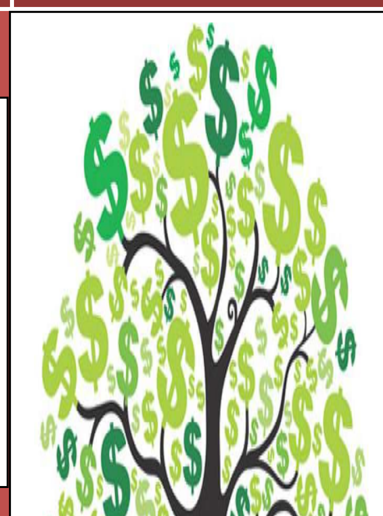
FAIR TRADING COMMISSION

An Exploratory Review of Moneylender Services

May 2017



KINGSTON, JAMAICA

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FAIR TRADING COMMISSION

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EXECUTIVE SUMMARY

Introduction

1. Increasing access to credit is arguably the most powerful strategy any government can implement to drastically improve upon the social and economic status of individuals during the span of one generation. Financial Inclusion may be defined as "the delivery of financial services at affordable costs to sections of disadvantaged and low-income segments of society."[1] The World Bank affirms that "…financial inclusion is a key enabler to reducing poverty and boosting prosperity."[2] In March 2017, the Government of Jamaica articulated its National Financial Inclusion Strategy (NFIS), in support of Vision 2030-National Development Plan.
2. A fundamental problem faced by most businesses and individuals is that the resources available at the earlier stages of the life cycle is inadequate to support the level of consumption required to generate the additional resources in the later stages. This problem is solved by financial intermediaries who take funds from individuals and businesses with excess resources and on-lend to consumers who have inadequate resources.
3. Accordingly, the incidence of financial intermediation is the hallmark of economic and social progress in any economy.
4. The primary objective of the study is to inform the National Financial Inclusion Strategy by assessing the nature and scope of competition in the moneylender market.

Description of the Moneylender Market

5. Moneylenders issue loans at nominal rates which are typically significantly higher than the rates for comparable loans issued by regulated financial institutions such as commercial banks, building societies and credit unions. In this section, the report describes important structural characteristics of the market which inform the assessment of the extent of competition in this market.

[1] https://en.wikipedia.org/wiki/Financial_inclusion (accessed April 30, 2017)
[2] http://www.worldbank.org/en/topic/financialinclusion (accessed: April 30, 2017)

6. The key findings in this section are that the moneylender market is subject to competition as it is characterized by easy entry conditions and a distribution of fractional market shares.

Methodology

7. Data used in this study were gathered primarily through surveys administered by the FTC over the telephone.
8. The FTC administered the client questionnaire to the representative sample of 38 individuals during the period October 27, 2016 to January 12, 2017. Also, the FTC administered the moneylender questionnaire to the 11 moneylenders during the period January 16 through March 3, 2017.

Interpretation of Key Survey Results

9. In this section, the results of the moneylender and client surveys are organized to provide an integrated demand-side and supply-side analysis of the nature of competition in this market. In assessing the nature of competition, the report characterizes the demographic profile of clients, the main reason clients access this market, the basis on which suppliers attract clients and the main strategies suppliers employed by suppliers.
10. The key findings in this section are that (i) A significant proportion of clients served by moneylenders could be considered a part of the group of disadvantaged members of the society; (ii) moneylenders differentiate their services from traditional providers of small loans on two dimensions: (a) easy access and (b) short processing time; (iii) There is scope for significant growth in the demand; (iv) moneylenders compete with each other; (v) moneylenders compete with traditional sources of credit for small loan amounts; (vi) In general, loan agreements issued by moneylenders contain all the materially relevant information about the loan; (vii) A significant proportion of clients lack an appreciation for the basics of personal finance; (viii) One of the findings of the study is that creative advertising by moneylenders is likely to confuse financially illiterate clients; and (ix) An important finding of the study is that delinquency rate is relatively high in the moneylender market, despite measures to limit the inherent delinquency risks.

Policy Discussion

11. In this section, the report presents critical perspectives revealed by the study which should inform policies being developed for the financial sector in general, but the moneylender market in particular.
12. The true social value of moneylenders is not only the products they offer but also who they serve. In particular, preliminary data suggest that 30% of persons who access credit through moneylenders were reportedly not eligible to access credit at traditional sources. If the data are confirmed, it would mean that the National Financial Inclusion Council of Jamaica, for example, would have a clear and unambiguous interest in seeking to facilitate the improvement and expansion of the moneylender market in support of its goal of financial inclusion. The most efficient means of improving and expanding the market is to safeguard competition in the market.
13. Based on the study, ways of improving the moneylender market from the perspectives of moneylenders and the FTC are offered below.
    a. Moneylenders' Perspectives
14. Moneylenders offered three suggestions to improve the market: (i) Access to cheaper source of funds; (ii) An expansion in clients captured by Credit Bureaus; and (iii) Regulations limiting the number of moneylenders.
    b. FTC's Perspectives
15. The most efficient means of improving and expanding the market is to safeguard competition in the market.
16. The FTC's primary concern is that the Bill contains clauses which are likely to unduly impede competition by unnecessarily restricting entry as well as unnecessarily interfering with movements in the interest rates.

Conclusion

17. The true social value of moneylenders, however, is not only the products they offer but also who they serve. In particular, preliminary data suggest that 30% of persons who access credit through moneylenders were reportedly not eligible to access credit at traditional

sources. If the data are confirmed, it would mean that the National Financial Inclusion Council of Jamaica would have a clear and unambiguous interest in seeking to facilitate the improvement and expansion of the moneylender market in furtherance of its goal of financial inclusion. It is the FTC's position that such expansion should take place on the foundation of competition.

Recommendations

a. Policymakers should consider omitting clauses in the Draft MicroCredit Bill which are likely to unnecessarily restrict the scope of competition in the sector;
b. Policymakers should ensure that adequate sanctions are imposed on moneylenders which do not disclose Annual Percentage Rates in advertisements;
c. Policymakers should identify a cheaper source of funding for all financial intermediaries, including moneylenders;
d. Policymakers should develop a set of terms that should be included in contracts issued by moneylenders. For example, penalties and all other relevant charges that may be levied on a borrower in the course of the loan should be included in the loan agreement. There should be no ambiguity in the determination of these charges;
e. Consumers should be given access to programs designed to improve financial literacy; and
f. Credit Bureaus should be encouraged to capture a wider cross-section of the public.

I. INTRODUCTION

1. Increasing access to credit is arguably the most powerful strategy any government can implement to drastically improve upon the social and economic status of individuals during the span of one generation. Financial Inclusion may be defined as "the delivery of financial services at affordable costs to sections of disadvantaged and low-income segments of society."[3] The World Bank affirms that "…financial inclusion is a key enabler to reducing poverty and boosting prosperity."[4] In March 2017, the Government of Jamaica articulated its National Financial Inclusion Strategy (NFIS), in support of Vision 2030-National Development Plan. The stated goal of the NFIS is to

   > "…create the conditions in which Jamaicans, particularly those who were previously underserved by the domestic financial system, are able to save safely and build up resilience against financial shocks, and firms are able to invest, grow and generate greater wealth."[5]

2. The social surplus generated by any economy is predicated on the strategic consumption of goods and services during the respective life cycles of businesses and residential consumers. For example, adequate consumption of crucial items such as food, shelter, education and health care services in the earlier stages of the life cycle of individuals is likely to significantly augment the flow of resources generated by the individual in the later stages of the life cycle. Similarly, adequate consumption of crucial items such as start-up capital, business training and capacity building advisory services in the early stages of the life cycle of businesses is likely to significantly augment the flow of resources generated by a business in the later stages of its life cycle.

3. A fundamental problem faced by most businesses and individuals is that the resources available at the earlier stages of the life cycle is inadequate to support the level of consumption required to generate the additional resources in the later stages.

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[3] https://en.wikipedia.org/wiki/Financial_inclusion (accessed April 30, 2017)
[4] http://www.worldbank.org/en/topic/financialinclusion (accessed: April 30, 2017)
[5] National Financial Inclusion Council of Jamaica, National Financial Inclusion Strategy: Access for All, 2016-2020. Available for download at http://boj.org.jm/pdf/Jamaica_NFIS_Final_Draft.pdf (accessed: April 30, 2017)

4. There is both good news and bad news regarding a viable solution to this problem. The good news is that this problem is solved by financial intermediaries who take funds from individuals and businesses with excess resources and on-lend to consumers who have inadequate resources. Through the loan services offered by financial intermediaries, business and residential consumers could arbitrarily increase their economic surplus during their life span through timely access to credit. The bad news is that a significant segment of the economy has limited access to financial intermediaries.
5. Accordingly, the incidence of financial intermediation is the hallmark of economic and social progress in any economy. In 2016, the Government of Jamaica took the initial steps to review access to funding in the space in which commercial banks operate. This is part of a wider initiative to conduct phased reviews of banking, insurance and pension regulations that impact access to finance.
6. The more popular species of financial intermediaries in Jamaica include commercial banks, building societies and credit unions. Government has created distinct regulatory environment for each species of financial intermediary typically restricting the behavior of the financial intermediaries including the number of financial intermediaries and the range of financial services that could be offered. In Jamaica, a notable exception to this general rule of tight regulations for financial intermediaries is a species called *moneylenders*. The Parliament of Jamaica, however, is debating the Draft MicroCredit Bill geared toward closing this regulatory gap.
7. Moneylenders offer consumers ('clients') immediate loans in small quantities at nominal interest rates which are significantly above rates offered by traditional financial institutions such as commercial banks, credit unions and building societies.[6] Casual observation suggests that the number of moneylenders operating in Jamaica has grown significantly in recent years. The moneylender market is therefore becoming an important access to credit for a growing number of clients and will likely be an important part of the wider financial sector in the foreseeable future.

[6] Moneylenders issue loans which are commonly known as "same-day loans" and "payday loans." Some moneylenders are informally referred to as "loan sharks" due to, among other things, the perceived exploitatively high interest rates on their loans.

8. The primary objective of the study is to inform the National Financial Inclusion Strategy by assessing the nature and scope of competition in the moneylender market. In some instances, this study replicates the findings of previous studies. In other instances, however, there are some distinct departures which should persuade policymakers to at least reconsider the utility of key provisions in existing and proposed legislation governing moneylenders.
9. This research complements previous studies which have examined the conditions under which moneylenders compete (Mann, 2013) and the effect of introducing transparency in the operations (Durkin, Elliehausen, 1990; Hadfield, Howse, Trebilcock, 1998; and Clemenz, 1979).
10. Existing legislation in Jamaica places a ceiling on the rates that could be legally charged by moneylenders. Presumably, such a provision might reflect a concern that moneylenders might otherwise charge excessively high interest rates. This concern may have been fuelled by previous studies such as one the United Kingdom (UK) which found that the moneylender market was characterized by usurious interest rates as well as questionable terms and conditions under which loans are disbursed.[7] This study departs from this characterisation by explaining why of interest rates are unlikely to be excessive and demonstrating that imposing a statutory ceiling is unnecessary.
11. In 2012, the Office of Fair Trading (OFT) in the UK conducted a review of the market to determine compliance with the Consumer Credit Act and the Irresponsible Lending Guidance. The OFT's review revealed that moneylenders competed on the basis of "speed of approval" rather than on the basis of "price". The fact that moneylenders compete (with traditional financial institutions) on the basis of speed of approval was also supported by this study.
12. The competition among moneylenders based on speed of approval resulted in inadequate affordability assessment being conducted and loans granted to consumers who were unable to repay. This further resulted in the refinancing of consumer loans (OFT, 2013). The OFT

[7] Caskey (2002) describes a payday loan as an uncollateralized closed-end loan intended to help a person meet financial needs prior to the borrower's next payday.

found evidence that the moneylenders benefited from refinancing the loans of consumers as their revenue streams relied heavily on rolling over and refinancing loans.

13. Regarding consumer information, the OFT concluded that consumers were unaware of the costs and the risks associated with payday loans. This was partly attributed to the action of moneylenders in emphasizing the speed and simplicity of accessing the loan with little attention to due process. The deficiency of consumer information is also revealed in the study.
14. The report also revealed that many consumers had weak bargaining positions once engaged in a loan and that the moneylenders were not accommodating to borrowers experiencing financial difficulties. In many instances, the moneylenders were engaged in aggressive debt collection practices.
15. The Competition Commission (CC) in the UK conducted an investigation on whether competition was working well in the sector.[8] The investigation revealed that moneylenders competed on non-price factors rather than price (Competition Markets Authority (CMA), 2015). The CMA also reported that competition from other credit products such as banks posed only a weak competitive constraint to moneylenders. Regarding consumer behaviour, the CMA indicated that more than half of clients did not shop around prior to taking out a loan.
16. The enhancement of consumer information is critical to the operation of competitive markets. Studies supporting the benefits of transparency to consumers include Reed, 2010; Durkin, Elliehausen, 1990; Clemenz, 1979; and Hadfield, Howse, Trebilcock, 1998. Similarly, transparency also benefits lenders as it ensures that those with the best offerings receive the bulk of business. Studies purporting the benefits of transparency to lenders include Arguello, et al. 2012; Augustine, 2012*;* Beales, Craswell, Salop, 1981.
17. A growing body of literature has emerged since the seminal work of Stiglitz and Weiss (1981) which detailed the impact of asymmetric information on the market for lending. According to Crawford *et al* (2015), this impact includes the rationing of credit, inefficient provisioning, mispricing of risk and, in the limit, market breakdown. One problem that has

[8] In April 2014, the Competition Markets Authority (CMA) took over many of the functions and responsibilities of the OFT and the CC.

been pervasive in the literature in this regard is that of the interest rate calculated being different from the annual percentage rate (APR).[9] Other less heralded but important omissions or distorted information relate to unreasonable fees, payment due dates and amount to be paid back.

18. There is always a threat that illegal activities will infiltrate any financial market. The financial market could therefore collapse if steps are not taken to discourage illegal activities. These steps usually form a significant part of the regulatory regime established for the financial sector. The threat of illegal activities is particularly heightened in the moneylender market in Jamaica because the market is unregulated. Moneylenders which engage in illegal activities are commonly referred to as "loan sharks." Unfortunately, some legitimate moneylenders often get mislabeled as loan sharks.
19. Previous research in this area suggests that Government should take care in how they regulate the market as the remedial measure system implemented could also threaten the viability of the market. For example, when faced with the problem of loan sharking, the Government of Malaysia adopted a heavy handed approach of empowering its police authorities to search, seize and arrest the properties or person of unlicensed lenders. The intent of the government was to cripple the forces that threatened the existence of the moneylender market by their unscrupulous actions. However, this approach has been criticized by Teo (2015), who posits that there have been some unintended consequences such as the choking of the operations of legitimate moneylenders. This study also highlights unintended consequences of provisions in the current Draft Micro Credit Bill geared toward regulating moneylenders in Jamaica.
20. In the next section, a structural description of the moneylender market is presented. Section III provides a brief description of the surveys administered to clients and moneylenders in Jamaica. This is followed in Section IV with an interpretation and discussion of the responses to both surveys. A discussion on policy is offered in Section V after which the report concludes in Section VI. Recommendations are offered in Section VII.

[9] The APR includes all costs associated with the loan such as fees or closing cost while the interest rate is the annual cost of the funds borrowed without the inclusion of fees etc.

II. DESCRIPTION OF THE MONEYLENDING MARKET

A. Analytic Framework and Overview

21. Moneylenders issue loans at nominal rates which are typically significantly higher than the rates for comparable loans issued by regulated financial institutions such as commercial banks, building societies and credit unions. In this section, the report describes important structural characteristics of the market which inform the assessment of the extent of competition in this market.
22. Competitive restraints refer to conditions which provide adequate incentives and opportunities for suppliers to offer their goods and services at competitive prices. All other things held constant, competitive restraints include (i) easy entry, expansion and exit ('low entry/exit impediments'); and (ii) fractional market shares ('low market concentration'). In assessing competition, the report identifies two features of the moneylender market which provide a competitive restraint.

B. Main Results

23. The key findings in this section are that the moneylender market is subject to competition as it is characterized by easy entry conditions and a distribution of fractional market shares.
24. The primary factors underlying these findings are presented below.

i. Easy Entry Conditions

25. The legislative framework regulating moneylenders is lax. The Money Lending Act is the only sector-specific legislation guiding moneylenders in Jamaica.[10] Moneylenders are not required to seek a license to operate either are they required to be registered with any central authority. Moneylenders are otherwise subject to general purpose legislation such as the Fair Competition Act, enforced by the FTC, and the Consumer Protection Act enforced by the Consumer Affairs Commission (CAC). Accordingly, moneylenders may enter the market quickly and face considerably less impediments, relative to more intensely

[10] The Government of Jamaica is finalizing a Draft Micro Credit Bill to regulate what are called microfinance institutions. Moneylenders will also be regulated under the Microcredit Bill even though the Money Lending Act will not be repealed.

regulated financial institutions. This means that the regulatory environment creates conditions which are relatively easy for moneylenders to enter and exit the market.

ii. Fractional Market Shares

26. Anecdotal evidence suggests that there are at least 100 moneylenders operating in Jamaica. In the November 3, 2013 edition of the **Sunday Gleaner**, for instance, Avia Collinder reported that there were about 100 brick and mortar moneylenders operating in Jamaica with an average two new entrants every month ("Moneylenders to be licensed under Micro Credit Bill"). A review of the yellow page listings suggests that the number of moneylenders continued to increase beyond 2013. In particular, in 2017 the number of moneylenders listed in the telephone directory was 47, which more than doubled the 21 listings of 2011. (Yellow Pages: Kingston and St. Andrew, 2017). Given the numerous incumbent moneylenders, it is likely that each moneylender will command only a small share of the market.

27. Based on the easy entry conditions and fractional market shares, it is likely that moneylenders face competitive restraints. The key feature of the market driving this result is the lax regulatory structure which has resulted in a market in which moneylenders most likely have fractional market shares and conditions which make it relatively easy for new entry. The overall impact of this legislative framework is indeterminate as it has both a positive and a negative effect on the market. The positive effect arises because the lax regulatory framework promotes competition by facilitating an environment in which there is virtually no impediment to entering the market- unlike the case for the tightly regulated financial markets. The negative effect arises because the lax regulatory environment makes the market more susceptible to collapsing because of heightened perceived reputational risks associated with illegal activities including money laundering and the illicit narcotics trade. These effects are discussed in greater detail in a later section of this report.

III. METHODOLOGY

28. Data used in this study were gathered primarily through surveys administered by the FTC over the telephone. In this section, the report briefly describes the sample selection process.

<u>Client Survey</u>

29. With the invaluable assistance of The Office of Utilities Regulation (OUR), the FTC compiled a list of 1,500 randomly selected mobile phone numbers. Of the calls made to the numbers on the list, 495 were answered but only the 38 individuals were willing and eligible to participate. The FTC administered the client questionnaire to the representative sample of 38 individuals during the period October 27, 2016 to January 12, 2017.

<u>Moneylender Survey</u>

30. All 47 moneylenders listed in the telephone directory were invited to participate in the study but only 11 consented to the interview. The FTC administered the moneylender questionnaire to the 11 moneylenders during the period January 16 through March 3, 2017.

IV. INTERPRETATION OF KEY SURVEY RESULTS

A. <u>Analytic Framework and Overview</u>

31. In this section, the results of the moneylender and client surveys are organized to provide an integrated demand-side and supply-side analysis of the nature of competition in this market. In assessing the nature of competition, the report characterizes the demographic profile of clients, the main reason clients access this market, the basis on which suppliers attract clients and the main strategies suppliers employed by suppliers.

B. <u>Main Results</u>

The key findings in this section are that (i) A significant proportion of clients served by moneylenders could be considered a part of the group of disadvantaged members of the society; (ii) moneylenders differentiate their services from traditional providers of small loans on two dimensions: (a) easy access and (b) short processing time; (iii) There is scope for significant growth in the demand; (iv) moneylenders compete with each other; (v) moneylenders compete with traditional sources of credit for small loan amounts; (vi) In general, loan agreements issued by moneylenders contain all the materially relevant information about the loan; (vii) A significant proportion of clients lack an appreciation for the basics of personal finance; (viii) One of the findings of the study is that creative advertising by moneylenders is likely to confuse (financially illiterate) clients; and (ix) An important finding of the study is that delinquency rate is relatively high in the moneylender market, despite measures to limit the inherent delinquency risks.

32. The primary factors underlying these findings are presented below.

i. Profile of Clients

33. The client survey provided useful insight into the demographic profile of clients of moneylenders. The results show that 61% are female, 89% are earning a living and 57% are between the ages of 25 and 44 years.[11] Approximately 54% are married while 70% reported having no more than two dependents and 55% earning between $30,000 and $99,000 monthly.[12] The survey also shows that 68% of clients completed secondary level education or higher.

34. With implications for implementing the National Financial Inclusion Strategy, the study revealed that moneylenders serve a significant number of persons who could be considered part of the group of disadvantaged members of the society. In particular, it is noted that 10% of clients are unemployed/retired. In terms of family structure, 35% were single and 30% reported having between 3 and 8 dependents. Regarding disposable income, the study revealed that 9% of clients earn less than $30,000 per month.[13] Regarding educational achievement, the study revealed that 32% of clients failed to complete a secondary school education. Regarding age, approximately 3% of clients are between the ages of 18-24 years with 40% being older than 44 years.

[11] Among the group earning a living, 42% are self-employed while the other 47% are employed by someone else.
[12] The group of "married" clients includes those involved in common-law relationships.
[13] By way of benchmarking, the National Minimum Wage in Jamaica is $6,200 per 40-hour work week. A person earning minimum wage in Jamaica will therefore earn $24,800 monthly.

ii. Differentiated Services

35. This result was confirmed in both surveys. In response to a question asking clients to identify the main characteristics which attracted them to the moneylenders, 28% of clients indicated that “less restrictive eligibility requirements” was one important factor while 27% indicated that “quicker processing time” was another important factor.

36. Further, 8 out of 11 moneylenders indicate that “ease of access/flexibility” was a distinguishing feature; and 8 out of 11 moneylenders indicate that “speed/less bureaucracy” was another distinguishing feature. Further, moneylenders use these features prominently when promoting their businesses. For instance, moneylenders use terms in advertisements such as “quick cash,” “hassle-free loans,” “speedy approval” and “quick process.”

iii. Anticipated Growth in the Demand

37. Approximately 49% of those surveyed reported that they were first time clients of moneylenders which suggest that the demand is buoyant.

38. It is also clear that moneylenders are anticipating a growth in demand as evidenced by a recent expansion and a recent entry in the sector. In particular, in April 2017 Grace Kennedy Money Services announced plans to expanding its services as a moneylender (**Sunday Gleaner**, “GKMS enters MicroLending Market,” April 2, 2017). Also ISP Finance Services Ltd (ISP) successfully raised J$260 million to expand in the sector. ISP reported that it expected to grow during 2017 despite the entry of new competition such as Grace Kennedy Money Service (Avia Collinder, “ISP Finance Floats J$ bond; targets $150 million in new funding,” **Daily Gleaner**, August 30, 2016; Steven Jackson, “Microlender ISP Bullish on New Business despite Competition,” **Daily Gleaner**, April 5, 2017.) Additionally, the Development Bank of Jamaica has given the sector its vote of confidence evidenced by its disbursement of loans valuing over 4.6 billion dollars to its 13 accredited moneylenders for the purpose of on-lending to entrepreneurs since 2009. [14]

[14] http://dbankjm.com/microfinance/

iv. Rivalry among Moneylenders

39. Based on survey responses, moneylenders appear to be actively competing among each other. In particular, one moneylender stated that it has had to lower interest rates and/or increase the maximum loan granted to meet the competition of the increasing number of moneylenders entering and luring away clients. This strategic reduction in interest rates in response to new entry is consistent with arguments presented earlier in this report indicating that easy entry conditions imposes a competitive restraint on incumbent moneylenders.

v. Market Space

40. In competition economics, the market comprises a group of products perceived by consumers to be close substitutes.
41. Moneylenders would be considered to be competing with traditional sources of credit if a significant number of clients perceive them to be close substitutes. In particular, the FTC was interested in determining what proportion of clients of moneylenders was also eligible to receive loans from traditional sources. In response to a question which asked clients why they selected moneylenders rather than another source of credit, 30% indicated that moneylenders were chosen because of the less restrictive eligibility requirements, i.e. loan qualification criteria. This suggests, albeit inconclusively, that at least 70% of clients of moneylenders were also eligible to secure loans at other sources of credit. If this proportion is confirmed with a more rigorous analysis, this is indeed strong evidence that moneylenders operate in the same market as traditional sources of credit for small loan amounts.

vi. Complete Loan Contracts

42. Ideally, the loan agreement should establish in clear terms, the obligation of the moneylenders and their clients over the tenure of the loan. Within this loan agreement are four critical pieces of information: penalties (fees for late payments); the rate of interest charged; the payments due date; and the amount to be repaid by the payment due date.

43. Understanding this agreement, therefore, is important for consumers to select the loan with the most favourable terms. Approximately 95% of the participants stated that they signed a loan agreement with 80% of them indicating that they were given a copy of the agreement.
44. Most of the clients surveyed indicated that they were given information on penalties (90%), interest rate (87%), due dates (97%) and amount to be repaid (100%). This is evidence that clients are given the information required, for the most part. Further all the moneylenders surveyed said that they provided clients with information on penalties, interest rates, payment due date and payment amounts in the loan agreement. They also indicated that they provided clients with a copy of the signed loan agreement. One moneylender stated that it provided its clients with the loan agreement only if requested.
45. One detail to be determined, however, is whether the information presented is being interpreted properly by clients. Based on the FTC's investigation of complaints lodged by clients, there a clear deficiency in clients' understanding of the terms of loan agreements. In 2016 the FTC received five complaints against moneylenders. Four of the five complaints involved the misinterpretation of the terms of the agreement signed. Clients claimed that the interest rate charged and the overall cost of the loan was higher than what they agreed to. In reviewing the loan agreements, however, the FTC concluded that the clients misinterpreted the terms of the loan agreement and the complaints were resolved in favour of the moneylenders.

vii. Financial Illiteracy

46. The responses to the client survey were also used to gauge the extent of financial illiteracy among clients. The results are reported below.
47. Moneylenders vary in how they disclose interest rates. Monthly interest rates were disclosed by 5 of the 11 moneylenders interviewed. Annual interest rates were disclosed by one moneylender while two of the moneylenders stated that the format by which rates were disclosed varied to coincide with the tenure of a given loan.
48. In the client survey, participants were asked to select between two hypothetical loans which differed only in how the interest rates was disclosed: One offered a loan at "2% per

week" and the other one offered the loan at "20% per month." A financially literate consumer would recognize that a direct comparison of the interest rates could be made only if both rates were disclosed for the same period. The financially literate consumer would then realize that "2% per week" is equivalent to "104% per annum" and "20% per month" is equivalent to "240% per annum."[15] Accordingly, the financially literate consumer would recognize that the cheaper loan was the one offering "2% per week." The survey shows that only 58% of consumers selected the cheaper loan whereas 32% unwittingly selected the less affordable loan with the other 10% indicating that they could not determine which loan to select.

49. Another important aspect of financial literacy is managing cash flow. A financially literate client would ensure that in any given pay cycle, the day on which the salary/wages is expected comes before the negotiated day on which the loan payment becomes due. This is important because late payments typically attract additional costs for the client. Only 18 individuals in the sample were employees, with the other 20 individuals being self-employed. Eighteen employees were asked whether their pay cycle was considered when signing the loan agreement. A total of 16 of the 18 respondents said that their pay cycle was considered by the moneylender when granting the loan; 2/18 persons said that their pay cycle was not considered. Not surprisingly, the 2 respondents whose pay cycles were not considered had a difficulty in repaying the loan since these individuals were required to make a payment each month before they received their pay.

50. *Understanding Non-Interest rate Costs*. In addition to interest payments, clients may incur other costs. The most significant of which are penalties arising from late payments. Half of the participants stated that they never missed a payment due date. Of those who were late in making a payment, 16% stated that they did not know how the penalty was calculated. It should be noted that none of the six loan agreements reviewed by the FTC indicated how late payment fees were calculated.

[15] The 104% and 240% are known as the Annual Percentage Rate (APR) of the respective loans. APRs are used to compare loans issued over different tenures.

viii. "Creative" Advertising

51. The Fair Competition Act explicitly prohibits false or misleading advertisements. The FTC reviewed the advertisements placed by the 47 moneylenders listed in the 2017 telephone directory. The FTC found that while none of the advertisements breached the Fair Competition Act, in a few cases moneylenders used some "creative" comparisons which are likely to confuse financially illiterate clients. For example, one moneylender creatively compared the interest rates offered by his rivals with its debt payment amount (expressed in dollar value) which could give the unsuspecting client that his loan is more affordable. The comparison was creative in the sense that one would have to be financially literate to realize that the interest rates offered by the rival moneylenders would have resulted in a payback amount which was not less affordable than the payment amount stated by the creative moneylender.

ix. Delinquency rates among moneylenders

52. Based on survey results, moneylenders adopt varying business models to screen (i.e. assess risk of) potential clients. Some moneylenders issue loans only to clients who are gainfully employed by established businesses; other moneylenders issue loans only to clients who can secure such loans with collateral.
53. For example, 8 of the 11 moneylenders surveyed required clients to present a job letter and the two most recent pay slips to qualify for a loan. In addition, 7 moneylenders required clients to have a loan guarantor, collateral or agree to salary deduction.
54. Delinquency rates are typically higher in the moneylender market, compared to rates in the traditional financial institutions. One moneylender reported a delinquency rate of 0%.[16] Five moneylenders reported delinquency rates not exceeding 10% while two moneylenders reported rates of approximately 60%. There were three moneylenders who opted not to disclose delinquency rates. By way of comparison, the delinquency rates reported by the Scotia Group Jamaica and the NCB Financial Group are 2.88% and 2.75% respectively.[17]

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[16] This moneylender issues loans only to clients who agree to salary deduction.

[17] Source: https://www.jamstockex.com/. Scotia Group Jamaica's delinquency rate was calculated from the audited financial statements ended October 31, 2016 while NCB Group's delinquency rate was calculated from the audited financial statements

55. Three of the moneylenders indicated that they believed that delinquency rates could be lower if Credit Bureaus would capture the credit history of more clients.

V. POLICY DISCUSSION

A. Overview

56. In this section, the report presents critical perspectives revealed by the study which should inform policies being developed for the financial sector in general, but the moneylender market in particular.
57. In previous sections of this report, it is noted that moneylenders offer loan services which are speedier and more readily accessed compared to loan products offered by traditional sources such as commercial banks, building societies and credit unions.
58. The true social value of moneylenders, however, is not only the products they offer but also who they serve. In particular, preliminary data suggest that 30% of persons who access credit through moneylenders were reportedly not eligible to access credit at traditional sources. If the data are confirmed, it would mean that the National Financial Inclusion Council of Jamaica, for example, would have a clear and unambiguous interest in seeking to facilitate the improvement and expansion of the moneylender market in support of its goal of financial inclusion. The most efficient means of improving and expanding the market is to safeguard competition in the market.
59. Based on the study, ways of improving the moneylender market from the perspectives of moneylenders and the FTC are offered below.

B. Moneylender Perspective

60. During the survey, moneylenders were asked to suggest ways they believe the market could be improved. Collectively, moneylenders offered three suggestions: (i) Access to cheaper source of funds; (ii) An expansion in clients captured by Credit Bureaus; and (iii) Regulations limiting the number of moneylenders.

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ended September 30, 2015. A loan is classified as delinquent when no payment was received during the preceding three payment cycles. Delinquency rates are calculated as the ratio of such loans and the total loans disbursed by the institution.

61. *The FTC offers a qualified endorsement of suggestion (i)*. Increased access to cheaper funds would provide moneylenders with the opportunity to onlend at lower interest rates and therefore facilitate the orderly expansion of the market by increasing the number of consumers who accessed these funds. Ultimately, this is likely to generate greater levels of social economic surplus. As noted in an earlier section in this report, moneylenders have sourced funds through the Development Bank of Jamaica. Another method used by at least one moneylender is to list on the Jamaica Stock Exchange's Junior market and float bonds. While we agree that moneylenders should have access to cheaper funds, these funds should be made available to all financial intermediaries and not exclusively to moneylenders. Such a qualification is necessary as the FTC would not want to disturb the competition that appears to be developing between the different species of financial intermediaries.
62. *The FTC endorses suggestion (ii).* Regarding credit checks, an expansion in the number of clients captured by the Credit Bureaus would allow for a better assessment of the credit risk posed by a wider cross-section of potential clients. As indicated in a previous section of this report, the delinquency is significantly higher among moneylenders compared to the financial groups which operate the two largest commercial banks in Jamaica. One reason for this may be that the credit history of a significant number of potential clients is not being captured by Credit Bureaus. This in turn would likely result in an improper assessment of credit risk and invariably a relatively high delinquency rate among clients.
63. *The FTC offers qualified endorsement of suggestion (iii)*. It should be of no surprise that existing moneylenders support legislation to limit the number of moneylenders operating in the market. This is consistent with arguments presented earlier in the report which identifies the numerous moneylenders operating in the market as a competitive restraint. While the FTC supports the need to introduce legislation in the market to discourage illegal activities which threaten the reputation of the market, policymakers must make considerable effort not to unduly limit the number of moneylenders because such action would unnecessarily restrict the level of competition that is needed in the market to adequately discourage excessively high interest rates.

C. FTC Perspective on Draft Microcredit Bill

64. The Draft Microcredit Bill, which seeks to regulate the microfinance sector, is being finalized for tabling in Parliament. The Bill will require entities to be licensed while providing measures for the protection of consumers.

65. This Bill therefore provides an insight into the Government's position toward the moneylender market and presumably is a significant component of the overall policy being formulated for the market going forward.

66. The FTC's primary concern is that the Bill contains clauses which are likely to unduly impede competition by unnecessarily restricting entry as well as unnecessarily interfering with movements in the interest rates.

i. Unnecessarily Restrictive Licensing Requirements: Clause 2(2)a

67. The introduction of stricter regulations is likely to have both positive and negative effects on the operation of the market. The positive effect arises as the licensing requirements will "…reduce reputational risks and be in compliance with International regulations."[18] The main negative effect is that the licensing regime is likely to impede competition in the moneylender market. Competition is likely to be lessened as the licensing requirements makes it more difficult to enter or remain in the market, relative to the *status quo*, so is likely to result in fewer moneylenders.

68. Policymakers are encouraged, therefore, to strike an appropriate balance by ensuring that the restrictions imposed on moneylenders are no more stringent than they need to be to comply with international regulations. To this end, the FTC notes Clause 2 of the Bill provides for a "fit and proper" test for persons involved in microcredit enterprises. While there is an undeniable need to include such a test, the concern remains that Clause 2(2)a appears to be unnecessarily restrictive since it requires persons to possess the requisite or prescribed educational and professional qualifications for the position he holds in a microcredit enterprise. For enterprises such as moneylenders which do not hold deposits, it is unnecessary to require them to achieve any threshold level of formal education since any

[18] "Microcredit Bill being finalized, says Shaw," *Daily Observer*, April 20, 2017.

deficiency in their business models which leads to insolvency could not adversely affect any third party (clients or rivals).

ii. Exclusionary Provisions: Clause 18

69. Clause 18 of the Bill requires that microcredit enterprises shall be engaged only in the provision of microcredit services. When this clause is understood in the context of clause 8(6)(a) which requires compliance with the Act as a condition for the grant of a license, and also clause 16(1)(e)(i) which allows a license to be revoked if there is non-compliance with the Act, it appears that it may operate as a impediment to entry for institutions with diversified lines of business that may complement each other, or which may lead to operational efficiencies.

70. It is unclear whether or not this measure is necessary for achievement of the object of the Bill, and given that it may impede competition by limiting the number and range of suppliers in the relevant market, it is recommended that consideration be given to removing clause 18 from the Bill.

iii. Unsubstantiated Concerns about "Excessive" Interests Rates: Clause 4(b)

71. Clause 4(b) and the title of the Act make reference to "excessive interest rates." The FTC is concerned that the proposed regulatory authority may determine which interest rates is excessive or may place a ceiling on interest rate that may be charged. The FTC discourages any attempt to place a ceiling, cap or to define a range within interest rates should fall.

72. Being mindful of the spirit in which the clause may have been crafted, however, the FTC is confident that competition within the moneylender sector would ensure that interest rates do not rise above competitive level. The interest rates would be sufficient to compensate moneylenders only for the cost of the "speedier/more accessible" loan product and the inherent credit risk of their clients. Indeed, previous research carried out in other jurisdictions have characterized this market as one in which moneylenders charge excessively high ('usurious') interest rates and disburse loans under questionable conditions. These characteristics have been historically considered accepted "truths" in Jamaica. The results presented in previous sections, however, provide a basis to explore an alternative set of "truths" for Jamaica.

The first truth is that moneylenders have a reasonable economic justification for charging higher interest rates than traditional sources of credit.

73. As noted earlier in the report, moneylenders differentiate themselves from traditional sources of credit by offering more accessible loans and speedier disbursement. To the extent that easier access and speedier disbursement are valued by clients, basic competition economics confirms that there is justification for the interest rates charged by moneylenders to be higher than the rates charged by traditional sources of credit.[19]

The second truth is that the interest rates charged by moneylenders are unlikely to be 'excessively' high.

74. As described earlier in the report, the moneylender market in Jamaica is contestable.[20] The competitive restraints which characterize the market are adequate to frustrate attempts by any moneylender to profitably set prices above the competitive level for a sustained period. In other words, moneylenders are unlikely to charge interests rates in excess of competitive rates for a sustained period because of the ease in which existing or future moneylenders could under-cut and compete away the excess profits.

VI. CONCLUSION

75. Increasing access to finance is arguably the most powerful strategy any government can implement to drastically improve upon the social and economic status of individuals during the span of one generation. Accordingly, the incidence of financial intermediation is the hallmark of economic and social progress in any economy.

[19] This phenomenon in which a faster delivery of a product commands a higher price is common in private and public sector commercial services. In Jamaica, the Passport, Immigration & Citizenship Agency also charges a premium for replacing passports sooner than its regular 7-day service: its 3 day service (*Rush 3 working days*) attracts a premium of 46% above the regular service price; its next day delivery service (*Rush Next Day*) attracts a premium of 77% above the regular service price; and its same day service (*Rush Same Day*) attracts a premium of 154% above the regular service price. Source: http://www.pica.gov.jm (last access: April 13, 2017). Also, for Federal Express to deliver a package within the United States of America by 8:30am the following business day (*First Overnight*), it typically charges a premium of 265% above its regular 3 day delivery service (*Express Saver*) price. Source: http://www.fedex.com/us.

[20] For a text book description of contestable markets, see Carlton, Dennis and J. Perloff, Modern Industrial Organization, 4th ed. Boston: Pearson Addison-Wesley, 2005.

76. The true social value of moneylenders, however, is not only the products they offer but also who they serve. In particular, preliminary data suggest that 30% of persons who access credit through moneylenders were reportedly not eligible to access credit at traditional sources. If the data are confirmed, it would mean that the National Financial Inclusion Council of Jamaica would have a clear and unambiguous interest in seeking to facilitate the improvement and expansion of the moneylender market in furtherance of its goal of financial inclusion. It is the FTC's position that such expansion should take place on the foundation of competition.

VII. RECOMMENDATIONS

g. Policymakers should consider omitting clauses in the Draft MicroCredit Bill which are likely to unnecessarily restrict the scope of competition in the sector;

h. Policymakers should ensure that adequate sanctions are imposed on moneylenders which do not disclose Annual Percentage Rates in advertisements;

i. Policymakers should identify a cheaper source of funding for all financial intermediaries, including moneylenders;

j. Policymakers should develop a set of terms that should be included in contracts issued by moneylenders. For example, penalties and all other relevant charges that may be levied on a borrower in the course of the loan should be included in the loan agreement. There should be no ambiguity in the determination of these charges;

k. Consumers should be given access to programs designed to improve financial literacy; and

l. Credit Bureaus should be encouraged to capture a wider cross-section of the public.

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