Interest Rates Caps

AN INTERNATIONAL PERSPECTIVE

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If this is such a bad idea, then why is it so common?

Interest rate ceilings have had a polarizing effect with lenders and consumers being at opposing sides of the case for and against caps.

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What does WBG offer as an alternative……

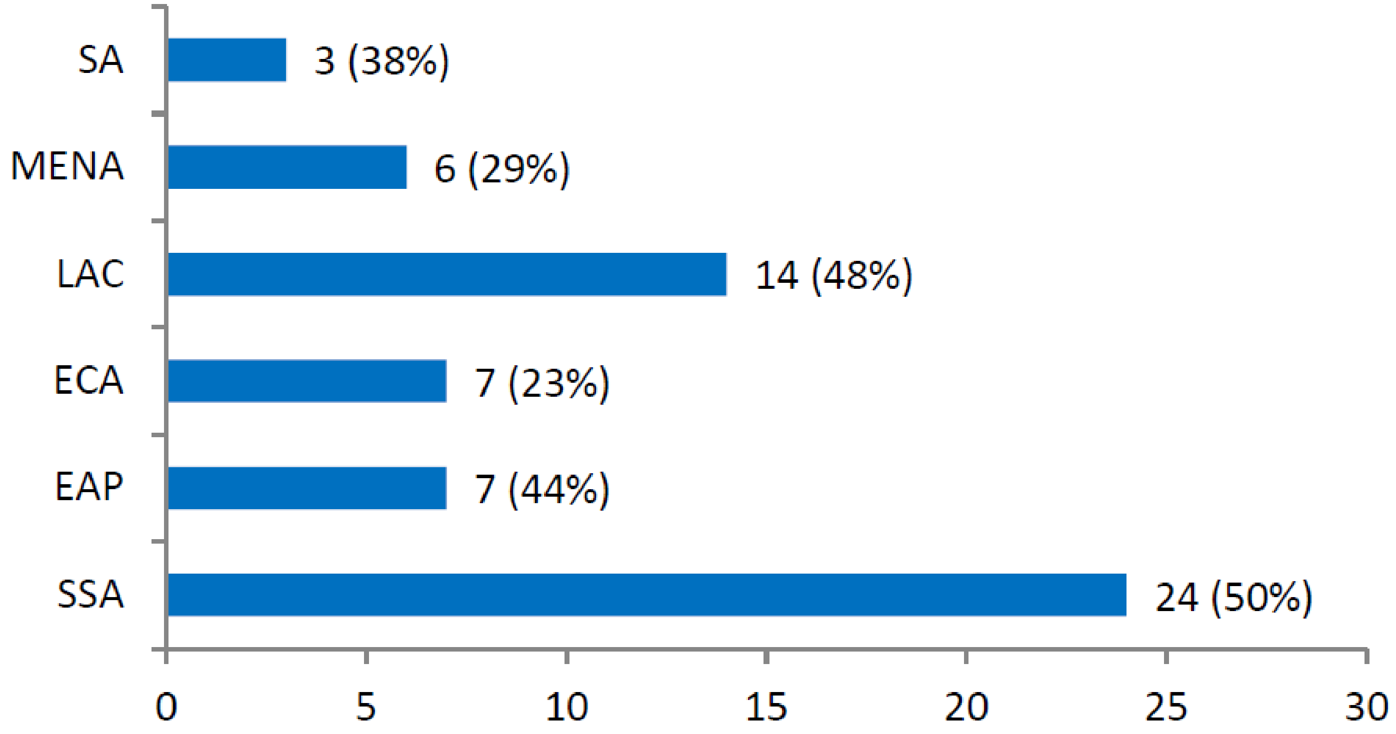
- The better way forward in protecting vulnerable consumers would appear to be a greater focus on ensuring best practice in consumer lending, eliminating unfair and exploitative practices and achieving greater transparency on pricing, terms and conditions.

- Better Consumer protection and financial literacy practices

- The most effective way to reduce prices for low income borrowers may be to foster an environment which stimulates competition and consumer protection, without imposing interest rate ceilings.

- ***There is a delicate balance between addressing cost of credit and ensuring access to credit.***

Countries with Interest Rate Ceilings by Region (2014)



Source: Maimbo & Gallegos, 2014

Countries with Interest Rate Caps, by Region

SSA (26)	EAP (7)	ECA (7)	LAC (12)	MENA (6)	SA	Western Europe	Others
Eritria	China	Armenia	Argentina	Algeria	Banladesh	Belgium	Australia
Ethopia	Japan	Estonia	Bolivia	Egypt	India	France	Bahamas
Ghana	Lao Rep.	Kyrygz Rep.	Brazil	Lybia	Pakistan	Germany	Canada
Guinea	Myanmar	Poland	Chile	Malta		Greece	USA
Kenya	Phillipines	Slovak Rep.	Colombia	Syria		Ireland	
Mauritania	Thailand	Slovenia	Ecuador	Tunisia		Italy	
Namibia	Vietnam	Turkey	Guatemala			Netherlands	
Nigeria			Hondurus			Portugal	
South Africa			Nicaragua			Spain	
Sudan			Paraguay			Switzerland	
Zambia			Dominican Rep.			UK	
WAEMU (8)			Urugay				
CEMAC (6)			Venezuela				

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Reasons for Interest Caps

To Protect Consumers from Excessive Rates /to make loans more affordable

- Thailand
- Kenya
- Phillipines

To Increase Access to Finance

Zambia

To Decrease Risk Taking behaviour by lenders/ Predatory Behaviour

- **Netherlands**
- **Portugal**
- **Belgium**
- **France**
- **Kyrygz**
- **Poland**
- **Slovak Republic**
- **UK**

Controlling Over-Indebtedness

- **Estonia**
- **Zambia**

Protection against excessive interest rate

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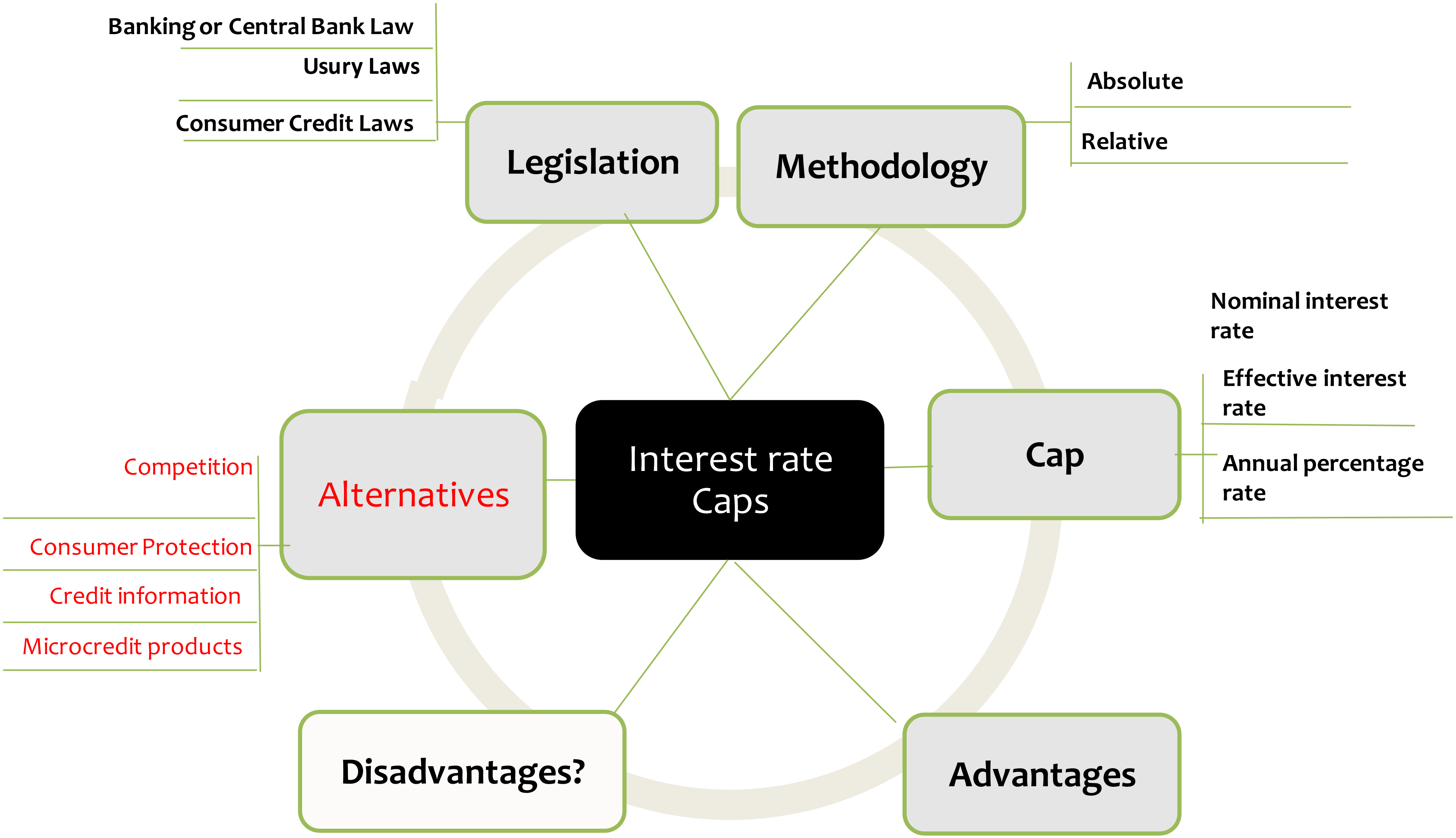
Framework for interest rate caps…



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Who sets the Caps in Different Countries?

Interest Rate Cap Setting Regime	Countries
Parliament	Kenya, Slovenia,
Central Banks/Banking laws	Myanmar, Turkey, Belgium, Colombia, Ecuador, Estonia, France, Kyrgyz Republic, Poland, Portugal, Spain, Uruguay, Venezuela, Zambia
Other Financial Sector Regulator	South Africa (NCA, 2007)
De- Facto limits/ (Gentleman's Agreement).	China, Brazil, Lao Republic, Vietnam, Pakistan, Ethiopia, Philippines, (Zimbabwe)
Court	Germany
Consumer Credit Laws	Spain (1995), Australia (2009),
Decrees	Tunisia (1999), Portugal (2009),

Common legal instruments used to cap rates*: usury laws (30%), criminal or civil codes (23%), consumer credit laws (13%) & Microfinance and Credit Union Acts (7%).*

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The impact on credit supply

- Lenders cannot afford to cross subsidize high risk borrowers without risking their competitive position
- In markets with no caps lenders typically meet demand through lending to high risky borrowers at higher prices.
- Lenders withdraw from such markets.
- Credit rationing & limited products.
- Lender set higher minimum lending thresholds unsuitable for low income households (higher loan sizes).
- Rise in pawn and illegal lenders.
- Rise in loan rejection rate.

The impact to consumers

- Some consumers are denied credit altogether when markets shift to lower APR.
- Lenders shift pricing from APR to other back end charges.
- Delinquency is consistently high in markets with rates ceiling than those without.
- Ceilings do not appear effective in controlling over-indebtedness.
- More debt becomes open ended and long term thus exposing consumers to risks during downturns.
- Under price controls, lenders are less tolerant of repayment difficulties.
- Higher insolvency arise when payment difficulties arise.
- Rise in adverse credit history for borrowers.

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Effects of Interest Rate Ceilings… Case Study Kenya

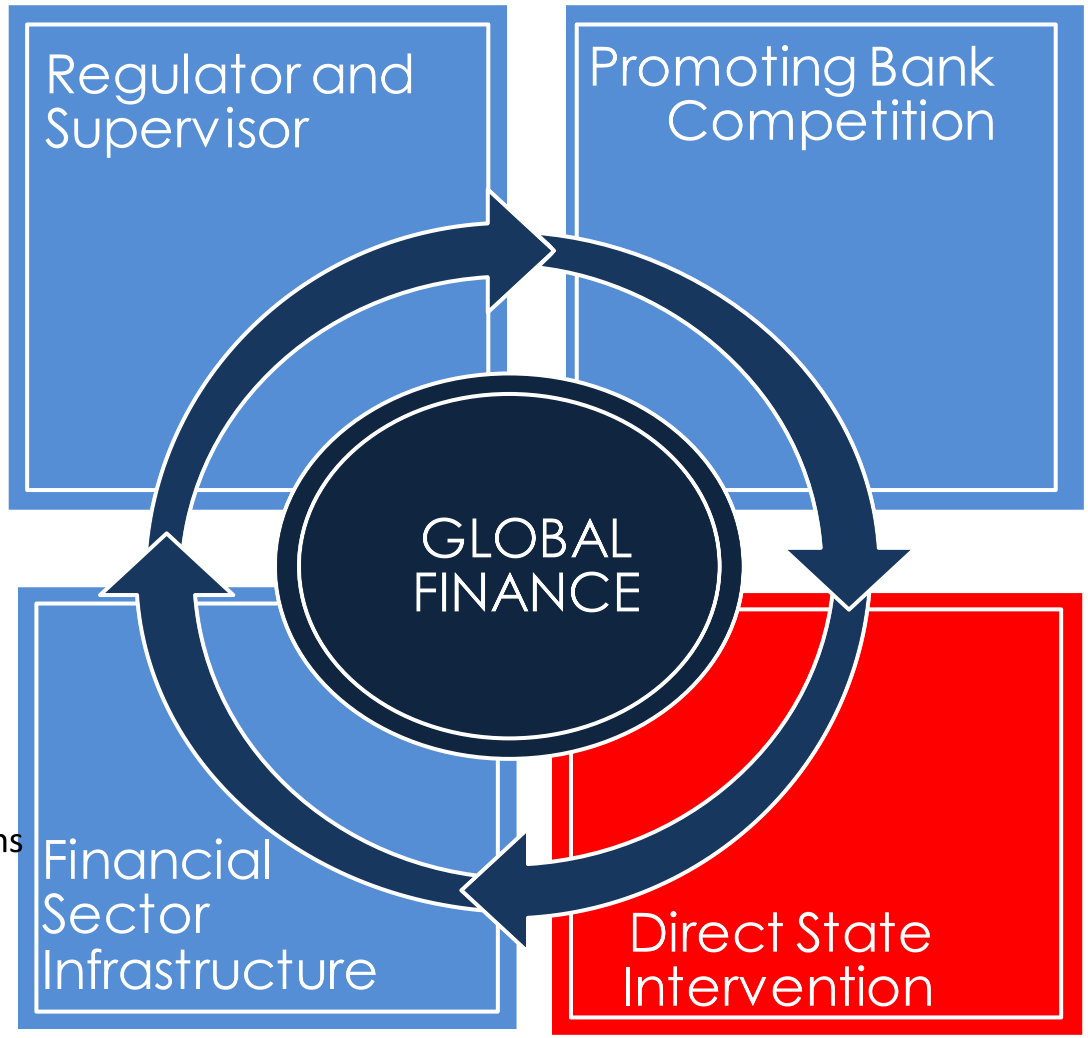
Cost of Credit and Banking Amendment Act 2016 resulted in:

- Bank stocks declined by up to 25%, overall market capitalization fell by 25%.
- Slow down in motor vehicle sales as credit was constrained.
- Rationalization of portfolios to less risk segments leading to crowding out effect of private sector lending as banks preferred to lend to government.
- Foreign investors exiting the market.
- Bank branch closures, staff reduction, relocation of shared functions to central locations for international banks.
- a change in composition of lending away from small and medium enterprises and toward safer corporate clients
- significant decline in aggregate lending,
- an increase in nonperforming loans

THE ROLE OF THE STATE IN FINANCE

- Anticompetitive behavior
- Market misconduct
- Information asymmetries
- Systemic Instability

- Banking stability
- Banking efficiency
- Access to finance
- Banking crisis
- Consumer protection



- Credit Reporting Systems
- Payment and Securities Settlement Systems

- Politics
- Policy
- Products
- People

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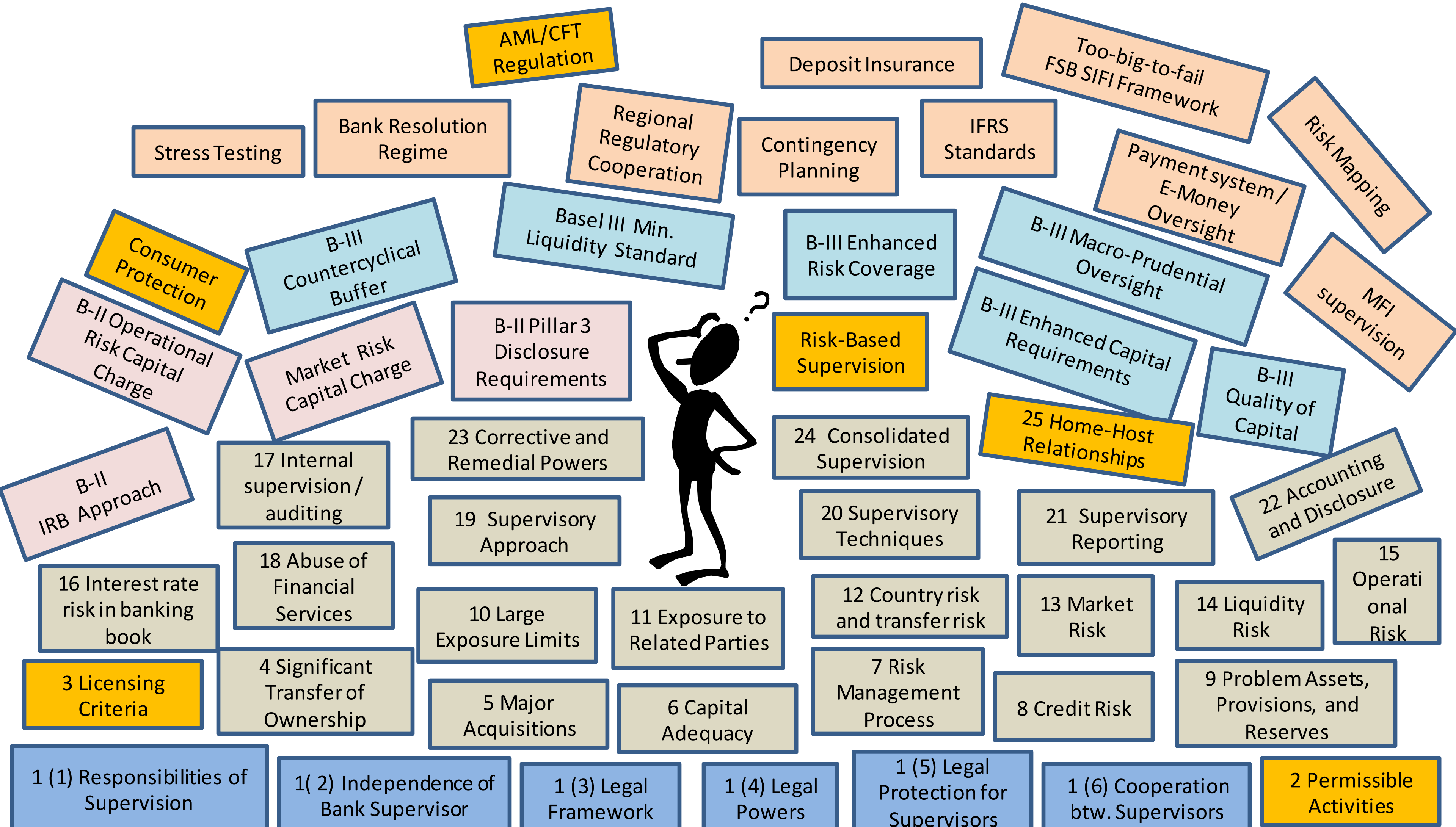
More regulatory reform… Not the shortcut of price fixing



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What concrete alternatives are we offering politicians?

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Key Recommendation on how to increase Private Sector Credit

Focus Area	Initiatives
Interest Rate	Instead of caps, rather promote the disclosure of APR by Banks and transparency in pricing (monitored by central banks/relevant agency
Collateral & Credit Information	Improve credit infrastructure by establishing central credit registries, collateral registry, WRS and an efficient insolvency resolution regime.
Efficiency	Implement National Payments Regulations to facilitate infrastructure sharing and interoperability of payment platforms.
Consumers	Enhance consumer protection laws and expand financial literacy programmes
Alternative Financing Instruments	Help Establish mechanism to deepen alternatives including early stage financing – e.g. Venture Capital, Equity Investment Vehicles or other early stage and SME financing instruments.
Long term Finance	Capital markets reforms since they provide alternative long term funds.

Conclusion

- Introducing interest caps does not address market failure but rather introduces one.
- Markets that have tried this blunt tool will end up hurting themselves.
- Interest rates are an outcome of an interplay of many factors – structural and policy – persistent high rates are remedied by addressing structural and policy problems.

Pegging interest rates

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