

Early Repayment of Personal Loans: Policy of Banks, Credit Unions, and Microfinance Institutions

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Loans play an essential role in consumers' lives as it allows them access to goods and services that they may not have been able to afford otherwise. For instance, consumers may use loans to acquire major assets such as real estate or motor vehicles, as well as other items such as furniture or household appliance. In March 2021, commercial banks in Jamaica disbursed approximately \$447 million in personal loans. This represents a six percent increase from March 2020, when \$421 million was disbursed, and a nineteen percent increase from March 2019, when \$364 million was disbursed.

Some consumers may seek to pay off the loan before the maturity date – this is typically referred to as early repayment. Consumers are usually motivated to engage in early repayment with the expectation that the loan's interest costs would be reduced. Based on complaints received by the Fair Trading Commission (FTC) regarding the early repayment of personal loans from microfinance institutions (MFIs), some consumers were being charged the complete interest on the loan and, in some instances, paid a penalty for early repayment. The discrepancy between consumers' expectations and their actual experiences with MFIs suggests that consumers are not fully aware of the policy of MFIs on the early repayment of loans. Consequently, the FTC reviewed the stated policy of MFIs, commercial banks, and credit unions concerning the early repayment of loans. This note aims to provide consumers with information on the practices of the financial institutions to facilitate a more informed decision-making process on the part of consumers.

Between January and March 2021, the FTC examined the websites of all the commercial banks, twenty-two credit unions, and thirteen members of the Jamaica Association for Micro Financing (JAMFIN) to check for information on their policy regarding the early repayment of personal loans. A few of the commercial banks and credit unions disclosed information on their websites; however, none of the MFIs in the study had information on their websites on their policy on the early repayment of personal loans.

The FTC contacted financial institutions for their response to two questions: (i) Whether there was a penalty for the early repayment of personal loans; and (ii) Whether the information was communicated to consumers at the start of the loan process. The results of the telephone survey showed that 95 percent of credit unions, 93 percent of MFIs, and 71 percent of commercial banks indicated that there was no penalty for the early repayment of loans. Fourteen percent of the banks and seven percent of the MFIs indicated that a penalty might be applied based on the type of personal loan or the terms of the loan contract. Finally, fourteen percent of banks and five percent of credit unions indicated that a penalty was applied for the early repayment of personal loans. In response to the second question, all of the commercial banks, 64 percent of MFIs, and 50 percent of the credit unions indicated that they communicated their early repayment policy to consumers at the

start of the loan process. Further, just over 25 percent of both MFIs and credit unions indicated that the information was supplied if the client specifically asked.

The results from the study suggest that members of JAMFIN usually inform consumers of their early repayment policy at the start of the loan process. Note that this finding cannot be generalized to the estimated 200 MFIs in Jamaica. Further, the passage of the Microcredit Act in January 2021 will offer some relief to consumers, as Section 43 (1) (a) of the Act requires that MFIs provide consumers with the terms and conditions for early repayment of loans before they sign the loan agreement. Therefore, this legislative change will reduce, if not eliminate, incidences of information asymmetry in the microfinance sector. Until the Microcredit Act takes effect, the FTC encourages consumers to ask questions if they are unclear about a financial institution's policy on early repayment.