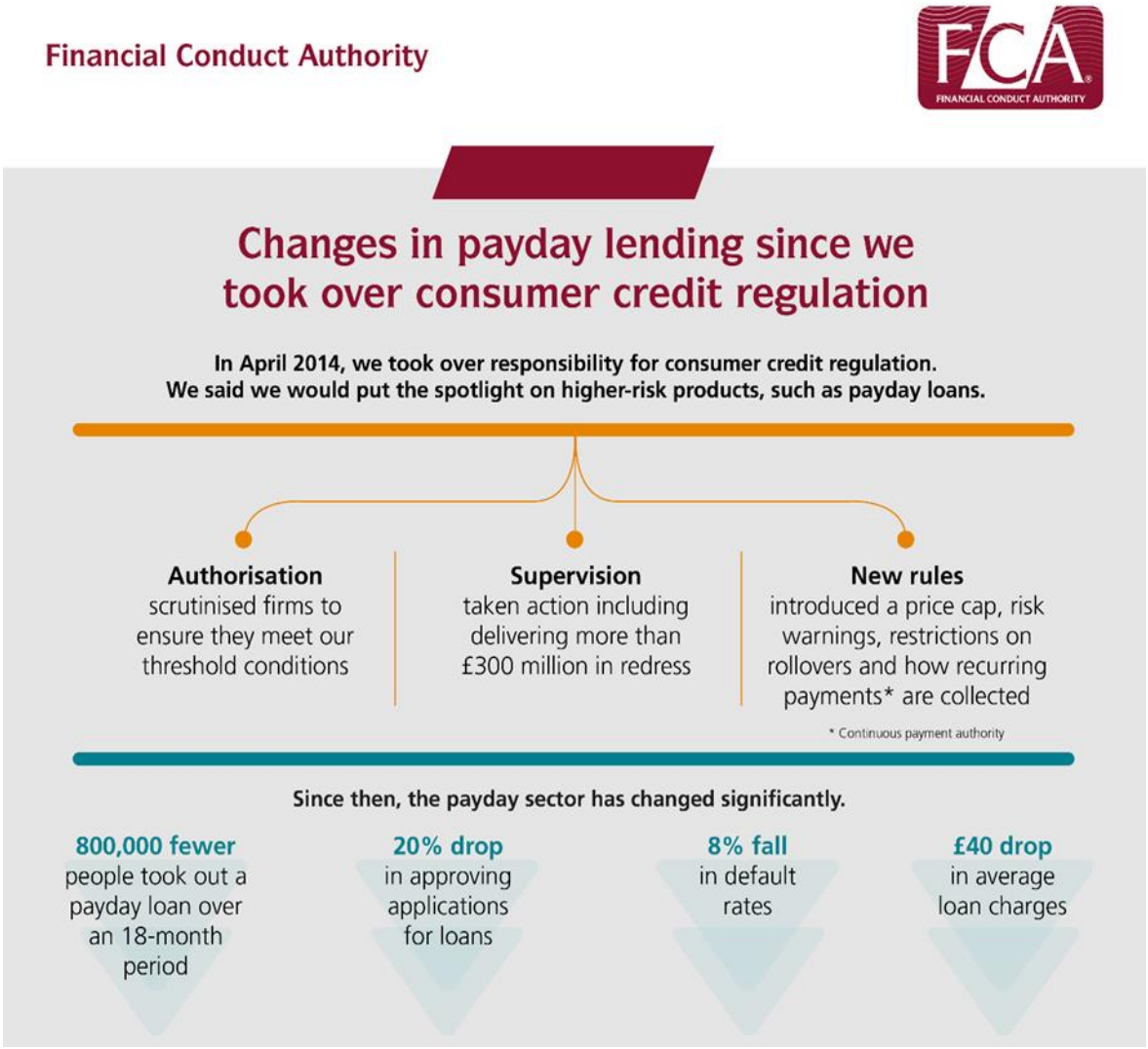


Figure 6: the impact of consumer credit regulation in the UK (Source: FCA website 2016)

According to Citizens Advice - which provides free, confidential and independent advice to people in England and Wales - the cap on payday loans in the UK has been a success. Before the cap was introduced, Citizens Advice was dealing with around 9,000 issues a quarter related to payday loans. By late 2016, this had dropped to about 4,000 issues a quarter, with a dramatic fall taking place over the first year of the price cap's introduction.

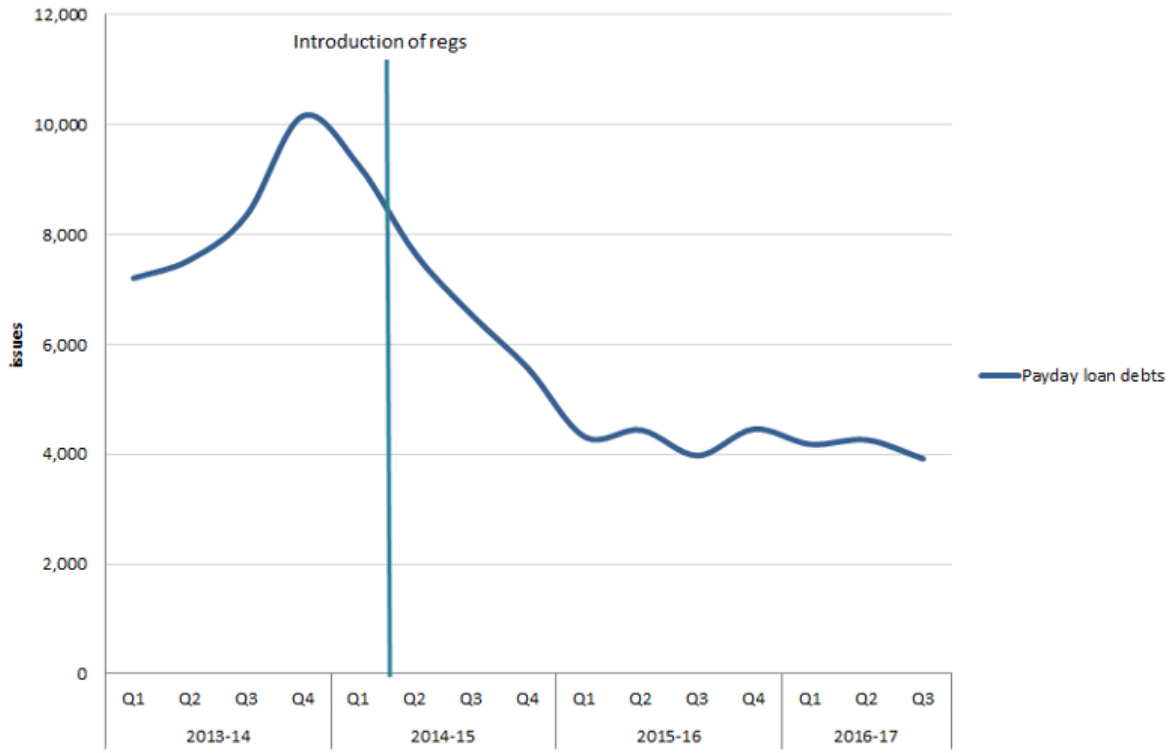


Figure 7: changes in the number of Citizens Advice clients with payday loan debt issues before and after the introduction of regulations (Source: Citizens Advice 2017)

The Consumer Finance Association (CFA, the principal trade association representing the interests of some of the best-known short-term lending businesses in the UK) acknowledges that the price cap has delivered benefits to consumers in terms of a lower cost of credit. The cost of credit has come down by around a third, default rates have approximately halved and the average amount paid in additional fees has halved since 2013. In addition, the other regulatory changes that were introduced have had a notable impact: the loan acceptance rate fell from 50% to 30%, and the number of rollovers and extensions of loans has fallen from 6 in 2013 to 4 in 2016. Firms' profitability has also fallen in terms of gross profits per loan, per customer and per amount funded, which has forced lenders to either leave the market or alter their business models (CFA, 2016).

While the CFA acknowledges the benefits the changes have brought for customers, it also argues that the regulations and price caps have resulted in reduced access to credit, with certain groups of customers – excluded due to their risk profile - no longer having access to credit, although the actual level of exclusion is difficult to quantify (CFA, 2016).

There was a concern that tighter regulation of payday lending would lead to knock on problems elsewhere. A key question is what alternatives, if any, were used by the 800,000 fewer people who took out a payday loan over an 18 month period. Alternative credit sources in the UK include sub-prime credit cards, logbook loans, guarantor loans, home credit, bank overdrafts, instalment loans, pawnbrokers, borrowing from family and friends, or illegal lenders. In a 2015 survey carried out for the CFA, when asked what they would do in the hypothetical situation of being unable to access a payday loan, more than a third of people say they would borrow from friends or family and over a quarter said they would go without daily essentials. 6% said they would resort to borrowing from an illegal moneylender.

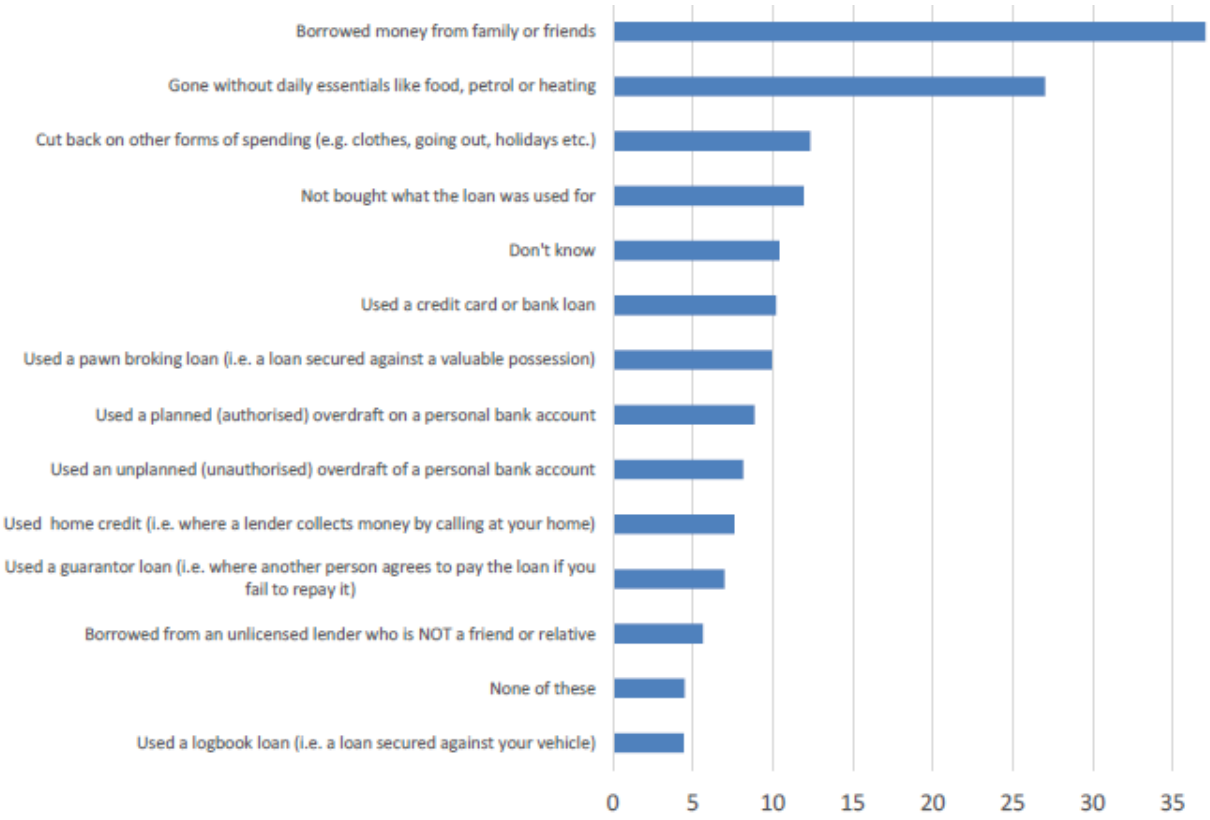


Figure 8: Percentage of consumers citing potential alternatives had a high-cost short term loan not been available (Source: CFA YouGov 2015 survey)

Citizens Advice says that the payday loan regulations has not led to a surge of problems in home credit or the hire purchase market. Of the 8% of former payday loan users who now cannot access such a loan, most have access to other forms of credit. Citizens Advice also states that the total cost cap has not led to more people going to illegal moneylenders.

Analysis of the debts held by Citizens Advice clients shows the number of loan shark debts has remained constant since the introduction of the cap (Citizens Advice, 2017).

In 2015, the FCA had committed to review the payday loan price cap in the first half of 2017 and this review is now underway, with a report due for publication later in 2017. The FCA have expanded this study to look at high-cost credit products as a whole, to enable them to consider whether policy interventions should be extended to other products. This means that home-collected credit will be included within the scope of the study (FCA, 2017).

Citzens Advice believes the limits on the cost of credit should be extended to other sectors in the UK including the home credit market, which provides loans to at least 1.3 million people in the UK. It estimates that last year it helped 23,000 people with unmanageable "doorstep debts", with a third of borrowers taking out more than one loan (Citizens Advice, 2017).

As in all countries, it is difficult to get precise figures on the scale of illegal moneylending in the UK. In 2010, it was estimated that the illegal lending market in the UK was used by 310,000 individuals, which equated to 0.5% of the population (Ellison, Dignan, Forster and Whyley, 2010).

Poland

In an email communication, the Polish Office of Protection and Competition and Consumer Protection confirmed that there are two caps on the cost of consumer credit in Poland. There is a cap on the percentage rate which is set no higher than four times the Lombard rate of the National Bank of Poland (in February 2017, this works out as 4 x 2.5% = 10%). This cap, introduced in 2005, is provided for in the Civil Code.

The second price restriction is a cap on non-interest costs of consumer credit. This is provided for in the Act on Consumer Credit and covers all costs, including costs of non-obligatory services. This second cap was introduced in March 2016 by the Amendment to the Act on Consumer Credit. It limits non-interest costs of credit to a flat level of 25% of the loan value and an additional cap of 30% per annum. The combined total of the flat 25% and the time dependent 30% p.a. may not, in any event, exceed 100% of the loan value. To prevent circumvention of the law by credit providers, the Act on Consumer Credit states that in the case where a loan is rolled over within 120 days of the first withdrawal, the total amount of

the credit (for the purpose of calculating the cap) is the total amount of the first credit, while the total cost of credit is the total cost of all credits/roll-overs granted within that period. If two loans are issued to a consumer, these are classified as two separate loans, thus they have separate total amounts of credit and separate costs which must respect the cap on non-interest costs (Polish Office of Protection and Consumer Protection, 2017).

In 2013, the Polish Financial Supervisory Authority estimated the total scale of operations of personal loan companies (which includes home credit companies, lending companies with branches/outlets and online lending companies) in Poland was in the region of PLN 3bn - PLN 4bn (approx. €696m - €928m). Unlike banks and credit unions, home credit providers in Poland are not covered by the regulations and prudential supervision of the Polish Financial Supervision Authority. However, they must adhere to the Act on Consumer Credit (PwC, 2013).

Home credit providers in Poland provide loans to individuals or businesses. Loan amounts in 2013 were reported to vary between PLN 200 – PLN 10,000 (approx. €46 - €2,300), with loans of higher amounts made available to regular customers. Loan terms are between 18 and 62 weeks. Customers can make repayments through a bank account or through home collection by an agent. Revenues are generated through loan interest, loan commission, insurance, repayment commission and other contractual costs. In the event of delays in repayments, additional sources of income are generated from charges such as penalty interest, costs of reminders (phone calls, letters, personal visits) and other contractual penalties. Home collection payments are described as an optional form of repayment and therefore incur additional collection charges, which can amount to 42% of the loan amount or 56% of the total costs of the loan (PwC, 2013).

Data provided by members of the consumer credit association, KPF, shows that both the value and number of loans provided by KPF members increased steadily from 2009 to 2013. The number of loans increased from just under 1 million in 2009 to over 1.2 million in 2013, with the value of loans over the same period growing from an average of PLN 1,500 (approx. €350) in 2009 to more than PLN 2,000 (approx. €460) in 2013 (PwC, 2013).

While most households borrowed to pay for home repairs regardless of the source of funds (whether personal loan companies, banks or credit unions), 39% of households with debts to a

personal loan company reportedly used the loan to cover current spending needs (versus 15% for other institutions) and 31% of households used the loans to repay other debts (compared to 7% of loans from other institutions). Data also showed that households indebted to personal loan companies assign a larger portion of their net monthly income to repay their debt than the households with debts to other institutions (PwC, 2013).

The Act on Consumer Credit places a number of obligations on credit providers. Before granting a loan, a credit provider should: conduct a customer credit risk assessment; explain the terms and conditions of the loan agreement to the consumer; inform the customer of the loan interest rate and the charges included in the total cost of the loan, the total loan amount, the APR value, and, when applicable, the total amount payable by the consumer, the repayment amounts and the duration of the loan agreement. Advertising used by the personal loan company may not suggest that no credit assessment is required and the consumer has a right to withdraw from a credit or loan agreement within 14 days, without having to state the reasons for the withdrawal (PwC, 2013).

Ordinarily, consumer credit legislation falls within the remit of the Ministry of Finance. However in December 2016, the Polish Ministry of Justice published a draft bill which, amongst other details, proposed to further reduce the existing cap on non-interest charges on consumer loans that became effective in March 2016. Under the Ministry of Justice proposal, the flat level cap would be reduced from 25% to 10% of the loan value and the additional cap per annum would be reduced from 30% to 10%. The combined total of the flat 10% and the time dependent 10% p.a. would not be able to exceed 75% of the loan value (IPF Annual Report, 2016).

The introduction of the new total cost of credit legislation in Poland was one of the main reasons cited for a £28.7m reduction in IPF's profit before tax for 2016. It is likely that this is what led IPF to review customer profitability in late 2016, the result of which was a decision to cease lending to certain higher risk segments of customers in Poland (IPF Annual Report, 2016).

Netherlands

In 2006, the maximum interest rate for consumer credit in the Netherlands was set at the legal interest plus 12%. However, for a number of years, loans with a duration of less than three months were not covered by this restriction. One such product was Flitskrediet (Flash Credit). Introduced to the Netherlands in 2007, Flitskrediet are short-term (less than three months) loans from which a new customer can receive credit in less than 24 hours (i.e. payday loans).

In June 2011, the rules for consumer credit changed. The Act on Financial Supervision was amended due to the implementation of the Consumer Credit Directive. The amendment meant that the interest rate restriction (16% a year in 2011) now also applied to loans of less than three months' duration (AFM, 2011). Some payday lenders attempted to circumvent the legislation by claiming that a charge for credit provided within 24 hours rather than five business days was outside the scope of the total cost of credit, claiming the 'speed transfer' was an ancillary service (IFLR, 2012). Other changes included rules on advertising, a mandatory credit check, loan-to-income norms and a requirement that all payday providers must have a licence to operate from the AFM. Currently, the interest rate restriction is 14% a year.

Since 2014, there is also a cap on the costs a pawnbroker can charge, which was 4.5% per month in July 2015. People who cannot access credit may apply to municipal credit institutions such as the association for debt and social banking (NVVK) who provide social consumer loans, or to social welfare. However, some borrowers resort to borrowing online from firms that are based in other EU countries (Warnnar, 2017).

From 2011 to 2014, The Dutch financial services authority AFM investigated 21 payday loan companies, 15 of which subsequently left the market. The AFM says its research shows the number of payday loans issued in the Netherlands has dropped from tens of thousands in 2011 to about 1,500 in 2014. Today, almost all providers of small loans with interest rates above 100% have left the market (Dutch News, 2014, Ministry of Finance, 2017). In February 2017, the Netherlands Authority for the Financial Markets (AFM) announced a consultation for a ban on the advertising of harmful financial products, which includes payday loans (AFM, 2017).

Door-to-door lending has not been in practice in the Netherlands for at least 40 years, With the mass introduction of banking accounts in the 1960's and 1970's, credit was transferred into bank accounts, not given in cash (Warnnar, 2017).

Portugal

Since January 2010, Portugal has had an interest rate cap framework in place applicable to consumer credit agreements. The framework was introduced in parallel with the transposition of the EU Consumer Credit Directive into national law. The main objective of the introduction of the interest rate cap was to enhance the access to a diversified array of unsecured credit products by the consumer, coupled with adequate consumer protection rules. Before June 2013, interest rate caps were defined for different types of consumer credit as the average value of the APR of the agreements concluded in the previous quarter (calculated by Banco de Portugal) increased by one third. In July 2013, the framework was changed to avoid significant increases in the maximum APR of specific types of consumer credit, in particular, revolving credit. The maximum APR for each type of consumer credit agreement in each quarter was redefined as the average value of the APR of the agreements concluded in the previous quarter, plus 25%. In addition, the maximum APR for each type of consumer credit agreement cannot be higher than the average APR of all consumer credit agreements (irrespective of the type) concluded in the previous quarter, plus 50%. Banco de Portugal asserts that the interest rate caps framework has been globally positive, having enhanced the creditworthiness assessment of the consumer and enabled a better comparison among credit (FinCoNet, 2015).

Finland

Payday loans which can be applied for via the internet or text message (SMS loans) first entered the market in Finland in 2005. Since then, legislation has become progressively tighter on the sector. In 2013, an amendment to the Finnish Consumer Protection Act imposed an interest rate cap on certain types of consumer credit. The objective was to make credit available to consumers under more reasonable terms and to reduce the debt-related problems of households. It imposed an interest rate ceiling on cash credit under €2,000, whereby the maximum actual annual interest rate could not exceed the reference interest rate by more than 50%. In 2015, this equated to an interest rate ceiling of 50.5% (Hentunen, 2015).

In 2012, 1.2 million payday loans were granted in Finland, which at the time had a population of 5.4 million people. The average loan amount was slightly more than €200 and the payback period was 30 days. Since the law entered into force, the number of small loans granted to households has declined, the average amount of money borrowed by means of small loans fell and the number of credit providers declined. In the first quarter of 2014, the amount of new small loans issued dropped by 54% compared with the previous quarter. The total value of small loans dropped to €6 million in the January to March period, a decrease of 71% on the previous year. In 2015, 470,000 payday loans were granted, with an average loan amount of €500 and a payback period of around 140 days (Panztar, 2017, Statistics Finland, 2014).

The number of credit providers has decreased since the introduction of the interest rate restriction, with smaller companies leaving the market. Before the 2013 legislation, there was 87 non-bank credit providers in Finland; this has now dropped to 55 companies (Panztar, 2017).

However, an unintended consequence of the legislation was that credit providers switched their product type and started granting loans greater than €2,000 with annual interest rates in excess of 100% or higher. Credit providers also started looking at providing new product types, such as a Mastercard prepaid card for which the interest rate cap regulation does not apply. It is also reported that some credit providers are circumventing the interest rate cap regulation by requiring a guarantee (which involves a fee) to access credit (Finnish Consumer Ombudsman, 2014).

Attempts made to circumvent the interest rate restrictions led to the Supreme Court issuing a ruling in 2016 that an effective interest rate of 118% per annum was unconscionable. It referred to the 50% ceiling on loans below €2,000 and stated that rates exceeding the limit are suspect, but the ruling did not articulate a ceiling rate for the limits (Viljanen, 2017).

An assessment of the 2013 amendments to the Consumer Protection Act (of which one of the most significant changes was the interest rate cap on instant loans) concludes that, while the amendments seem to have reduced the number of debt problems in all age groups, it has at the same time increased the size of the average debt per debtor. The results also suggest that while the tightened lending conditions have meant that young adults in particular can no longer obtain an instant loan as easily as before, debt problems related to instant loans may

have moved to older age groups (University of Helsinki, 2016). Another impact of the legislation has been a reduction in the number of district court decisions on default cases (Panztar, 2017).

There are currently proposals to amend the legislation so that the interest rate ceiling also applies to credit amounts greater than €2,000. In addition, it is proposed that new legislation address some loopholes in relation to long-term credit. The Consumer Ombudsman is also investigating whether larger credit sums should be subjected to a lower interest rate, as well as assessing the ability of social credit to address some of the credit needs of consumers. It is also keen to include powers to impose penalties and sanctions to act as deterrants to breaches of legislation (Makkonen, 2016).

Slovakia

In January 2015, Národná Banka Slovenska (NBS, the National Bank of Slovakia) formally took over responsibility for consumer protection in the Slovak financial market, making 2015 the first year of supervision in the area of financial consumer protection. The range of supervisory tools and powers available to the NBS were extended through an amendment to the Financial Market Supervision Act (NBS Annual Report, 2016). Non-bank credit providers are obliged to register with the NBS and must fulfil a number of conditions in order to secure their licence. Before the NBS took over the register of creditors, there were 279 non-bank lenders in Slovakia. Currently, this now stands at 34, which includes hire purchase and auto-leasing companies as well as home credit providers (Národná banka Slovenska, 2017). Creditors must also check at least one electronic register of consumer loans data before issuing a loan in order to assess ability to repay. If credit providers are found to be in breach of the legislation, penalties include a fine of up to €140,000 or having their licence revoked.

In 2014, an interest rate ceiling of twice the average APR was introduced for consumer credit from banks. In 2015, a vote in the Slovak Parliament to change consumer legislation was passed, legislating for a cap of twice the average rate of bank loans (27% in 2015) on remuneration to all costs (mandatory and non-mandatory) associated with consumer loans. The 2015 interest rate cap had a dramatic impact on International Personal Finance, a

company that created out of Provident in 2007. In the 12 months to June 2015, its Slovak business had generated £43 million in revenue and pretax profit of £6 million. However, as a result of the cap, it closed its Slovakian business in 2016 (The Guardian, 2015, Investors Chronicle, 2016).

NBS (2017) reports that subsequent to the 2015 cap, credit providers attempted to introduce new charges that could circumvent the legislation, which resulted in misleading consumers and unfair practices.

There were concerns that the tightened restrictions would push people with low or irregular incomes without bank accounts to illegal moneylenders. However, a study led by the Institute of Savings and Investment in 2015 found that the main source to which consumers switched for credit was the banking sector (Šebo, 2017). While there is no specific data available on other alternatives, it is likely that unregulated lending such as peer-to-peer lending and lending from friends and family has also grown.

Czech Republic

In 2016, The Czech Republic signed a new Consumer Credit Act into law. This Act sets a cap on charges for early loan repayment and a cap on charges for non-performing loans. The new legislation also requires non-bank credit providers to obtain a licence from the Czech National Bank (CNB), with the CNB maintaining a publicly accessible register of non-bank credit providers (Euromonitor International, 2016). The new licensing regulations also stipulates that agents must have either a secondary education or at least three years' of financial service experience and there must be a clear separation of duties between sales and credit decisioning teams. Modifications to proof of income processes were also introduced (IPF Annual Report, 2016).

Lithuania

In 2011, the maximum permissable APRC in Lithuania was reduced from 250% to 200% (Bublienė, 2013). In 2016, this was reduced further with the introduction of new legislation, which states that the overall cost of consumer credit is considered to be unreasonable if at any time the percentage rate exceeds 75% and all other fees and charges (other than interest)

exceed 0.04% of the total amount of the consumer credit; or the overall total cost of consumer credit (including all fees and charges) exceeds the overall amount of the consumer credit. Other consumer protection measures introduced include a limit on default interest charges, a requirement on lenders to inspect databases and available registers to assess creditworthiness and a reassessment of creditworthiness if there is a significant increase in the amount of credit being requested by an existing customer (Sorainen, 2015).

Estonia

In 2009, the Estonian Parliament passed a legislative amendment setting forth a rule that usurious credit contracts can be considered to be against good morals and thus void. In the case of consumer-credit contracts, it is assumed that an agreement is contrary to good morals if the APRC payable by the consumer is more than three times the average Estonian Central Bank rate (Sein, 2013). However, the legislation has not been effective in limiting the costs of consumer credit loans in Estonia.

In 2014, the Estonian government approved a bill that set an upper limit to the credit cost of consumer loans. The bill was passed into law in July 2015 and was part of a package of legislative acts targeted at solving problems in the speed lending market. According to the new regulations, a contract that exceeds the triple credit cost rate of Bank of Estonia would be automatically null and void. Currently, the APRC is 18.95% which means that credit agreements with an APRC in excess of 56.85% are null and void (The Baltic Course, 2014, Sein, 2017).

In 2014, it was estimated that 123 firms were operating in the high-cost credit market in Estonia, accounting for 25% of the consumer credit market. From March 2015, all credit providers were required to obtain a licence in order to legally operate. In June 2016, only 39 companies were authorised to operate as credit providers. The supervision of non-bank credit providers used to be the sole responsibility of the Consumer Protection Authority but since April 2015, the responsibility is now shared by the Consumer Protection Authority and the Financial Supervision Authority. The latter may impose fines of up to €32,000 or may revoke the license of credit providers that are found to be in breach of the legislation (Sein, 2017).

Cyprus

The right to engage in moneylending is not restricted to licensed financial institutions in Cyprus. Therefore, any person or company can engage in moneylending.. The Moneylenders Law 1962 requires moneylenders to register but this legislation has never been enforced. Therefore, the number of moneylenders operating in the country is unknown. In 2011, new legislation applicable to non-financial institutions was introduced through an amendment to the Criminal Code. The legislation included a restriction on the interest rate calculated using a formula based on half the average bank lending rate of the previous year plus a margin of between five and 10 percentage points, depending on various risk factors. In December 2011, the interest rate ceiling was 12.57% and this has since dropped to 9.42%. The cap includes interest received or charged on granting of loans, extension of repayment, pre-payment and renewal (Harneys, 2011, Markou, 2017).

Hungary

In Hungary, high-cost consumer loans and credit card loans are capped at 39 percentage points over the Hungarian National Bank base rate (International Law Office, 2011). In 2015, loan repayments were capped at no more than 50% of a person's income (The Telegraph, 2015).

Bulgaria

Interest rate cap were introduced in Bulgaria in 2014 through its Consumer Loans Act. The amended law sets the ceiling on annual interest rates at 10% above the legal rate set by the Cabinet for overdue payments, multiplied by five. This means that in 2014, the cap was about 50.5%, given that the Government rate for overdue payments is 0.1 % [(0.1 +10) x5]. The cap is targeted at non-banking lending institutions offering quick loans of about €500 usually repaid over one year (The Sofia Globe, 2014).

5.3 EU countries considering IRR

Denmark and Sweden do not have IRR in place. However, there has been discussions on the issue in both countries in recent years.

In 2009 and 2010, the debate on interest rate ceilings came to the fore in Denmark, due to the emergence of SMS loans, offering quick loans via mobile phones with APRs in excess of 2,000%. A bill was proposed to introduce an interest rate cap set at the Central Bank base rate plus 15%. The Danish Consumer Council was in favour of introducing a restriction (iff/ZEW, 2010). However, in March 2011, the Danish Financial Supervisory Authority said it did not consider direct interest rate restrictions an appropriate way to regulate the market for borrowing (Danish Financial Supervisory Authority, 2011).

In 2006, SMS loans were introduced in Sweden in 2006 and proved popular with the youth population. Although there has been legislative changes on consumer credit in Sweden in recent years (Consumer Credit Act 2010 and the Certain Consumer Credit-related Operations Act 2014) these did not include the introduction of any interest rate caps (FI, 2016). The provisions that entered into force in 2014 gave the Swedish Consumer Agency powers to impose sanctions on firms that do not properly conduct creditworthiness assessments. Before the 2014 legislative changes, payday loan providers were only required to register with the authorities. Now, all credit providers have to be authorised by the Swedish Financial Supervisory Authority. Currently, there are 42 consumer credit companies with permits to operate in Sweden (Swedish Ministry of Finance, 2017)

In 2015, a public inquiry was launched in Sweden to investigate the high-cost consumer credit market. The report was published in 2016 and proposed that an interest rate restriction should be introduced for high-cost credit. The proposed restrictions were: a) maximum APR set at the national benchmark interest rate (currently -0.5%) plus 30%; b) the interest rate or the default rate not to exceed the national benchmark rate plus 40%; c) a cap on the total cost of credit of 100% the amount of credit. The proposals are currently being analysed by the Government (Swedish Ministry of Finance, 2017). Some sources expect that interest rate caps, total loan amount caps, and restrictions on marketing and loan extensions will be introduced in 2018 (Euromonitor, 2016).

5.4 EU countries with no IRR

As well as Denmark and Sweden, other European countries that have not introduced interest rate ceilings are Austria, Croatia, Latvia, Luxembourg, Romania and Ireland.

The payday loan industry has been growing in Spain in recent years, with loans of between €50 and €500 offered for 30 days. In 2016, a 30 day loan of €300 the 30 day cost between €84 and €111, representing interest rates between 28% and 37% (AEMIP, 2016). While there are interest rate restrictions on overdrafts, default charges and mortgage loans in Spain, there are no limits set by the Regulator on high-cost credit providers, though the issue has come up in the courts. In 2015, there was a ruling in the Supreme Court that an interest rate of 24% was excessive and thus in breach of the 1908 legislation on usury, but it would seem that this is often exceeded in practice (Herrero, 2017).

5.5 Section Summary

There has been a growing trend in recent years towards the use of interest rate restrictions as a consumer protection tool in European countries. Today, 21 of the EU 28 member states now have some form of interest rate cap on credit. In some cases, this is directed at bank lending, such as instalment loans, overdrafts or credit cards. In other cases, it is directed at non-bank lending such as payday/SMS loans or home credit. The latter accounts for much of the recent increase in IRR as a policy tool in EU member states. Other catalysts have been the transposition of the EU Consumer Credit Directive into national law, as well as public and parliamentary concerns about the detrimental impacts of specific products on consumer welfare. Countries such as Belgium, France, Germany, Italy, Netherlands, Portugal, Poland, Slovakia and Slovenia have had strong interest rate restrictions in place for several decades. Some of these countries (Netherlands, Poland and Slovakia) have tightened their legislation in recent years, either in response to the expansion of payday/SMS loans and home credit, or to curb attempts to circumvent existing legislation. A number of Eastern European and Scandinavian countries, along with the UK, have also changed their policies on interest rate restrictions over the last ten years.

The UK introduced a number of regulatory measures in 2015 to the payday loan market, including a price cap consisting of interest rate %, a total cost of credit cap and a cap on

default fees. The cap has reduced the cost of payday loan credit by around a third. There were concerns that the regulations would lead to an increase in illegal lending. The trade association CFA's 2015 survey showed that only 6% of people said they would resort to borrowing from an illegal moneylender if they were unable to access a payday loan. An analysis of debts held by Citizens Advice clients shows that the number of loan shark debts has remained constant since the introduction of the cap. Citizens Advice say the cap has not led to more people going to illegal moneylenders. This is similar to the findings from a study in Slovakia. In 2015, Slovakia passed legislation for a cap on all mandatory and non-mandatory costs associated with consumer loans. This led to the home credit provider IPF (a spin-off from Provident) exiting the market. There were concerns that the restrictions would push people with low or irregular incomes without bank accounts to illegal moneylenders. However, a 2015 study found that the main source to which consumers switched for credit was the banking sector. The FCA is currently reviewing the entire high-cost credit market, to consider whether policy interventions should be extended to other products including home credit. Its report will be published later in 2017.

Attempts to circumvent legislation by introducing new fees and charges or altering the product is a common reaction by credit providers to interest rate legislation, as evidenced in Poland (e.g. cost of reminders such as phone calls, letters, home visits), Netherlands and Germany ('speed transfer' fees) and Finland (providing new product types for which the cap does not apply). This highlights the importance of an interest rate restriction being part of a comprehensive cap (i.e. interest rate restriction plus a cap on the total cost of credit, or an interest rate restriction plus a cap on non-interest fees and charges) to avoid the need to introduce additional legislation.

Section 6: Interest rate restrictions in non-EU developed countries[11]

6.1 Japan

In 1954, Japan introduced two laws relating to interest rates. The first was a Capital Subscription Law which stated that any charging of interest rates in excess of 109.5% was a

[11] A brief examination of IRR in developing countries is contained in Appendix 3.

criminal act with possible sanctions of imprisonment and fines. The second was the Interest Rate Restrictions Law (IRRL) which set an interest rate limit for moneylenders of 20% for loans less than 100,000 Yen (approx. €820 using today's interest rates); 18% for loans in the range of 100,000 – 1,000,000 Yen (€820 - €8,200) and 15% for loans in excess of 1,000,000 Yen (Gibbons, 2012).

In 1983, the Moneylending Control Law was introduced. This law led to a series of incremental reductions in the interest rate cap imposed by the Capital Subscription Law, from the 109.5% level (set in 1954) to 73% (1973), to 54.75% (1986) to 40% (1991) with a further reduction to 29.2% (2000). However, these interest rate reductions failed to deter the moneylender boom. Between 1991 and 2006, the number of people in debt in Japan doubled to 14 million and the number of bankruptcies increased sixteen fold in the 1990 – 2005 period. It is reported that almost 8,000 people committed suicide for economic reasons in 2005 (Gibbons, 2012).

In 2006, the Financial Services Agency reviewed the Moneylending Control Law and made a number of recommendations to curb the moneylending crisis in the country. The Moneylenders Law of 2006 introduced a number of measures to tighten regulation. These measures included an increase in the maximum sentence for loan sharking; changes to debt collection rules; qualification examinations for moneylending managers; increased asset requirements for moneylending companies; the establishment of designated credit bureaus; a limit on lending to one third of the borrower's gross annual income and a further reduction in the interest rate cap from 29.2% to 20%. Moneylenders were also required to keep track of borrower income on an annual basis and seek relevant tax documentation for loans in excess of 500,000 Yen/€4,100 (Gibbons, 2012).

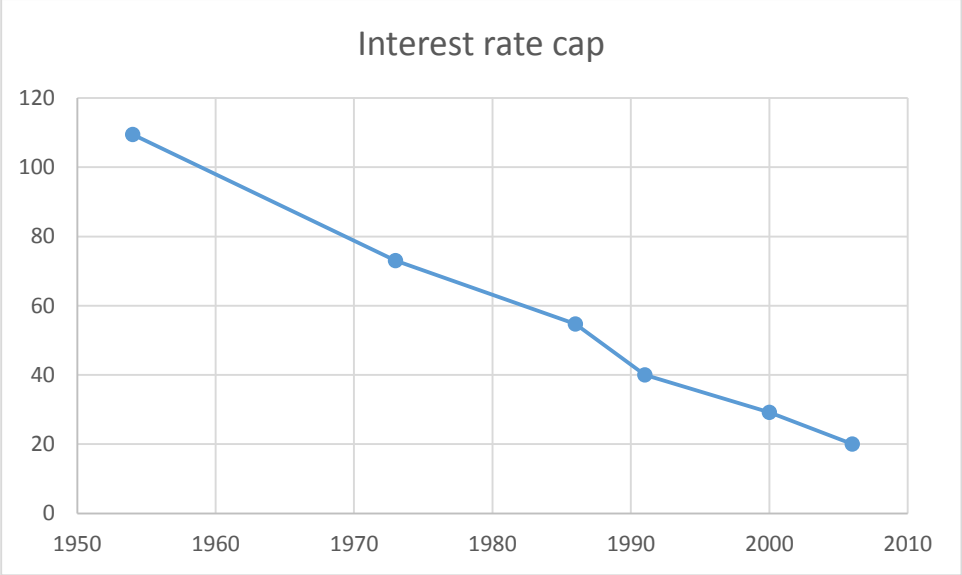


Figure 9: changes in interest rate cap in Japan from 1954 - 2006

Kozuka & Nottage (2007) attribute the moneylending boom in Japan to four main factors. On the demand side, the economic slowdown was a significant factor. On the supply side, three key factors were technological advances that made access to credit easier (including un-staffed loan dispenser booths from 1993 onwards), expansion of advertising operations and the development of a high level of rollover and repeat lending.

The Japanese Supreme Court also played an important role in the decline of moneylending in Japan when, in 2006, it ruled that interest rates in excess of 20% were 'excessive' and that moneylending companies were liable to repay to borrowers interest charged in excess of the 20% stipulated in the IRRL. This resulted in litigation by borrowers organised by the Japanese Federation of Bar Associations (Gibbons, 2012, Financial Times, 2014).

Between 2007 and 2011, the number of people borrowing from moneylenders reduced from 11.7 million to approximately 8 million. The outstanding balances on consumer finance companies (11.7 trillion Yen in 2006) reduced to 3.6 trillion Yen by March 2011. In addition, it is likely that the Moneylending law contributed to the reduction in the number of moneylending firms.

Description	2006/2007	2011
No. of borrowers	11.7 million	8 million
Outstanding balances on consumer finance	11.7 trillion Yen	3.6 trillion Yen
No. of debtors with at least five unsecured loans	2.3 million	440,000
No. of bankruptcies	150,000	100,000

Table 7: Summary of the changes in the moneylending sector in Japan

With regard to the question of where the borrowers have gone, data from the Statistics Bureau show no signifcant increase in the amounts lent by domestic banks or Shinkin (regional co-operative banks similar to credit unions) for non-mortgage lending. Gibbons (2012) concludes that restricting the level of borrowing from moneylenders has not led to increased borrowing from other sources but has shifted borrower behaviour to reducing their use of credit.

An argument against imposing interest rate restrictions on legal moneylending is that in doing so, borrowers will switch to using illegal moneylenders. However, Gibbons (2012) argues that the evidence from Japan shows that illegal moneylending grew alongside the expansion of legal moneylending. In April 2012, the Minister for Financial Services Mr. Shozaburo Jimi confirmed that the official position of the Japanese government is that the 2006 Moneylending Law (which includes an IRR of 20%) has been successful in reducing illegal lending (Gibbons, 2012).

In 2014, it was reported that the Japanese Government was considering an easing of the consumer credit laws, with the Liberal Democratic party confirming that a working group had been assembled to discuss reforms to consumer finance laws (Financial Times, 2014).

6.2 Australia

Enhancements to the Australian National Consumer Credit Protection Act 2009 were enacted by the Consumer Credit Legislation Amendment (Enhancements) Act 2012. The 2012 enhancements included specific provisions for small amount credit contracts (SACC) and consumer leases. SACC loans are basically payday loans of up to Aus$2,000 (about €1,400) with a contract term of between 16 days and 12 months (Australian Government the Treasury, 2016). In 2015, a survey conducted by the Australian Securities and Investment Commission (Australia's consumer credit regulator) found that the payday lending industry provided over $831 million in credit in the 2014–15 financial year with almost 1.5 million loans issued (ASIC 2015). The short term lending market in Australia is predicted to be worth AUS$2bn by 2018. In 2015, repeat borrowers made up 38% of payday loan recipients (The Guardian, 2017).

Restrictions on fees and charges for SACCs included in the 2012 legislation are as follows:

- A maximum permitted establishment fee of 20% of the adjusted credit amount
- A maximum monthly fee of 4% of the adjusted credit amount (i.e. charged on the initial amount, not on a diminishing balance)
- A maximum amount recovered of twice the adjusted credit amount for payments in default
- A government fee, charge or duty payable

In addition, enforcement expenses (the costs of the credit provider going to court to recover the money owed to them) can also be charged by lenders.

The 2012 enactments also called for a review of SACCs to be undertaken as soon as practicable after 1 July 2015. This review was carried out and a final report issued in March 2016. The terms of reference for the review outlined a number of specific issues to be taken into account: competition, fairness, innovation, efficiency, access to finance, regulatory compliance costs, consumer protection and appropriateness of the legislation to the current economic climate (Australian Government the Treasury, 2016).

The review came up with a number of recommendations for SACCs, several of which related to clarifications on fees and charges. It recommended that direct debit fees should be incorporated into the existing fee cap; a credit contract must have equal repayments over the life of the loan (to avoid consumers having to pay a higher cost through an artificial lengthening of the contract term); the monthly fee cannot be charged after early repayment of a loan; default fees charged must reflect actual costs and should not exceed $10 per week; and providers should not be permitted to set up arrangements with subsidiaries or third parties under which consumers would incur fees or charges that exceed those set out in the legislation. Other recommendations related to affordability, namely reducing the cap on the total amount of SACC repayments from 20% of a consumer's gross income to 10% of a consumer's net income. The report also recommends that the obligation for SACC providers to obtain and consider 90 days for bank statements be retained (Australian Government the Treasury, 2016).

The report acknowledged that SACCs can be a useful source of funding in emergency situations whereby the benefits of having access to this credit source justifies the relatively high-costs, provided the consumer can afford them. However, it noted that repeat borrowing can put consumers on the path of financial exclusion when the repayments consume a greater portion of their income (Australian Government the Treasury, 2016).

There is now pressure on the government from consumer advocates to act on the recommendations in the 2015 review and a spokesperson for the Minister for Revenue and Financial Services said new legislation would be introduced later in 2017 (The Guardian, 2017).

6.3 Canada

The payday loan industry first emerged in Canada in the mid-1990s. Since then, it has grown rapidly. There are now almost 2 million people using payday loan providers annually and there are an estimated 1,400 retail outlets across the country (Canadian Consumer Finance Association, 2017).

Up until 2006, payday loans in Canada were limited by federal usury laws from charging annual interest in excess of 60%. In 2007, an Act to amend the Criminal Code was passed. This amendment to the Criminal Code (criminal interest rate) delegated responsibility to the provinces for protecting recipients of payday loans and limiting the total cost of credit. The amendment also defined a payday loan as a loan of $1,500 or less with a loan term of 62 days or less. Since 2007, six provinces have introduced legislation and two other provinces have signalled that they intend to pass legislation. Quebec limits the annual rate of interest for all lenders to 35% and legal payday lenders have never established themselves in the province. Newfoundland retained the 60% interest rate ceiling in the Federal Criminal Code (Packman, 2014, Consumers Council of Canada, 2015).

In 2016, the province of Ontario dropped its total cost of borrowing from $21 per $100 borrowed to $18 per $100 borrowed. In addition, legislators in Alberta dropped the total cost of borrowing to $15 for every $100 borrowed for a two-week loan, making it the lowest in Canada and one of the lowest in the world. Similar low rates can be found in British Columbia, where a $17 cost cap for a $100 two-week loan is in place (Barry, 2017).

In February 2017, a study by an Ontario insolvency firm revealed that a record one in four people who file for insolvency in Ontario use payday loans (Newswire, 2017).

6.4 United States of America

Although there are general federal laws such as the Truth in Lending Act which apply to consumer lending, there has been no federal law regulating interest rates on consumer loans in the US. Restrictions on interest rates on consumer credit is an issue for state legislatures, which has led to a high degree of heterogeneity in the interest rates charged on high-cost credit across the country. While 18 states and the District of Columbia ban or cap payday loans at 36% or less, in other states it is legal to charge 400% or more per annum for a loan (Goldsmith and Martin, 2014). There are also special protections through the Military Lending Act for active duty service members and their dependents who use certain payday loans and other small dollar credit products (Consumer Finance Protection Bureau, 2017). In June 2016, the Obama administration announced plans to regulate the payday loan industry. Instead of

resorting to an interest rate cap, the administration was proposing a payday rule, requiring lenders to administer a full payment test on potential borrowers, offer a principal pay-off option for certain short term loans, offer less risky longer-term lending options and adhere to a cutoff for direct debit attempts (Wall Street Journal, 2016).

6.5 Section Summary

In 2006, Japan introduced a number of measures to deal with the moneylending crisis in the country, which had boomed due to economic slowdown, easier access to credit due to technological advances, expansion of advertising products and high levels of rollover and repeat leding. The Japanese Government coupled a reduction in the interest rate with a number of measures including an increase in the maximum sentence for loan sharking, changes to debt collection rules, the establishment of credit bureaus, and limiting lending to one third of a borrower's gross annual income. A 2012 study of the moneylending sector concluded that restricting the level of borrowing from moneylenders did not lead to increased borrowing from other sources but instead shifted borrower behaviour to reducing their use of credit. However, in 2011, there were still 8 million people borrowing from moneylenders in Japan (down from 11.7 million in 2006/2007), indicating that there was still quite a high demand for this type of credit. There was also a concern that restricting legal moneylending would result in borrowers switching to illegal moneylenders. However, the official position of the Japanese Government is that the 2006 Moneylending Law has been successful in reducing illegal lending.

In Australia, the short-term lending market is predicted to be worth AUS$2 billion (€1.37 billion) by 2018. The Australian Government is strengthening the legislation around high-cost short-term credit (payday loans). In 2012, it introduced a number of restrictions on fees and charges. In 2015, it reviewed the regulations and made a number of recommendations including clarification on fees and charges, limiting repayments to 10% of a consumer's net income and improved creditworthiness checks. Canada also has a large payday loan industry, with different rules in place across the different provinces. Since 2007, six provinces have introduced legislation and two other provinces have signalled that they intend to pass legislation. Alberta has a total cost of borrowing of $15 for every $100 borrowed for a two-

week loan, making it one of the lowest in the world for payday loans. In the US, practice depends on state legislatures. 18 states and the District of Columbia ban or cap payday loans at 36% or less, while in other states it is legal to charge 400% or more per annum for a loan.

Section 7: Potential impacts of an interest rate restriction policy

The debate around interest rate restrictions is often ideological, given that the arguments can be framed in terms of social or economic costs and benefits. Those in favour of interest rate ceilings note the role such a measure can play in protecting low-income borrowers from usury (consumer protection), preventing over-indebtedness, reducing the cost of credit for low-income borrowers and addressing market failures. The World Bank (2014) summarises the main arguments in favour of IRR as follows:

> "Most countries regulate interest rates with the broad aim of protecting consumers, as in the case of Spain. Other countries provided more specific objectives, such as protecting the weakest parties (Portugal); shielding consumers from predatory lending and excessive interest rates (Belgium, France, the Kyrgyz Republic, Poland, the Slovak Republic, and the United Kingdom); and decreasing the risk-taking behaviour of credit providers (the Netherlands). Similarly, in Thailand, authorities stated that the purpose of the caps was to make finance more affordable for low-income borrowers. Finally, Zambia's authorities introduced the cap to mitigate the perceived risk of over indebtedness and the high-cost of credit, as well as to enhance access to the underserved."

On the other hand, those who oppose the introduction of IRR highlight the possible unintended consequences that can arise from implementing such a policy: an increase in illegal moneylenders, an introduction of other charges to circumvent the IRR (reducing transparency) and a reduction in access to credit, competition and choice.

7.1 Social impacts

7.1.1 Consumer protection

Moneylender customers (50% of whom relate to customers of catalogue firms) "are more likely to be in the lower socio-economic group" (Central Bank, 2013:5) for whom the cost of credit may be more of a challenge. Interest rate restrictions can ensure that the best interests

of all consumers are protected, making credit available at a reasonable and fair rate of interest. In its report on responsible lending, FinCoNet (2014, page 18) noted:

> "While it is recognised that consumers have responsibilities in the decision-making process when obtaining credit, regulatory intervention may be necessary to address the imbalance of power between a consumer and a credit provider. In some instances, it may be appropriate to ban or restrict certain products or product features that may adversely affect a consumer's interests."

7.1.2 Access to credit

There is strong evidence that interest rate restrictions reduce access to credit for consumers, particularly for low-income borrowers (University of Bristol, 2013).

The 2010 EU study of IRR in the EU found that it was plausible that IRR reduce credit access, in particular for low-income borrowers. When respondents to the EU 2010 study were asked what the likely effects of IRR will be on low-income borrowers, the majority of respondents perceived that the introduction of IRR of twice the average interest rate would decrease credit access. This view was unanimous amongst provider associations but opinion was split almost 50:50 among consumer organisation respondents. When asked again about the introduction of IRR (this time set at a maximum of 30% APR) respondents were more emphatic of the negative consequences this would have on credit access for low-income borrowers. This suggests that most respondents (in countries where there is no IRR) consider a floating interest rate/relative rate ceiling as a better option from the perspective of credit access for low-income borrowers. Finally, respondents were asked to describe the level of credit options available to low-income consumers in their member state. The findings suggests that the majority of low-income borrowers are perceived to have limited credit options, regardless of whether or not member states have IRR in place (iff/ZEW, 2010).

Other studies cited by iff/ZEW (2010) highlighting that access to credit will reduce with the introduction of an interest rate cap include those completed by Policis (2004), OFT (2010), Villegas (1982, study on automotive credit markets), Zinman (2008, study on interest rate caps on payday loans in the US) and IGF/IGAS (2009). IRR resulting in reduced access to credit is confirmed by existing literature on IRR in the US, although it should be noted that this is based

on a relatively low interest rate of 12%, whereas in many European countries (including Ireland for legal moneylending entities) the interest rate is much higher and so care should be taken in drawing a direct comparison. Some studies also indicate that the presence of interest rate restrictions means that small amounts of credit often become unavailable (iff/ZEW, 2010).

If the IRR is set at a level that is deemed to make the business untenable, credit providers may leave the market, as was the case with the home credit provider IPF in Slovakia in 2016. A restriction on interest rates will force credit providers to re-examine their business model, which could mean they are less likely to lend to high risk borrowers with a high probability of defaulting. In Poland, following a review of customer profitability in 2016, IPF took the decision to cease lending to certain higher risk segments of customers and the firm expects this action to reduce the level of loan impairment (IPF Annual Report, 2016). This is similar to the impact of a lowered interest rate cap in Ecuador, where financial exclusion increased due to the reduction in the provision of smaller, riskier loans to poorer clients (FSD Africa, 2013). It is therefore possible that the benefit of an interest rate restriction only accrues to the 'better off' borrowers, with more high-risk borrowers being eliminated by credit providers.

One likely reaction of credit providers to an interest rate restriction is to increase the loan size (fewer loans but larger size) or to extend the loan duration, as a means of maintaining overall profits.

However, whether or not an interest rate cap reduces access to credit largely depends on the level at which the cap is set. If it is set at a level which, from the perspective of credit providers, allows the sector to remain profitable, then credit providers will continue to operate, although the number of credit providers may reduce (smaller firms may not be able to continue operating). Furthermore, in some cases, reducing credit access may actually be an objective of IRR, as a means of reducing over-indebtedness.

7.1.3 Over-indebtedness

The stakeholder survey of experts included as part of the 2010 EU study ranked IRR as the second most effective policy measure in reducing over-indebtedness (with responsible lending

ranked as the most effective policy measure). In addition, products with significantly higher interest rates were mentioned as possible drivers of over-indebtedness by experts in Estonia, Czech Republic, Austria, Ireland, Denmark and Finland. Latvia reported that the absence of regulation and control mechanisms led to a significant rise in over-indebtedness in the country (iff/ZEW, 2010).

However, using a number of proxy indicators (arrears on mortgage or rent, utility bills or hire purchase, arrears on hire purchases or loans and the ability to make ends meet) from the EU Survey on Income and Living Conditions (EU-SILC) to assess the level of over-indebtedness, the same study concluded that it does not appear that the level of over-indebtedness is predominantly related to the regime of IRR. The views of expert stakeholders also suggest that overall, the problem of over-indebtedness is perceived as equally strong in countries with and without IRR. Literature on over-indebtedness shows that - rather than IRR - the main reasons for over-indebtedness are reported to be a loss or reduction in income/unemployment, divorce/relationship breakdown, illness and poor household management (Kempson 2002, Jentzceh and Riestra 2006). Other reasons cited for over-indebtedness were increased living costs and an overestimation of ability to repay, with only 20% of cases attributed to excessive and irresponsible borrowing (iff/ZEW, 2010).

An IRR will likely force a high-cost credit provider to re-examine its business model, to assess how to maintain its profits in a tightened regulatory environment. The relatively high rate of delinquency on home credit suggests that affordability assessments could be more rigorous. Limiting the interest rate charged could force moneylending firms to more closely assess a borrower's ability to repay to offset the reduction in profits that a cap would impose. One possible outcome is a closer consideration of a borrower's ability to repay as a means of maintaining a low ratio of impairment to revenue, which could mean that those at risk of over-indebtedness may be refused credit, which could serve to limit a borrower's financial difficulties in the long run. As discussed in Section 6.2, data from Poland showed that households indebted to personal loan companies (which includes home credit companies, lending companies with branches/outlets and online lending companies) assign a larger proportion of their net monthly income to repay their debt than the households with debts to other institutions. Similarly, the Australian Government has noted that high-cost credit (in this

case, payday loans) can put consumers on the path of financial exclusion when repayments consumer a greater portion of their income.

7.1.4 Illegal moneylending

A research survey undertaken for Policis in 2003 and referenced by them in a report on illegal moneylending three years later, concluded that the lower incidence of illegal lending in the UK (compared to France and Germany) was due to higher risk borrowers in the UK having more legal credit options (Policis 2006). The report concluded that usury ceilings in Germany and France had led to a high degree of exclusion from small loans for poor people because interest rate restrictions resulted in providers of loan products for low-income households withdrawing from countries with restrictions. Several UK provider associations, home credit providers and commercial banks reference the Policis report in their assertion that interest rate restrictions will result in an increase in illegal moneylending. However, concerns have been raised about the validity of the results in the Policis report. The New Economics Foundation (2009) notes that the Policis study does not fully disclose its methodology of how the sample of respondents was chosen, how many people replied from the individual countries and how the questions were asked. In addition, the report did not include a copy of the questionnaire that was issued. It is also noted that the report assumes that credit demand is uniform across countries, although this assumption is unlikely to hold true due to different credit cultures in the three countries (iff/ZEW, 2010).

The majority of respondents to the EU 2010 study acknowledged that illegal lending may happen in their countries. It is interesting to note that illegal moneylending is deemed more likely to be significant/maybe significant in countries without IRR by the respondents, suggesting that the level of illegal lending may be more pronounced in countries without IRR.

Overall, 80% of respondents (providers, provider associations, consumer organisations, regulators and others) believed that the introduction of IRR would lead to an increase in illegal moneylending. However, while this belief is unanimous amongst provider associations, about 50% of consumer organisations and one third of the 'other' category of respondents (which

includes regulators) believe that an IRR of twice the market average would not increase illegal lending to low-income communities (iff/ZEW, 2010).

It should be borne in mind that all of the above is based on expert opinion rather than empirical evidence. However, it does indicate that the often quoted assertion that IRR leads to an increased market in illegal lending is disputable.

It is plausible that a proportion of the 24% of respondents to the 2013 Central Bank study who said they would go to another moneylender or don't know where they would source credit (if their current moneylender ceased operating) could revert to an illegal moneylender, given that 13% of respondents were aware of illegal moneylenders operating in their area.

However, there is no empirical and undisputed evidence that interest rate restrictions result in an increase in illegal moneylending. In the UK, it was feared that the price caps on payday loans would push a large percentage of people towards illegal moneylending. However, Citizens Advice has said that the caps on payday loans has not led to an increase in illegal moneylending, with analysis of debts held by Citizens Advice clients showing that the number of loan shark debts has remained constant since the introduction of the cap. The iff/ZEW report (2010, p. 269) concluded that:

> "To our knowledge, the question if and to what extent customers enter the illegal market due to interest rate restrictions has not yet been empirically answered".

7.2 Economic impacts – supply of credit

7.2.1 Cost of credit

The 2010 EU study concluded that IRR could bring the level of interest charged by monopolists down to a more competitive level, but the lack of micro data on individual credit costs before and after the introduction of IRR made it difficult to test this hypothesis. However, the stakeholder survey carried out as part of the study found that IRR was ranked as the most effective policy measure in reducing the cost of credit (iff/ZEW, 2010).

However, the rules on payday loans introduced in the UK in 2015 (which include restrictions on the interest rate and total cost of credit) resulted in an average drop in loan charges of £40 (FCA, 2016).

Provided care is taken to ensure that regulations cannot be circumvented with the introduction of other fees and charges, restricting the cost of credit will mean that borrowers pay less.

7.2.2 Competition

In countries where competition is limited (such as Ireland, where the number of moneylending providers is limited through the licensing process) interest rate caps could decrease oligopoly rates, shifting the price to a more competitive figure and transferring the benefits to the customer.

The effect of IRR on competition depends on the level at which the interest rate cap is set. It is likely that the introduction of an interest rate ceiling will result in some credit providers exiting the market, thus reducing the level of competition among providers. It is also likely that it will be the smaller firms who will exit the market, with the larger firms at an advantage due to the scale of their operations. The introduction of rate restrictions and price caps on payday loans in the UK in 2015 resulted in the number of firms contracting from 240 to 60 (CFA evidence to House of Lords, 2016).

If the interest rate cap is set at a level that is unprofitable from the credit providers' perspective, this can lead to market contraction and withdrawal from expensive market segments. There is evidence that interest rate restrictions on microfinance institutions in Nicaragua resulted in microfinance institutions withdrawing from poor and remote areas and increasing the average loan size to improve efficiency and returns. Similar evidence of market contraction after IRR was introduced was observed in West Africa (World Bank, 2014). Therefore, interest rate ceilings can in theory reduce competition.

7.2.3 Convergence at the level of the cap

Interest rate restrictions may serve as a target rather than a limit, with providers using the ceiling as a de facto rate rather than considering a potentially lower rate based on the market.

While some studies in France report that certain types of IRR may be used by competitors to collude on prices, the experience in Poland and the Netherlands does not demonstrate a clustering of rates at the level of the interest rate cap (iff/ZEW, 2010). However, the 2016 review report on small amount credit contracts in Australia noted that the vast majority of credit providers charged the maximum permitted fees introduced by legislation in 2012. It acknowledged that this might suggest an absence of market competition between providers (Australian Government the Treasury, 2016). The likelihood of cost convergence depends on the market and the nature of the cap.

7.2.4 Displacement to alternative credit sources

If access to one source of credit is no longer available, some borrowers may abstain from sourcing credit. However, the majority of people will seek credit from other sources. As one former moneylending agent in Ireland put it, "people will get credit from wherever they can get it".[12] Determining which credit providers displaced borrowers will resort to is important in determining the full impact of a policy change. When asked in a 2013 survey where they would seek credit if their moneylender ceased operating, 43% of Irish moneylender customers said they would go to a credit union, 21% said they would go to a bank/building society, 13% said they would no longer require credit, 12% said they would go to another moneylender and 12% said they do not know where they would go for credit (Central Bank of Ireland, 2013).

7.3 Regulatory impacts

7.3.1 Circumvention by credit providers

Experience from a number of countries shows that a ceiling on interest rates generally leads to an introduction of new charges and fees by credit providers. Non-mandatory costs that have been introduced as non-interest fees include insurance fees, guarantee costs, speed transfer costs, costs of reminders, direct debit fees, home collection fees and default fees.

In South Africa, some financial institutions evaded caps by charging credit life insurance and other services (World Bank, 2014). In Poland, the 2009 restriction on interest rate charges was

[12] Interview with former moneylending firm employee in February 2017

followed up with a further legislative amendment to cap non-interest charges in 2016 (Polish Office of Competition and Consumer Protection, 2017).

The introduction of such fees and charges reduce the transparency of credit agreements and can negate the intended impact of the interest rate restrictions in reducing the cost of credit. However, certain types of circumvention can be anticipated and eliminated by clarifying what fees and charges are incorporated within the APR and capping the total cost of credit, with no additional fees or charges permitted.

7.3.2 Opportunity cost of other policy options

An interest rate ceiling is just one policy option for addressing consumer protection concerns relating to high-cost credit. It is argued by some that other policy options are likely to be more effective than the introduction of interest rate caps, such as enhancing competition, improving consumer protection, increasing financial literacy and capability, imposing maximum debt-to-income affordability limits, price comparison websites, promoting credit bureaus and promoting microcredit products (World Bank, 2014). However, all of these policies could be applied in parallel with an interest rate cap policy.

7.4 Addressing the demand for credit

An interest rate ceiling is targeted at impacting the supply side of credit, while the demand for credit is likely to remain unchanged by such a policy measure, resulting in what economists refer to as a distortion of the market. Addressing the demand for high-cost credit will require a supplementary intervention that shifts consumer behaviour away from 'short-term gain long-term pain' credit options.

Social science studies demonstrate that, in many cases, individuals make decisions they would not have made if they had paid full attention and possessed complete information, unlimited cognitive abilities, and complete self-control. At the same time, markets often give companies a strong incentive to profit from human frailties, which means products may not always be designed in the best interests of the consumer. 'Libertarian paternalism' describes a policy approach that allows people the freedom to do what they like, while at the same time trying

to influence people's behaviour by 'nudging' them in a direction that will improve their wellbeing (Thaler and Sunstein, 2008).

Thaler and Sunstein (2008) argue that consumers may need a 'nudge' from the government to steer people towards choices that will improve their lives. In particular, they note (p. 76):

> "people may most need a good nudge for choices that have delayed effects; those that are difficult, infrequent, and offer poor feedback; and those for which the relation between choice and experience is ambiguous."

While regulation alone may succeed in changing behaviour in some situations, relying solely upon the force of the law may not always be the optimal regulatory practice. More effective legislation may be achieved by integrating regulation with mechanisms that change individual behaviour (Kennedy, 2010).

In the context of high-cost consumer credit, this would suggest that an optimal policy is one whereby consumers are still free to choose more expensive alternatives while at the same time being 'nudged' by the government to consider alternatives that are more financially beneficial in the long run.

The G20 High Level Principles on Financial Consumer Protection state that the provision of financial education and information that deepens consumer financial knowledge and capability should be promoted, especially for vulnerable groups, so that consumers can take effective action to improve their own financial well-being.

The Financial Capability Strategy UK (2014), in its evaluation of various financial education interventions, suggested that the most effective interventions are financial education programmes that are targeted to groups, workplace schemes and debt advice. Interventions which showed some evidence of effectiveness are family focused programmes, intermediary focused programmes and social marketing. Interestingly, financial education through the schools has been shown to have limited or no effect.

MABS has very successfully combined financial education and debt advice. However, they would also see themselves as having a preventative financial education role. Their educational approach is one of partnership with key organisations on the ground to de velop highly targeted financial education programmes and resources. However, the role of MABs could be far more extensive, with greater resources, particularly since they have statutory recognition for a money management education role under the Social Welfare (Miscellaneous Provisions) Act 2008. In addition, while the main banks are involved in financial education initiatives through the BPFI, there is a need for greater involvement of the community and voluntary sector, including credit unions, in developing national approaches to financial education. Otherwise, there is a danger of commercialisation of financial education. As is often the case, the responsibility for financial education is assigned to marketing personnel in financial services organisations.

Cartwright (2014) argues that it is necessary to go beyond education if consumers are to be persuaded towards more socially desirable outcomes. Social marketing uses traditional marketing techniques to inform the public about issues, with the aim of achieving behavioural change. It is based on the premise that mere awareness of a problem and self-interest gains may be insufficient to prompt meaningful behavioural changes (Kennedy, 2010). Evidence from other countries suggests that social marketing might be an effective way to increase people's financial capability (NPC, 2014). FinCoNet (2014) recognises community outreach programmes that raise awareness about consumer finance and improve financial literacy as a good practice example of responsible lending.

Section 8: Potential barriers to policy change

The issue of moneylenders' fees and charges appears periodically in the Irish media, often as an emotive argument that laments the fact that those who can least afford it pay the most for credit. However, there appears to have been limited public engagement on the issue of legal moneylending prior to the political engagement and publicity surrounding the introduction of PMC, and customer satisfaction appears to be high, with borrowers reported to be willing to pay a premium for the ease and convenience that the moneylending service provides.

A clear advantage of the legal moneylending industry is that it is legal and therefore borrowers benefit from a degree of consumer protection. There is a fear that if restrictions are put in place so that moneylending firms can no longer operate, this could push people towards using illegal moneylenders instead, which carries much greater risks for the consumer. However, as already discussed, there is limited evidence that this will be the main default option for people.

Another potential barrier to policy change is the concern that some people who currently receive credit from legal moneylenders may be excluded if the cost of credit is reduced, as moneylenders may focus on higher loan values and lower-risk customers. While most people already have access to alternative legal credit providers, there will be a small percentage of people who may be financially excluded.

The moneylending industry will not be in favour of an interest rate restriction and other associated cost limits if it means their current income is reduced. The industry is likely to lobby the Government if any such changes are proposed. The industry has been subjected to increased regulation over the last number of years and could argue that the increased costs of compliance is already putting a squeeze on their profit margins.

Changing the status quo requires motivation to do so as well as an understanding of how potential unintended negative impacts can be managed. Driving policy change on this issue will require both strong leadership and increased political will, as it is likely that any change will need to come directly from the Government, rather than the Central Bank. The current Government has been active in supporting the development of alternatives to moneylenders, with the rollout and extension of the Personal Microcredit Scheme included in the Programme

for a Partnership Government, as part of its strategy for the growth and development of the credit union movement (Irish Government, 2016).

Any policy change involves a degree of risk, with a number of unintended impacts that need to be managed. The following table outlines the main potential unintended effects of an IRR, categorises the relevance for the Irish context, outlines the likely impact on consumers, and proposes actions that can be taken to mitigate the risks. Clearly, the existence and promotion of alternatives to legal moneylenders, such as PMC in the Irish context, is a central mitigating factor for any likely impact on financial inclusion.

Table 8: Matrix of unintended impacts of IRR policy change and suggested mitigation actions

No.	Unintended impact	Relevance to the Irish context	Likely impact on consumer protection (best interests of the consumer)	Likely impact on financial inclusion (consumers' access and use of legal financial products and services)	Mitigation action
1	Reduced access to credit	High	Percentage of people cannot access credit because perceived as high risk or unable to demonstrate ability to repay More difficult for over-indebted borrowers to use legal moneylenders Legal moneylenders increase loan amount/value to offset reduction in no. of loans	Reduced financial inclusion - high risk customers are excluded by credit providers	Support legal alternative credit products for low-income and high risk consumers (such as credit unions) Set interest rate and total price cap at a level that enables legal moneylenders to continue to operate but with reduced risk-based impairment and smaller profit margin
2	Increase in illegal moneylending	Medium	Percentage of borrowers resort to illegal moneylending	Reduced financial inclusion - percentage of borrowers are excluded from legal credit providers Reduced financial inclusion - some borrowers resort to illegal moneylenders	Enforcement of existing legislation on illegal moneylending Support legal alternative credit products for low-income/high risk consumers
3	Circumvention	High	No reduction in cost of credit as	-	Ensure interest rate and total price cap

	of IRR legislation		other fees and charges introduced to 'fill the gap'		is carefully designed to avoid circumvention through introduction of other fees and charges Ensure that resources are provided to enforce interest rate restrictions
4	Distortion of the market	Medium	Demand for credit remains unchanged	-	Separate from interest rate restriction and total price cap- introduce policy measures which address the demand side
5	Opportunity cost of other policy interventions	Medium	Resources not given to enforcement of other measures which could have a greater impact on consumer protection – improved creditworthiness assessments, elimination of top-up loans, reduction in repeat borrowing	-	Interest rate restrictions and total price cap can be implemented in parallel with enforcement of existing regulations on areas of concern such as creditworthiness assessements and top-up loans Interest rate restriction and total price cap designed to disincentivise repeat borrowing (lower APR/total cost of credit limit on 2nd and subsequent loans)
6	Reduced competition	Medium	Some moneylending firms may leave the market, resulting in less choice of providers for consumers	Customers displaced to alternative credit providers (legal and/or illegal)	Set interest rate restriction and total price cap at a level that enables legal moneylenders to continue to operate but with reduced risk-based impairment and smaller profit margin
7	Reduced product diversity and	Low	Reduction in the availability of credit types	-	No suggested mitigation action. Low risk in an Irish context. Currently, legal moneylending market in Ireland is

	innovation inhibited				quite stagnant, with little innovation in product or service over the last 30 years
8	Convergence at the interest rate cap	Low	Little difference in costs of credit providers' products	-	No suggested mitigation action. Low risk in an Irish context – closed market, already appears to be limited price competition

Section 9: Conclusions and Recommendations

The legal moneylending industry in Ireland provides high-cost credit to about 7% of the Irish population, with the majority of customers being female, in the lower socio-economic group and between 35 and 54 years of age. Research in the past has shown that the majority of customers are willing to pay a premium for the ease and convenience that the service provides, with credit delivered to the door and repayments collected from a borrower's home on a weekly basis. There also appears to be a high degree of customer satisfaction with moneylending firms. Moneylending firms offer certain advantages over other credit providers: the service is provided at the door, the loans are unsecured, there are no default fees and the total cost of credit is capped.

However, moneylending firms also provide certain challenges from a consumer protection perspective. There is evidence that creditworthiness assessments are not as rigorous as they should be, topping up loans is still a common practice and the level of repeat borrowing is relatively high. A fourth area of concern is the cost of credit, which is the most common reason given by consumers for dissatisfaction with moneylenders.

The cost of credit is an issue that can be partly addressed through the introduction of interest rate restrictions. There has been a clear trend in recent years towards the use of interest rate restrictions as a policy tool to control high-cost credit in Europe. It can be argued that Ireland has a de facto interest rate restriction, with moneylenders licensed to charge up to 188.45% APR excluding collection charges and up to 287.72% APR including collection charges. However, these interest rates seem to have evolved over time. There is no clear understanding of the breakdown of the cost components of interest for moneylending firms and what percentage of the APR is attributable to the costs of funds, operating costs, risk premium, cost of equity and profit. Ireland is now in the minority of countries in Europe with no formalised interest rate restriction on high-cost credit, with this coverage gap now addressed in almost all other European countries. Historically, Ireland's legislation and regulation on moneylending has mimicked that of the UK. Now, even the UK is considering following up its successful price cap on payday loans with a cap on other forms of high-cost credit.

While this study has focused on interest rate restrictions, introducing a restriction on interest rates will be ineffective unless there is also a limit on all other possible fees and charges, as evidenced recently in Poland. An advantage of the current system in Ireland is that default fees are not permitted and there is a cap on the total cost of credit. It is important to maintain these protections and to ensure that any policy change is designed so as to avoid circumvention through the introduction of additional fees and charges, all of which can add significantly to the cost of credit.

Central Bank research shows that the majority of moneylending customers do not consider alternative financial service providers before securing their moneylending loan. This can be explained by some of the findings from behavioural economics, which notes that people do not always make rational decisions that are in their best interests. The main concern of moneylending customers is how much they will have to pay back weekly, rather than how much the credit is going to cost them in the long run. This, along with the intergenerational aspect of moneylending (whereby the next generation uses the credit provider their parents used) and the ease and convenience of doorstep credit, explains why most people don't consider the alternatives that are available to them.

One of the main barriers to placing restrictions on the supply of legal moneylending is a concern that it will drive people to using illegal moneylenders. However, the key question is: what are the full range of alternatives available to people? As discussed in Chapter 3, almost 75% of people said they would use an alternative legal credit provider (credit union, bank or building society) if they were no longer able to obtain credit from their moneylender. We have also seen that many of those who use moneylenders already use other sources of credit. There are also alternatives within the moneylending sector itself, retail firms and catalogue companies often providing lower APRs and costs of credit than home credit providers. While it must be acknowledged that illegal moneylenders are one possible alternative credit source, they are not the only alternative and as recent evidence from the price cap on payday loans in the UK shows, a migration to illegal providers is not inevitable. Enforcement has an important role to play in ensuring existing legislation on illegal lending is enacted when necessary.

Introducing restrictions on interest rates and limiting the total cost of credit can help protect the public interest by ensuring that a fair and reasonable price for credit is provided for those

who are typically from low-income households and thus least able to afford high-cost credit. A restriction on interest rates and the total cost of credit will force moneylending firms to re-examine their business model and while this may result in some people no longer being able to access credit, there is a high probability that some of these people would not pass a rigorous affordability check and may already be over-indebted. It is also worth noting that the use of the Central Credit Register by moneylenders from 2018 onwards, for loans in excess of €2,000, with all loans over €500 being recorded, could also play an important role in improving creditworthiness assessments of such loans.

Policy and regulatory frameworks that promote responsible lending can limit the negative impacts of irresponsible lending on consumers. As a credit provider, moneylenders have a responsibility to consider the best interests of the consumer, particularly in relation to consumer affordability, product suitability as well as repeat borrowing, transparency of the cost of credit and credit-worthiness assessment.

While an interest rate restriction and a cap on the total cost of credit could make credit cheaper for people, it unlikely to reduce the general demand for credit. However, it is possible to promote the demand for cheaper alternative credit providers, for example, through the use of social marketing campaigns whose aim is not just to provide information but to instigate behavioural change.

Consumer credit plays a key role in the economy. However, it must be moderated to protect consumers from any imbalance of power between a credit provider and a consumer.

Full details of the recommendations of this report are summarised below. Recommendations 1 to 4 relate directly to interest rate restrictions, with 5, 6 and 7 designed to supplement and enhance the first four recommendations, so as to optimise the outcomes from a consumer protection and financial inclusion perspective.

Based on the risks, relevance, impact and possible mitigation actions outlined in Table 7, this report makes the following recommendations:

Recommendations on interest rate restrictions:

1. Government to adopt a policy which prohibits usurious rates of interest in the interests of fairness to the most vulnerable in Irish society by the introduction of a restriction on interest rates and charges.
2. Such a policy to be conditional on the credit union movement in Ireland committing to and being enabled to serve the community currently serviced by the moneylending firms, subject always to adherence to prudent credit guidelines.
3. In consultation with the credit union sector, the Department of Finance consider increasing the 1% monthly cap on interest rates for credit unions as per Section 38 (1)(a) of the Credit Union Act, 1997, for this type of lending to cater for the significantly greater costs associated with such small lending.
4. Ensure interest rate restriction is coupled with a limit on other fees and charges and a limit on the total cost of credit, with the rules carefully designed to avoid circumvention through the introduction of other 'innovative' fees and charges.
5. Consider reducing the permissible interest, fees and charges on second and subsequent loans taken out by consumers.
6. Ensure that resources are provided to enforce the interest rate restrictions and price caps as well as existing lending practices.

Recommendations to supplement the above recommendations, so as to optimise the outcomes of policy change:

7. Ensure moneylenders engage in responsible lending practices.
8. Introduce other policy measures, including actions to promote financial inclusion, which includes financial education initatives, to complement the above measures.

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Appendix 1: Terms of Reference

Research Proposal - Interest Rate Restrictions

Proposal

It is proposed that research is conducted on the extent and variety of interest rate restrictions in the EU with an assessment as to the appropriateness of such restrictions in the Irish market. The purpose of the research is to inform any policy considerations and possible decisions and does not imply any commitment to implement findings.

Background

The Program for Government 2016 states *"We specifically support the rollout and extension of the Personal Microcredit (PMC) Scheme, which is providing simple microloans to members and helping to combat the use of moneylenders."* The scheme was designed expressly to provide a credible alternative to moneylenders. The credit union movement are the body providing the credit facilities under the scheme through their network of nearly 300 locations around the country. Other key stakeholders have played crucial roles in the scheme including the Central Bank, Department of Social Protection, An Post, CIB/MABs, Department of Finance and others. Its implementation is being managed by the Social Finance Foundation.

The scheme is being rolled out across the country. It is anticipated that a majority of relevant credit unions will sign up to the scheme. This is likely to happen over the coming 12-18 months. When this position is reached, there should be a sustainable credible alternative to the licensed moneylending firms, some of which charge interest rates of up to 187% to individuals and families who can least afford to pay such rates.

Policy context

The rationale for the PMC initiative was to provide an alternative to the moneylending firms so that much needed credit could be made available at normal interest rates. This is a fundamental element of financial inclusion. The number of individuals who are customers of moneylending firms was estimated by Central Bank in 2013 at 360,000 and may have increased since then. It is estimated that excessive interest (relative to a credit union loan) is being paid to the tune of approximately €50m - €100m annually by those using moneylending firms for credit. Providing access to loans from credit unions not only can lessen the cost to individuals but also provides the opportunity for financial inclusion for those outside the financial system. Ireland currently has one of the highest incidences of financial exclusion in the EU.

From a policy point of view, a key issue is how to balance the high-cost of micro credit versus access to and availability of appropriate amounts of micro credit to low-income or disadvantaged consumers. In this regard, it is worth noting that while moneylending firms are characterised by high interest rates they do offer high levels of flexibility, convenience and customer satisfaction. The research will focus on inequality *within* the current lending system, rather than critiquing the broader system of money-lending in and of itself.

Regulation

Moneylending, as defined in legislation, Is the practice of providing credit to customers on foot of a moneylending agreement which is, inter alia, where the total cost of credit is in excess of an APR of 23%. Any firm charging over 23% requires a moneylender's licence from the Central Bank under the Consumer Credit Act, 1995. The Central Bank determines the maximum APR which can be charged by any individual moneylending firm. The rate approved is influenced by the business case presented to the Central Bank by the firm when applying for their licence. In the case of one of the major players in the Irish market (Provident), the Central Bank allows 187% APR on a €500 loan for 26 weeks.

Timing

The option to restrict interest rates for moneylending firms to much lower levels, either selectively or across the board, could not be considered up to now whilst a viable alternative was unavailable. This situation should be changed in another 12 -18 months' time with the successful full roll-out of the PMC scheme.

There remains a number of challenges to ensure that a credible alternative is available nationwide and to persuade individuals to switch from the money-lending firms to the credit unions. However, assuming that project progress to date continues and PMC borrower sentiment remains very positive, it is imperative to gather empirical evidence to answer a fundamental question: What can be learned from the recent EU experiences of interest rate regulation/restrictions with particular regard for people with limited ability to negotiate for better lending terms?

Aim and objectives

The aim is to explore the effects of changing regulations regarding interest rates in Ireland with particular regard for those who can least afford credit. The research output will be used as a decision support tool for Irish policy makers, to weigh up and assess the available policy options. In particular, the question of restricting interest rates charged by moneylending firms to a

much lower level than they currently charge will be addressed. This requires a comparative review of current interest rate policy in selected EU countries (resulting in a concise inventory of policy options), with a comparative evaluation of the experience of other EU countries, some of which have restrictions and others which have not (resulting in a review of effects). A robust comparative framework will be established to manage this process, indicatively using a selective case-study approach. The question needs to be considered very carefully to ensure that an understanding of potential unintended effects of policy change are also identified. This is of particular importance to this study given the lack of reliable information on informal/illegal moneylending markets (out of scope of this research). Indicators for evidence of such limitations on consumers' access to credit, or displacing lending from legitimate moneylenders to illegal moneylenders will be developed within the case studies. The approach proposed is to:

- Explore the arguments for and against restricting interest rates charged by moneylending firms
- Elucidate the current situation regarding interest rate restrictions in a select number of developed EU countries
- Provide a concise inventory of policy options
- Review the incidence of interest rate restrictions in the developed economies in the EU and establish what these restrictions are at present
- Evaluate the context for such restrictions with particular focus on relevance to Ireland e.g. levels of financial exclusion, scope of mainstream financial institutions, levels of interest rates, presence of credit unions or equivalent organisations, existence of moneylending firms etc.
- Summarise the rationale for the implementation of interest rate restrictions in those countries which have them
- Address the issues of restricting interest rates charged from the perspective of moneylending firms (identifying potential barriers to policy change)
- Evaluate the effects (intended and unintended) of interest rate restrictions on those with low levels of income
- Summarise the situation in a small number of developed countries outside the EU
- Assess Ireland's situation in the context of the EU countries studied
- Draw conclusions on the Irish context and make recommendations for consideration by the relevant stakeholders
- Provide evidence that will limit the potential unintended effects of policy change in Ireland.
- As part of the examination of IRR the matter of regulation reform will also be considered. Where IRR exists, and where a licensed money-lending sector exists, is this accompanied by regulation reform? If yes, were these measures introduced in tandem and is there any high level evidence of enforceability. The term reform refers to additional

regulation and restrictions around items such as roll-overs, advertising, cold calling and affordability.

Appendix 2: List of stakeholders consulted

Country	Organisation	Contact person(s)
Ireland	Central Bank of Ireland	Bernie Mooney Joe Donnelly Toni Mc Intyre
	MABS	Annmarie O' Connor Carol Dunne Nigel Hugo
	Saint Vincent de Paul	Tricia Kielthy
	Irish League of Credit Unions	Dave Matthews Dave Hewson
	St. Anthony's Credit Union	Louise Shields
	Other	Former moneylending firm employee
	Ex-TCD/UCD	Georges Gloukoviezoff
UK	Centre for Responsible Credit	Damon Gibbons
	Toynbee Hall	Carl Packman
	Citizens Advice	Joe Lane
	Consumer Finance Association	Russell Hamblin Boone
	Financial Conduct Authority	Luke Tyrell
	Your Credit Union	Jonathon Read
Poland	Polish CU movement	Izabela Rutkowska
	Office of Competition and Consumer Protection	Aleksandra Mrozowska
	College of Management and Finance	Malgorzata Iwanicz-Drozdowska
	PwC	Mateusz Walewsk
	KPF	Andrzej Roter
	IP Finance	Michal Konopka
	SKOK	Wiktor Kaminski
Belgium	Law at Janson Baugniet, KU Leuven	Johan Vannerom
	Ministry of Economy, Service Public Fédéral (SPF) Economie	Karin Swinnen
	Test Achats	Danièle Bovy
Cyprus	University of Nicosia	Christiana Markou
Estonia	Ministry of Justice	Kristina Kroll
	University of Tartu	Karin Sein
	Consumer Protection Board	Kersti Kurval
	Estonian Union of Credit Cooperatives	Andrus Aristkok
Finland	University of Turku	University of Turku
	Ministry of Justice Finland	Katri Kummoinen
	Guarantee Foundation	Juha Panztar
	Finnish Competition and Consumer Authority (Kilpailu- ja kuluttajavirasto)	Serina Kavonius

Netherlands	NIBUD	Marcel Warnnar
	Ministry of Finance Netherlands, Directie Financiële Markten	Martin van Harten
	Authority for the Financial Markets Netherlands (AFM)	Wijnand Van de Beek
	Association of Credit Unions Netherlands	Roland Lampe
Slovakia	Matej Bel University/Institute of Savings and Investment	Dr. Jan Sebo
	National Bank of Slovakia	Roman Fusek
	Ministry of Finance of Slovakia	Pavol Matyasovszky
Sweden	Umea University	Ann-Sofie Henrikson
	Ministry of Finance Sweden Financial Institutions and Markets	Daniel Fast
	Swedish Consumer Agency (Konsumentverket)	Anna Hult
Spain	University of León	Dr. Elena Perez Carrillo
	ADICAE	Fernando Herrero
	CECU	Cesar Diaz
Bulgaria	Economic Research Institute, Bulgarian Academy of Science	Iskra Balkanska
Romania	Federation of Romanian Credit Unions	Florin Simion
Global contacts	E-MFP	Daniel Rozas Gabriela Erice
	IFAD	Francesco Rispoli Michael Hamp
	World Bank	Katharine Mc Kee Pierre Olivier Jennifer Chien
	CGAP	Ivo Jenik
	Former CEO of the National Credit Regulator South Africa	Gabriel Davel
	Microfinance Centre (MFC)	Ewa Bankowska
	European Microfin. Network (EMN)	Jorge Ramirez
	WOCCU	Michael Edwards

Appendix 3: Trends on interest rate ceilings in developing countries

Global overview

The popularity of interest rate ceilings as a policy tool for consumer protection has fluctuated over time. A few decades ago, its use had declined globally as many countries moved to liberalise their financial policies. However, in recent years, interest rate ceilings have become more prevalent in both developed and developing countries. In 2014, 76 countries around the world imposed some form of interest rate caps on loans (World Bank 2014). The World Bank is generally not in favour of using interest rate restrictions as a policy tool. This is because its work focuses on developing countries, where interest rate ceilings could act as a barrier to expanding the reach of credit into unserved or underserved sectors.

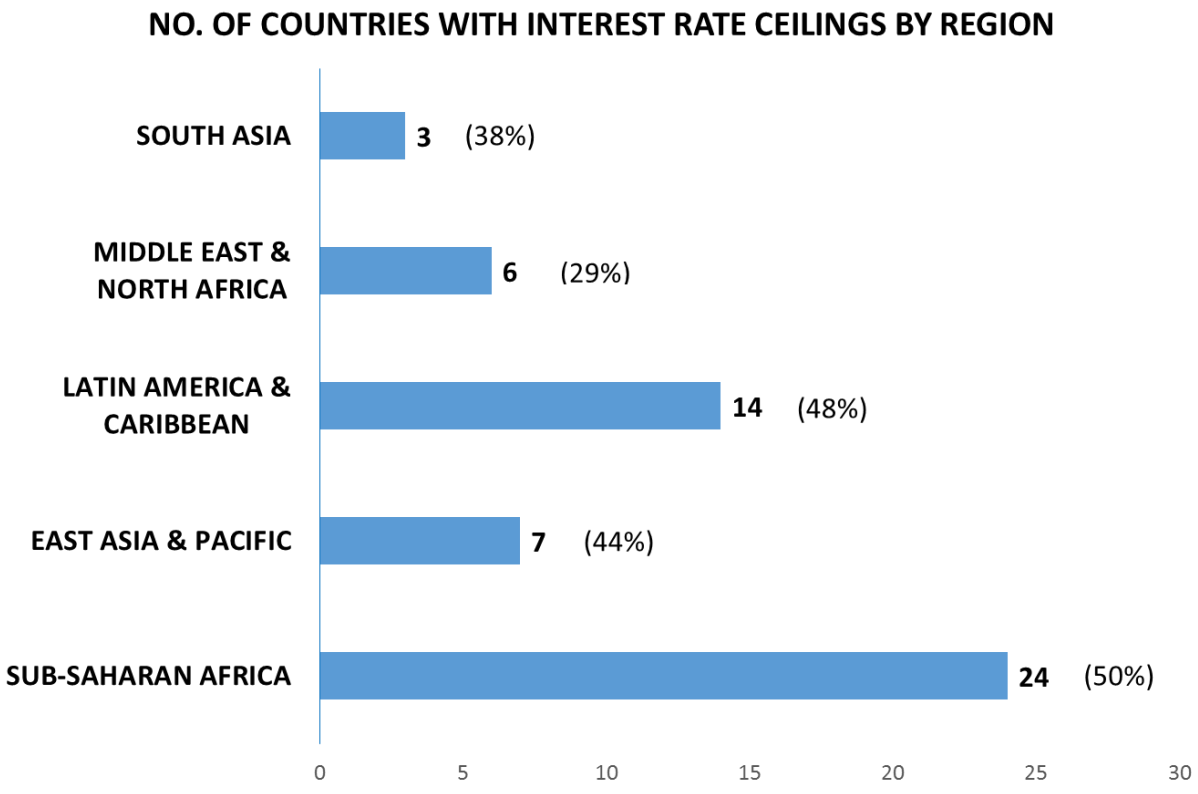


Figure 10: Number and Percentage of Countries with Interest Rate Ceilings by Region, excluding Europe and Central Asia regions (Source: World Bank 2014)

South and Central America

The trend towards reintroducing interest rate caps began in South and Central America from 2000 onwards. In 2000, Colombia defined a usurious interest rate for credit operations to be 1.5 times the weighted average of interest rates. Nicaragua introduced an IRR in 2001, followed by Venezuela in 2006 and Uruguay in 2007. In 2011, Brazil launched a programme to boost microcredit, capping interest rates at 8% per year for loans up to a certain value. El Salvador followed suit with the introduction of a cap in 2012 (World Bank, 2014). In 2013, Bolivia introduced a new Financial Services Law to replace the previous 1993 banking law, which included interest rate controls for different loan types, subject to annual review by the government. The interest rate for microfinance loans was capped at 11.5% (Heng, 2015).

Asia

In Asia, a number of countries have recently introduced or tightened interest rate caps. Japan reduced its interest rate cap to 20% in 2006 (following incremental reductions from a high of 73% in 1983). In 2011, Myanmar implemented a new law to cap interest rates for microloans at 2.5% per month or 30% per year. Bangladesh introduced an interest rate ceiling of 27% on microcredit loans in 2011. In 2013, the Ministry of Finance in Thailand capped the annual rate that microfinance lenders can charge at 36% and in the same year the Kyrgyz Republic passed a usury bill imposing a cap on microloans (World Bank, 2014).

India introduced an interest rate cap on microcredit loans in 2011, set at 26% on a per annum basis. Other restrictions include a margin cap of 10-12% above the borrowing cost and a processing fee of 1% which is not included in the 26% cap. The cap was introduced in order to reduce reckless lending and over-indebtedness, and to remove inefficient MFIs from the system. The impact was a 50% reduction in the MFI loan portfolio (July 2011 figure compared to October 2010 figure) and a reduction in bank lending to MFIs. In order to mitigate some of the impacts of the cap, experts recommended that the interest rate caps should be relaxed in infrastructure challenged or underserved parts of the country, and that new or small MFIs should also be given an exemption from the cap (FSD Africa, 2013). In March 2017, Cambodia

introduced an interest rate ceiling of 18% on all microfinance and rural credit operators (National Bank of Cambodia, 2017).

Africa

Zambia

In Zambia, interest rate restrictions were introduced in December 2012 and January 2013. The policy goals of the interest rate caps were to mitigate risks of over-indebtedness and the cost of consumer credit, and to enhance credit access to the underserved. Interest rate caps were introduced for commercial banks and non-bank financial institutions. The interest rate for non-bank financial institutions was capped at 1.644 times the bank rate. Interviews with MFIs in Zambia in the first half of 2013 showed that the market response to the interest rate cap ranged from reduced lending or expansion to try to achieve economies of scale, consolidation of operations, migration towards higher loan sizes and fees, and some migration to informal moneylending (FSD Africa, 2013).

In November 2015, the Bank of Zambia removed the caps on lending rates in order to improve the functioning of the credit markets. At the same time, it introduced consumer protection measures to protect borrowers, requiring financial service providers to ensure that borrowers understand key terms and conditions, disclose the interest and all related costs and base fees on the actual cost of the underlying service. The Bank of Zambia also stipulated that it would review fees for reasonableness, to ensure they reflect the actual cost of providing the underlying service or operational activity (Bank of Zambia, 2016, Bank of Zambia, 2015).

Kenya

In August 2016, the President of Kenya, Uhuru Kenyatta, signed into law a bill capping interest rates at 4 % above the Central Bank rate. The President stated that the objective was to promote competition between banks, with lower rates making credit accessible to more people. In January 2017, Equity Bank, the largest bank in terms of customer base in Kenya with 10 million customers, scaled back its mobile phone based loans, preferring to issue smaller denomination, shorter term credits. This means that customers who used to get relatively large loans through a simple process are now limited to smaller shorter-term loans.

Banking analysts deem that tightening of credit policies in this manner is seen as a direct response to the interest rate cap, which limits banks' ability to price in risk (Business Daily Africa, 2017). Although the cap was introduced to increase credit, credit growth has actually declined.

South Africa

In South Africa, the 2005 National Credit Act (effective in 2007) introduced comprehensive credit legislation which included regulation on interest and fees, reckless lending rules and disclosure requirements on pre-agreement quotes and advertisements. A cap on small loans that was removed in 1993 was reimposed in 2007, set at 5% per month on short-term loans. In addition, the maximum interest rate on unsecured credit transactions was set at 2.2 times the Central Bank rate plus 20% per year. Different credit categories were also permitted a maximum initiation fee, set at a percentage of the credit agreement (10% for unsecured and short term credit agreements) but with a fixed maximum fee (FSD Africa, 2013, World Bank, 2014).

Summary

In recent years, interest rate ceilings have become more prevalent in both developed and developing countries. The regions of South and Central America, Asia and Africa all show a number of countries introducing or re-introducing interest rate ceilings over the last decade. The extent of IRR ranges from being applicable to all consumer credit (e.g. Zambia, Kenya) to being applicable only to specific consumer credit products such as microfinance or microcredit. When interest rate restrictions are applied to all bank credit, there is evidence (such as in Zambia) that they can damage the functioning of markets if they are set at a level that no longer enables credit providers to price in risk and actual operational costs. South Africa designed very sophisticated regulations on interest rates and fees in 2005, with different credit categories permitted different charges. Several countries in Latin America and Asia have introduced IRR on microfinance over the last decade. Once again, there is evidence that if the restriction is not carefully considered, it may do more harm than good, as was evidenced in India, where the interest rate cap resulted in reduced credit in underserved parts of the country.