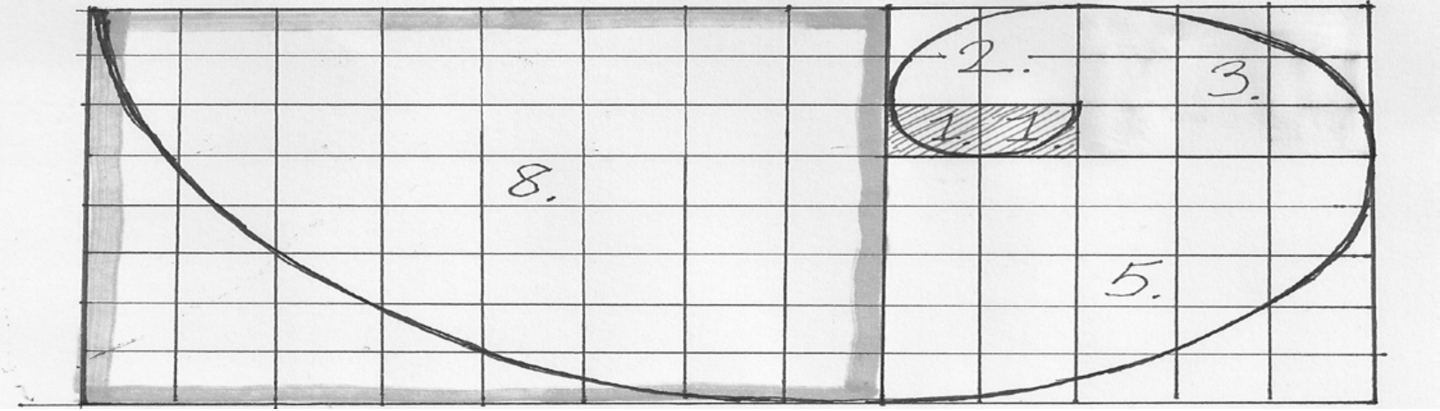

THE PARADOXICAL CASE AGAINST HARD INTEREST RATE CAPS – AND HOW FINTECH & REGTECH CAN SOLVE THE DILEMMA

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A.

The Issue

Data speaks…

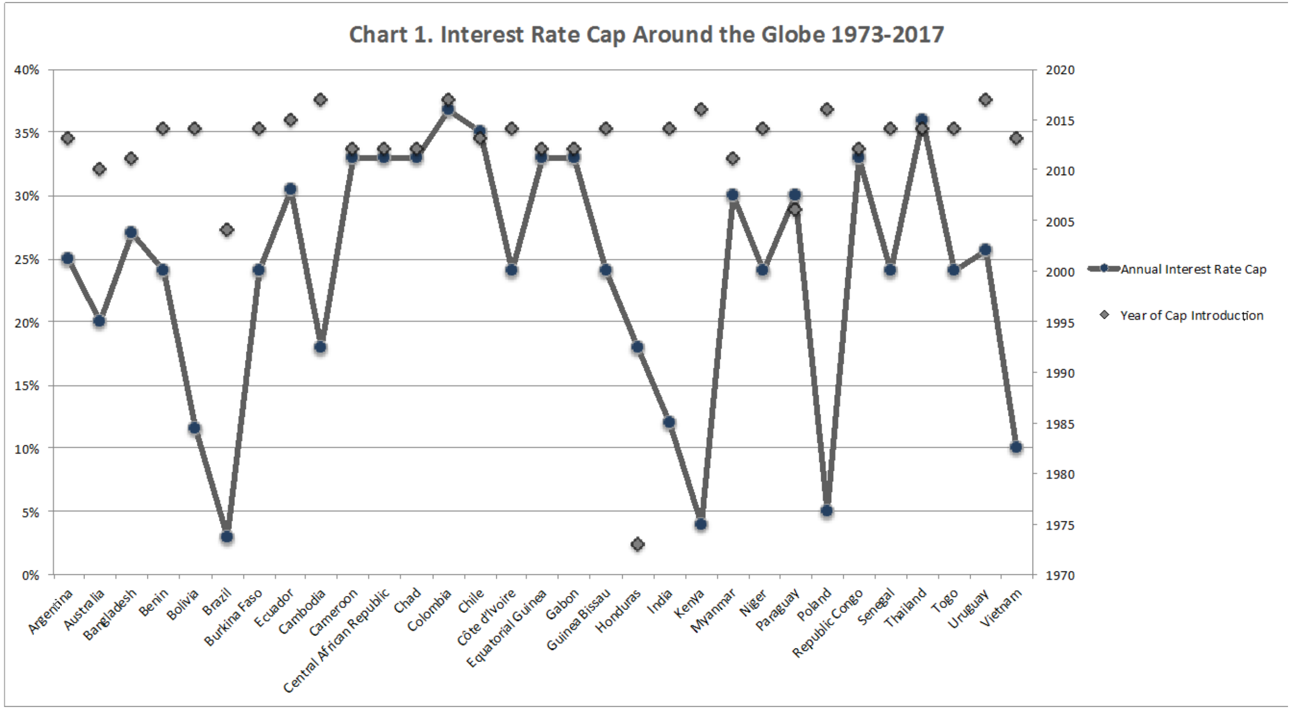

Chart 1. Interest Rate Cap Around the Globe 1973-2017
40%
35%
30%
25%
20%
15%
10%
5%
0%
2020
2015
2010
2005
2000
1995
1990
1985
1980
1975
1970
Annual Interest Rate Cap
Year of Cap Introduction
Argentina
Australia
Bangladesh
Benin
Bolivia
Brazil
Burkina Faso
Ecuador
Cambodia
Cameroon
Central African Republic
Chad
Colombia
Chile
Côte d'Ivoire
Equatorial Guinea
Gabon
Guinea Bissau
Honduras
India
Kenya
Myanmar
Niger
Paraguay
Poland
Republic Congo
Senegal
Thailand
Togo
Uruguay
Vietnam

Research question

1. *How to achieve fair interest rates?*

2. *Are there better solution instead of ‘hard interest rate cap’ to decrease interest rate?*

Embarking on terminology

- **‘soft caps’**

- **‘mezzo caps’**

- **‘hard caps’**

Why imposing interest rate cap?

- Ensuring a ‘fair’ price
- Prevention of exploitation by deceptive credit providers
- Political and economic reasons
- Challenging anticompetitive behavior
- Client protection

B.

The analysis

The weak fundament of interest rate regulation

- The cost of funds
- Credit risk: Substance vs Form
- Transaction costs
- Value-added services

Side effects of hard interest rate caps

- Deprive the quantity of credit available for the poor
- Limit product diversity
- Prevent providers to stay in the market
- Clients of MFIs are forced to re-enter the informal credit market
- Mission drift

The weak case for hard caps – in relation to service level

Cost	Service	Interest Rate (IR)	Appraisal
Low (-)	Low (-)	Too high	Could be (1) an efficient MFI or (2) inefficient MFI - with low service level and high MFI profit
High (+)	Low (-)	Too high	Inefficient MFI
Low (-)	High (+)	Too low	Could be an efficient MFI struggling with too low IR
High (+)	High (+)	Too low	Could be (1) an efficient MFI or (2) inefficient MFI - with high service level and both are struggling with too low IR

We do not know who is of which type? -
- Information Asymmetry --

Comparison with the North

- Differences in the ecosystem

- Effective interest rate disclosures

C.

Contribution

We add to the literature…

- To look at the clients side: the case for a credit register
- To look at the intermediary side: disclosure of effective rates
- Enhance competition among all credit intermediaries
- Facilitate Digital Financial Services (DFS)

Pro RegTech-based credit registers

- Mitigate the risk of over-indebtedness
- Increase efficiency, competitiveness and the volume of lending
- Reduce information asymmetry in the credit markets
- Enhance information of Central Bank on risk side => precondition for mezzo cap enforcement
- Decrease default rates

Enhancing competition

- It urges providers to propose the most attractive products and services to client.

- It helps to mitigate against economically inefficient and socially undesirable business model

Disclosure of effective rates

- Increase transparency

- Clients can obtain a clear picture to compare interest rates between lenders, while deceptive lenders will lose business

- Full disclosure paired with fair practice is the best protection for borrowers, particularly where financial literacy is low

Facilitating Digital Financial Services / DFS

- Decrease transaction cost
- Increase efficiency
- Enlarge potential outreach which could bolster financial inclusion
- Redefines accessibility and affordability
- Enables underserved clients to transact in small amounts at (hopefully) affordable costs
- Minimize the risk of financial crimes peculiar to cash-based transactions

D.

Conclusion & Theses

Conclusions

- Exorbitant microfinance interest rates are undesirable.
- A hard interest rate cap, albeit if it sets with good intentions, it most often fails to achieve the objective.
- One size fits all regulation disregards the unique needs of different MFIs characteristics.
- We recommend to focus more on cost side rather than income side:
    a. Implementing Credit Register
    b. Enhancing competition
    c. Applying disclosure (transparency)
    d. Facilitating Digital Financial Services

How FinTech and RegTech Resolve The Dilemma of Hard Interest Rate Caps in Microfinance
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