

FinTech Alliance: Interest Rates for Consumer Loans

As an advocate of financial inclusion and fair and transparent lending practices, the FinTech Alliance Philippines (“FinTech Alliance”) has been an active participant in and contributor to the discourse on the imposition of interest rate ceilings on consumer loans. In particular, FinTech Alliance has exhibited thought leadership through the following initiatives:

White Paper on Interest Rate Ceilings for Consumer Loans

In November 2020, FinTech Alliance drafted a white paper threading together various studies on the imposition of interest rate ceilings and its effect on financial inclusion. The paper noted, among others, that interest rate caps can lead to reducing the supply loans below market demand (i.e., credit supply shrinkage). As a consequence, higher-risk borrowers, typically the underbanked and underbanked, may be compelled to resort to the predatory black market, which is beyond the ambit of regulation. The paper highlighted that the imperative to protect consumers and borrowers from predatory lending practices and unconscionable interest rates need not be addressed solely through interest rate caps; alternative solutions should focus primarily on promoting transparency and financial consumer literacy.

Dialogue with the SEC

In December 2020, representatives from FinTech Alliance met with regulators from the Corporate Governance and Finance Department (CGFD) with the SEC to present the white paper. Mr. Mel Carvill, a resource speaker invited by FinTech Alliance, presented on the economic theory behind interest rate caps, the alternatives to interest rate caps, and examples from other jurisdictions such as the UK and Indonesia. The main thrust of Mr. Carvill’s presentation was that any interest rate ceiling introduced in the market should be set “at a level well above the economic rate” to ensure continuation of credit supply and protection of the consumers from predatory unregulated lending. It should also be combined with measures to improve financial inclusion: (i) enhanced financial literacy activities; (ii) improved credit bureau infrastructure; and (iii) improved capital market access to reduce funding costs. FinTech Alliance emphasized that any interest rate cap must be driven by a formula based on market data from both industry players and consumer research.

Consumer Survey

In parallel with the industry survey conducted jointly by the SEC and the BSP in Q1 of 2021, the FinTech Alliance commissioned GeoPoll, a consumer research firm, to conduct a customer survey to get a pulse of the performance, sentiment, and use cases of mobile loans in the Philippines. The survey results indicated that the proliferation of mobile loans in the Philippines expanded credit access, drove business growth, and generated very high satisfaction ratings.

Dialogue with the BSP

In July 2021, FinTech Alliance met with representatives from the Department of Economic Research and the Financial Inclusion Office of the BSP to provide insights on the pricing of interest rates as well as to discuss the high-level findings from the GeoPoll study.

The FinTech Alliance presentation noted that there is evidence that caps set above market rate can be effective at removing extreme pricing with little impact on the efficient working of the market. The GeoPoll Study and the UK and Indonesia case studies provide baseline reference for setting market rates, while the World Bank Group provides helpful framework/ parameters on the process.

In August 2021, the FinTech Alliance also submitted supplemental market data from selected member companies upon the BSP's request. This supplemental data showed that:

- Risk losses from bad debts consume about 50–90% of the companies' revenues. Given the high credit risk of customers in the unbanked/underserved market, these companies face monthly default rates of 5%–15%, depending on the type of credit product. Moreover, less than 15% of such customers have existing records in the registry of the Credit Information Corporation, indicating that these borrowers who need access to credit are not served by other formal lenders.
- These companies encounter difficulties in raising local funding from banks, as the latter have restrictive credit policies against companies serving the unbanked/underserved market. Thus, these companies generate a high cost of funding as they need to source capital from their own equity or to borrow from credit foreign investors. Based on market pricing for debt funding, the cost of capital would range from 15%–25%.
- Fintech companies also invest significant amounts of operating expenses (OPEX) into a mobile technology platform to deliver credit products nationwide. OPEX costs consume about 40% of revenues.

FinTech Alliance emphasized that any interest rate pricing framework should be grounded on these costs in order for any lender to have long-term viability and sustainability in serving the unbanked/underserved market. At the current pricing levels, these companies incur net losses reaching billions of pesos.

FinTech Alliance also noted that if an interest rate ceiling were to be implemented, the industry will need an accommodation of a transition period of at least six (6) months. Such a period would provide the industry with enough time to modify their business models and underwriting processes. This transition period should also give the government sufficient time to manage the pandemic response and to foster the country's economic recovery, which will in turn improve the economic capacity of the unbanked and underserved customers that financing and lending companies aim to serve.

References:

- [FinTech Alliance White Paper on Interest Rate Ceilings for Consumer Loans](#)
- [FinTech Alliance Presentation to the BSP](#)
- [FinTech Alliance Supplemental Submission on Market Data](#)