

Opinion of the Czech National Bank on Consultation Document on the Study on Interest Rate Restrictions in the EU

A. General assessment of the study

(1) Do you think that the inventory of IRR presented in the study accurately reflects the reality in EU27? If not, please explain why, and what information you think is missing or incorrect.

In the Czech National Bank's opinion, the study provides very limited insight for assessing the effects of IRR (as data and information are missing). We trust that the errors and inaccuracies presented below using the example of the Czech Republic are isolated ones and do not occur for the other countries under review. The opposite situation would result in a substantial negative effect on the study's results.

The CNB also feels that the study lacks a thorough analysis of the impacts of IRR on lenders, for example its effect on risk management and potential compensation of limits (reallocation of credit risk costs to other groups of clients or products, etc.). We consider this to be a fundamental shortcoming of the study.

As regards the data for the Czech Republic, we would like to point out that some of them are inaccurate:

- According to the third paragraph of section 2.1 of the consultation document the Czech Republic has IRR in relation to default interest. This information is inaccurate, as it is possible, in addition to restricted default interest, to agree a contractual fine, which can take the form of a percentage of the amount owed per day of default and, unlike default interest, is not limited by law (except for the principle of good morals). The contractual fine has a similar function as default interest. In this regard, we deem it necessary to regard the default interest rates analysed in this study as the sum of statutory default interest and any contractual fine costs. The default interest rate restrictions in the Czech Republic are thus, in principle, similar to IRR (the obligation of compliance with good morals).
- Page 3 of the consultation document states that the Czech Republic is indifferent to direct IRR (ceilings in particular). However, the Czech National Bank (like other Member States, e.g. Spain, Germany, Slovenia, the United Kingdom and Ireland) considers IRR to be less effective.
- The inaccuracies referred to in the indents above also appear in the study (e.g. in the Executive Summary and repeatedly also in the text of the study itself).
- The study states incorrectly (on p. 10) that the Czech Republic has special provisions indirectly restricting fees for arranging loan contracts. No such provisions exist, with the general exception of compliance with good morals.¹
- According to the study (Table 3), the Czech Republic has a ceiling “four times the average’ (court rule)”. However, according to the CNB's information, the rulings of Czech courts do not apply such a strict ceiling. This is just a reference limit, as other rulings stipulate that each case and all its circumstances should be assessed on an

¹ However, the fee for early repayment of consumer credit has been restricted since 1 January 2011.

- The study states that the Czech Republic will introduce IRR in 2010 (statistics No. 2, and, for example, p. 128 et seq.). Legislative proposals in this direction have in the past been rejected by the Czech parliament or returned to submitters for revision.
- The study states that respondents in the Czech Republic would favour the introduction of interest rate ceilings (p. 60). The study does not make clear which respondents the text is referring to. We would appreciate it if future studies clearly identified the sources of such claims. Both the Czech National Bank and the Ministry of Finance repeatedly spoke against such restrictions in 2010.

(2) Do you think IRR policies are justified? Why? Under which conditions?

The Czech National Bank's has long held the opinion that consistent enforcement of the prohibition of usury and compliance with the principle of good morals combined with the interpretation practice of the courts are sufficient tools to eliminate undesirable excesses in interest rate setting and IRR. In our opinion it is not possible authoritatively to set maximum interest rates (be they uniform or differentiated by types of loans) without the possibility of considering the individual situation of the loan applicant. The Supreme Court of the Czech Republic supports a similar approach. It has repeatedly ruled that any cases of excessive interest rates (and also excessive default interest) should always be assessed on an individual basis, taking all relevant facts into account. In our view, introducing interest rate ceilings would have no clear benefits that would outweigh the negative impacts, such as a reduction in the supply of credit products, a narrowing of the room for manoeuvre in credit risk management, the "creative" structuring of some credit products in order to evade the limits (fees for arranging loan contracts or related services) and the shift of some groups of loan applicants towards the grey economy² and black economy³.

B. The impacts of IRR

(3) Do you agree with the conclusions of the analysis of the 12 hypothesis⁴ examined in the study?

Given the non-existence of IRR in the Czech Republic, the Czech National Bank cannot draw on direct experience, but it does consider the hypotheses and the related conclusions referred to in the study to be probable. As regards Hypothesis 5, we would like to draw attention to similar British studies⁵ that have, on the contrary, more or less proved this fact. As regards Hypothesis 11, we would like to emphasise the need to individually assess the situation in each Member State⁶, given different historical developments and other market conditions.

(4) Do you think that IRR are a barrier to the EU credit market integration?

² Private loans under disadvantageous conditions where interest is below usury levels but where the debtor does not enjoy protection under the Consumer Credit Act. These practices are on the edge of legality and often close to being unlawful business without relevant authorisation. Creditors as a rule do not tax interest income.

³ Usury and related criminal activity.

⁴ See the hypotheses listed in the table in the section dealing with the content of the consultation document.

⁵ See <http://www.bis.gov.uk/files/file35171.pdf> and <http://www.bis.gov.uk/files/file53897.pdf>.

⁶ Especially at a time when the study contains detailed information for selected Member States only.

In the Czech National Bank's opinion, the main barriers to the single market include the language barrier, poor awareness of the range of products on offer, and the conservative behaviour of consumers, whereas the potential impact of IRR is negligible in practice. The negligible impact of IRR on cross-border lending is also due to the relatively insignificant volumes of high-interest credit products⁷, which are the only credit segment affected greatly by the introduction of IRR⁸.

(5) Which would be the impact, at social and consumer level, of a ban of IRR?

In the Czech National Bank's opinion, non-application of IRR⁹ in all EU countries could foster increased competition on the cross-border market only minimally. On the other hand, a ban on IRR might encourage a wider range of products and, in particular, better credit risk management for some groups of debtors or loan applicants (thanks to the possibility of consistent risk assessment of applicants through a higher interest rate) in individual Member States. There might also be a shift of some loan applicants from the grey and black economies towards legal providers of credit products (a ban on IRR would make it possible for legal providers of consumer credit to assess an applicant's risk profile through a higher interest rate, which would, however, be below the usury levels in the grey or black economy; above all, applicants for such loans would enjoy protection associated with the provision of consumer credit – APR, pre-contractual information, etc.). However, across-the-board non-application of IRR should not in any way affect the current provisions of private and criminal law (including rulings) of individual Member States relating to the prohibition of usury and excessive interest due to conflict with good morals. As regards the need for intervention at Community level, we refer to our reply to Question 8. While expressing the opinion that IRR should not be applied in the EU, we would like to point out that it is necessary to educate consumers so that they are not under the impression that they are not protected from illegal practices (unreasonably high interest on loans, etc.) as a result.

(6) What system/type of IRR, if any, do you find is most appropriate/effective to prevent potential consumer over-indebtedness? Please describe.

As stated above (see the reply to Question 2), the Czech National Bank considers consistent enforcement of the prohibition of usury and of compliance of loan agreements with the principle of good morals to be sufficient; any excesses must be judged exclusively on an individual basis after all relevant facts have been evaluated. We believe that these two principles are sufficient if combined with an adequate reporting duty¹⁰ (especially in the pre-contractual phase) and a proper assessment of the applicant's creditworthiness and are supported by enhanced financial literacy among consumers. For these reasons, we consider no form of IRR to be efficient and desirable.

(7) What system/type of IRR, if any, do you find has less negative effects in terms of limiting the access to credit? Please describe.

⁷ See Hypothesis 1.

⁸ See Hypothesis 2.

⁹ In the study, IRR refers mainly to interest ceilings, not the prohibition of usury and/or rulings based on the principle of good morals.

¹⁰ In our opinion, the current scope of obligatorily reported pre-contractual information arising from some Community regulations is in some respects too wide and puts a burden on both financial services providers and reporting duty addressees.

The Czech National Bank considers both a fixed maximum interest rate and the linking of such a ceiling to a reference rate to be undesirable, as neither system allows a flexible approach, consideration of the individual situations of loan applicants and, in particular, management of the related credit risk.

C. Further possible action at EU level

(8) Do you believe that, based on the findings of the study, there is a need for further action at EU level? If yes, what form such a policy response should take?

Despite the partial negative impacts of IRR in some Member States on cross-border lending (see the replies to Questions 4 and 5), the Czech National Bank is of the opinion that there is no reason to address this issue at EU level. Any introduction of harmonised IRR would be completely unjustified in light of the partial conclusions of the study.