EUROPEAN
MICROFINANCE WEEK 2015

FINANCIAL INCLUSION FOR SUSTAINABLE DEVELOPMENT

Does financial inclusion foster financial stability?

How access to toxic credits can increase financial exclusion ?

Olivier Jérusalmy – EFIN chairman

EFIN
European Financial Inclusion Network

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The fight against financial exclusion...

The European Financial Inclusion Network (EFIN) bases its actions upon the objective to tackle financial exclusion which refers to

a process whereby people encounter difficulties accessing and/or using financial services and products in the mainstream market that are appropriate to their needs and enable them to lead a normal social life in the society in which they belong.

EFIN on-going working groups on

2014 - 2015 Strategies to combat over-indebtedness

***-** Unfair lending practices and toxic loans*
- EU based “over-indebtedness” indicators
- Early financial difficulties detection & best practices for solution oriented treatment of financial difficulties

A public presentation will be organised in 2016 in Brussels (1st trim)

2016 – 2017 Next topic...
Financial services providers diversity and financial inclusion

Vulnerable people more exposed to predatory lenders

Markets allocate value according to economic power not according to the principles of fairness or social justice.
Free market providers will provide anything if **the price is high enough** and they can expect to make a return – nevertheless the higher level of arrears and defaults

A clear example of this can in **the sub-prime lending market** in certain member states where there is effectively no limit on the amount lenders can charge borrowers. For example, in the UK APRs of more than 200% are not uncommon - indeed, some lenders charge more than 1,000%.

Another example is the market of **mortgage credits in foreign currency**, which increase significantly the risk of default in case of change in the exchange rate

Unfair practice... increase instability of the users (illustrations)

In the UK, the Office of Fair Trading (OFT) and the Financial Services Authority (FSA) have led a research into the credit licensees' activities to develop a new regulatory regime for consumer credit...

OFT acts to revoke **Yes Loans**' licence … evidence of unfair business practices, including:

- using **high pressure sales tactics** to persuade consumers to provide their debit or credit card details on the false premise that they were required for an identity and/or security check
- **deducting brokerage fees** without making it clear that a fee was payable, and/or without the consumer's consent
- failing to introduce some consumers to the product originally sought, frequently **arranging short-term, high interest, loans** instead

Wonga reprimanded
In May 2012, the OFT told payday loan firm Wonga it must improve its **debt collection practices** after it emerged it had sent letters to customers accusing them of committing fraud.

Unfair practices ... increase poverty of the users

Loan shark victim helps jail his tormenter.

The following quotation is taken from the Guardian of the 26th June 2012.

*'Mike' ended up **paying over £90,000 over 17 years after buying car for £250** and tried to kill himself over stress and threats.' Mike' has been given a new identity and been praised for being brave enough to give evidence against the loan shark.*
A man who paid more than £90,000 to a loan shark after borrowing just £250 has been given a national award for helping to bring the illegal lender to justice.

Unfair practices... increase vulnerability of the users

From Romania (Romanian Financial Services Users Association)

Credits before crisis

• Loans with introductory interest rate – fixed for 3, 6 or 12 months and, after this period, variable starting from double or even more

• Very high interest rates for local currency (RON)

• Consumers were tempted by banks to borrow money in **foreign currencies** (EUR or CHF)

• **No restrictions on interest rates for banks** – most contracts have had abusive clauses

• The most frequent abusive clause: the bank have **the right to change the cost of credit (rate of interest) according to banking marke**t developments

Unfair practices... increase vulnerability of the users

*… **and the crisis hit Romania***

- **Fixed interest rates for limited periods becomes variable** – high increase of monthly instalments
- **Exchange rate for RON vs EUR and CHF rose significantly**
  - EUR: 3.13 (Jul 2007) - 4.28 (Feb 2009)
  - CHF: 1.89 (Jul 2007) - 3.60 (Jul 2011)
- Government decided to **cut all public wages** with 25% and to increase VAT from 19% to 24% (2010)
- Very sharp **decrease of the value of houses/flats**
- NBR (Central Bank) decided to introduce restrictions on lending (November 2008, but it was too late)

Unfair practices ... increase vulnerability of the users

… ***Consequences for Romanian consumers***

- Very sharp **increase of monthly instalments** for credits in foreign currency
- **Decrease of wages** and increase of unemployment
- Decrease of capacity to pay installments in time
- **Reduction in standard of living**
- Deterioration of some fundamental rights
- Increase of **financial exclusion**
- Home repossession became reality for many people

Unfair practices... increase vulnerability of the credit providers

Bad quality of the credit portfolio related to irresponsible practices

In March 2013, MCO Capital (online payday lender) loses its licence:
In August 2012, the OFT found that MCO had failed to put in place **adequate identity checks** for loan applicants. It is thought that this failure led to MCO being targeted by fraudsters who used the personal details of over 7,000 individuals to apply successfully for loans totalling millions of pounds.

Additionally, the OFT found that MCO **lacked the necessary skills**, knowledge and experience to run a consumer credit business.

Access to credit is not... a proof of financial inclusion

Consumers who **access sub-prime market credit** / or any other type of credit with unfriendly "terms and conditions"...
could be considered as "financially included" if at least they **do not meet difficulties in the use** of such products...

Difficulties can be...

- Unbalanced budget;
- Extra financial costs because of unclear terms and conditions;
- Extra penalties because of misuses;
- Default credit;
- Never ending credit;
- Over-indebtedness

and lead to poverty, financial exclusion & social exclusion

Unfair credit practices and stability

- US sub-prime credit market excess... and 2007 consequences
- Payday lenders and other predatory lenders that exploit vulnerable people and increase the risk to become poor and socially excluded
- Mortgage credit in foreign currency that generate big issue in countries where they have been sold... (situation in Romania...)

All these products have been designed to generate potential high level of profit even if they are generating a significant number of...

- **defaults;**
- **arrears;**

In some circumstances, some of these products are even more profitable WHEN they generate extra costs, penalties because of misuse, or never ending reimbursement...
Evidence exist in the revolving credit industry

***A fortiori*, unfair credit practices ARE NOT a factor of stability for the users, and, in some circumstances, for the lenders as well**

Why the quality of the credit portfolio is a relevant indicator...

- The default rate (default contracts /credits contracted) and the arrear ratio per type of credit bring relevant informations on :
  - the type of **credit that are « more risky»** than the others;
  - the type of **creditors that are more active in the field of risky credits**
  - the quality of the **general credit portfolio**, as part of the balance sheet of the creditor

These default and arrear ratios can be **relevant** ...

- **to assess « responsible / irresponsible credit » practices** (good and bad players)

- **to identify « toxic credit»**

  Credits with higher level of arrear and default than the average rate encountered on the market

… **for policy makers, in order to assess the credit market regulation on responsible practices**

Credit default rates should be part of credit industry reporting

- The default rate per type of credit, per credit providers should be included in the **compulsory reporting activities** of each credit providers.
- In too many cases, the credit industry has shown its capacity and creativity to develop profitable products “even if” or more likely « precisely because » they are generating arrears and defaults that increased extra charges and penalties to be paid by the credit users,... and therefore boost the whole profit – such products should be labeled as « **toxic products** »

- **Credit default rates should be part of micro-prudential reporting process**

Does financial inclusion foster financial stability?

Thank you for your attention!

EFIN
European Financial Inclusion Network

Olivier Jérusalmy
Olivier.jerusalmy@rfa.be
www.fininc.eu

www.fi-compass.eu

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