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SPECIALISED CONSUMER CREDIT PROVIDERS IN EUROPE

European Commission
Directorate General for Internal Market & Services
Unit H3 - Retail issues, Consumer Policy and Payment Systems

To: Philippe.Pelle@ec.europa.eu
Cc: Stefanos.Sofroniou@ec.europa.eu

Brussels, 25 March 2011

Dear Mr. Pellé,
Dear Mr. Sofroniou,

Eurofinas, the voice of consumer credit providers at European level welcomes the opportunity to respond to the European Commission's consultation on the IFF/ZEW study on *interest rate restrictions in the EU*.

As a member of the European Banking Industry Committee (EBIC), Eurofinas actively contributed to the EBIC response to the consultation and fully adheres to it. Our comments below should be seen as complementary to those made in the EBIC response.

We are willing to contribute to the Commission's work on interest rate restrictions in a positive and meaningful manner and stand ready to provide the Commission with any specific market expertise it may require.

I stay at your disposal to answer any question you may have on our comments below; alternatively feel free to contact my colleague Alexandre Giraud (a.giraud@eurofinas.org - tel: 02 778 0564).

Yours sincerely,

Tanguy van de Werve
Director General

Eurofinas is entered into the EC Register of Interest Representatives with ID N° 83211441580-56

In June 2010, Eurofinas published a number of preliminary observations on interest rate restrictions[1]. The Federation highlighted the importance of providing a complete analysis of the impact of interest rate restrictions on market conditions such as the number of players and the diversity/availability of consumer credit products before any conclusions were drawn on this issue.

We believe that, in this context, the IFF/ZEW study provides a starting point to reflect on interest rate restrictions at European level.

In September 2010, Eurofinas organised a roundtable on interest rate restrictions. The aim of this event was to bring together experts from different markets and professional background to share experiences and exchange views on pricing restrictions. A report of the event was published in January 2011[2].

Eurofinas' comments below shall therefore be read in conjunction with these existing documents. The Federation's response is based on feedback received from local experts, exchange of views organised on the subject matter in the last months and analysis of the academic work undertaken so far on interest rate restrictions (including the IFF/ZEW study).

1. Eurofinas takes the view that a sound and constructive discussion at European level on interest rate restrictions can only take place if it is first recognized that:

- different types of pricing control mechanisms for credit agreements coexist across Europe;
- their underlying rationales differ. The introduction of interest rate restrictions in some European markets can be explained by historical, social or cultural considerations;
- the impact of these mechanisms varies depending on the type of restrictions in place, the structure and maturity of the market and/or the type of active providers.

This was confirmed by the IFF/ZEW findings as well as other existing literature and more generally all market experts. This makes it difficult to draw uniform conclusions on the subject matter.

2. As previously highlighted by the Federation, the absence of statutory rate ceilings does not imply the nonexistence of limits or controls whatsoever on credit interest rates. In such cases, local jurisdictions are in charge of assessing *in concreto* the usurious/extortionate character of an interest rate/credit agreement.

Furthermore, the existence of statutory rate restrictions does not impact *per se* the validity of extortionate credit agreements. This is because in all cases borrowers still need to challenge at court the legality of a credit agreement.

This is why the Federation recommended to analyse interest rate restrictions in the wider context of consumer protection at European and national levels, addressing unfair commercial practices, unfair contract terms, information and pricing transparency[3]. Such regulations play a key role in structuring conduct of business in the field of consumer lending. We appreciate that these regulatory *corpuses* may not have a direct impact on interest rate levels. However, their objectives are congruent with those of local initiatives in the field of interest rate restrictions.

These elements could have been better taken into account in the IFF/ZEW study.

3. The Federation firmly believes that any statutory intervention in the field of interest rate restrictions undoubtedly has substantial impacts on market characteristics and business structures.

[1] See http://www.eurofinas.org/uploads/documents/positions/Eurofinas%20Preliminary%20observations%20IRR.pdf
[2] See http://www.eurofinas.org/uploads/documents/reports/Report%20IRR_web.pdf
[3] See Directive 2005/29/EC of 11 May 2005 concerning unfair business-to-consumer commercial practices in the internal market, Directive 93/13/EEC of 5 April 1993 on unfair terms in consumer contracts (both under review or soon to be reviewed), Directive 2008/48/EC of 23 April 2008 on credit agreements for consumers and ongoing EU regulatory initiative on mortgage responsible lending.

3.1 We support the view that interest rate restrictions reduce credit access, in particular for low-income borrowers. This is confirmed by all existing literature and evidence from markets where restrictions are in place. We do not believe that the 2003 Eurobarometer survey 60.2 on "consumers perception of easy and unlimited credit access" can possibly be taken as reliable data to assess the level of credit access.

> **3.1.1** As to the desirability of credit access for low-income borrowers, we believe that it is indeed an important question.
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> Every credit or loan application involves a certain level of risk to the lender, irrespective of the "quality" of the applicant borrower. If the level of risk is deemed to be too high, the lender will not accept such an application. This does not mean that any applicant turned down is a bad payer. It simply means that, based on the available information and the experience of applications from similar pools of borrowers, the lender is not prepared to take the risk of providing the credit to the applicant borrower.
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> Lenders are not obliged to accept any application. Each lender applies its own policies and has different risk assessment systems. Therefore, applications may be assessed differently by different lenders with the result that one lender may accept an application while another lender may reject it. Deciding upon acceptable levels of risk is, and should remain, a business decision.
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> Though this does not preclude the Commission from identifying and comparing the schemes that may be in place at national level to assist low-income borrowers, there are good reasons why those schemes are best handled locally. These include differences in local market characteristics (i.e. local risk segmentation of population, local competition, business strategies etc.), potential existence of alternative financing systems for those most in need and local cultural attitude towards credit in general.

3.2 We strongly believe that interest rate restrictions have an impact on the level of competition existing in the market where such restrictions apply. Large firms are better able to preserve a profitable activity than smaller competitors under such restrictive regulatory conditions and new entry by competitors is limited as new providers might face difficulties in offering alternatives to historical players. The impact is particularly important for specialised credit providers or non-deposit institutions whose funding costs are usually higher than those of deposit-taking institutions.

> **3.2.1** We support the view that interest rate restrictions impact on the diversity of products on offer. Markets without interest rate restrictions are able to provide a wider range of products to serve a diverse customer base.

3.3 Additionally, we take the view that the average consumer would not be granted cheaper credit in the presence of interest rate restrictions. Market data and existing literature show that following the imposition of a rate ceiling, lenders do not lower the price of credit but rather refuse more applications from high risk borrowers.

3.4 We strongly disagree with the consultants' conclusion that it is unlikely that the introduction of IRR leads to a decline in the volumes of consumer credit granted.

The premise that interest rate restrictions reduce credit access and exclude certain categories of borrowers from the market <u>without</u> having any impact on the overall volume of credit granted makes no sense. This is evidenced by past experience, notably in the Netherlands.

As mentioned by the consultants, other explanations can be found for countries that did not experience such decreases in credit volumes. For instance, we think that the increase in credit volume in Poland despite the introduction of IRR is to be explained by an extremely robust demand supported by a global convergence of CEE markets to EU 15 credit volume levels.

The economic principles underlying an operational credit market are equivalent to those applying to other types of services or to goods. The level of credit demand is linked to the price of the credit (i.e. the cheaper the credit, the more demand). In addition, markets generating profits for credit providers stimulate competition through market entry by new competitors and development of innovation. We support the view that banking regulation in general, the existence of state-owned banks and historical developments impact on the competitiveness of a market. We believe however that the existence of regulation on interest rates or credit pricing in general has also a significant bearing on market conditions and structures. Though these consequences may vary among markets, they should not be under-estimated.

In light of the elements mentioned above, Eurofinas believes that economic impacts of interest rate restrictions are indisputable. Though interest rate restrictions may respond to local concerns, we believe that the said elements are incompatible with European objectives of competitiveness, innovation, product diversity and sustainable credit markets.

4. We support the finding that there is no proven correlation between interest rate restrictions and reduced levels of over-indebtedness. As reported by the consultants, over-indebtedness is perceived almost equally strong among stakeholders from the same category in countries with and without interest rate restrictions.

The nature and causes of over-indebtedness vary widely. In addition, as it stands, definitions and measurement of over-indebtedness are not the same across European countries.

5. We believe that consistent European-level problems are yet to be identified and that the business case for an EU intervention is therefore still to be made. At this stage, the Federation warns against a potential intervention that could lead to profound structural and technical changes of the consumer lending business. When reflecting upon the outcome of the study and the possible next steps, Eurofinas believes that a number of elements deserve further analysis:

- Over-indebtedness, its preventive and curative treatments in European markets. Of key importance is a comprehensive dataset for the identification of reliable European trends.

- Illegal lending markets for which the study does not provide substantial information. The Federation believes that there is a strong correlation between rate restrictions and illegal lending. We recognise however that there is limited data and research available on the subject matter.

- Market exclusion in general and existing alternative finance mechanisms for low-income borrowers.

Eurofinas reiterates its willingness to cooperate with the European Commission on such issues.

ABOUT EUROFINAS

Eurofinas, the European Federation of Finance House Associations, is the voice of the specialised consumer credit providers in the EU. As a Federation, Eurofinas brings together associations throughout Europe that represent finance houses, specialised banks, captive finance companies of car, equipment, etc. manufacturers and universal banks. The scope of products covered by Eurofinas members includes all forms of consumer credit products such as personal loans, linked credit, credit cards and store cards. Consumer credit facilitates access to assets and services as diverse as cars, studies, furniture, electronic appliances, etc. It is estimated that together Eurofinas members financed over 320 billion euros worth of new loans during 2009 with outstandings reaching 720 billion euros at the end of the year.