Where Are Lenders of Last Resort?

Tougher Moneylending Curbs: By-effects?

By Katsuhiko SAKAI

Moneylending business law revisions designed to help solve the problem of consumer over-indebtedness in Japan took full effect June 18 after their gradual implementation following promulgation in December 2006. They include a cut in the maximum interest rate on consumer loans and new quantitative lending restrictions. “These revisions will help thwart the conventional structure of high-interest debt snowballing,” says one of lawyers engaged in rescuing seriously indebted consumers. But curbs on the supply of credit through interest rate reduction and quantitative lending restrictions are feared to seriously embarrass small, sound borrowers who support the economy at its bottom and to allow loan sharking to grow.

Total Debt Limited to 1/3 of Annual Income

Before the revisions, the investment deposit and interest rate law had set the maximum lending rate at 29.2% and provided for penalties on lenders imposing higher rates, while the interest rate limitation law had put the maximum lending rate at 20% without providing for any penalty. The revisions lowered the higher maximum lending rate to 20%, eliminating the so-called gray lending rate zone between 20% and 29.2%.

Major consumer loan companies lowered lending rates more than two years ago, preempting the tougher regulations under the revisions. At the same time, they began to screen and select borrowers more strictly. These moves expanded even among small consumer loan firms toward the day when the revisions took full effect. The Japan Financial Services Association (JFSA), a moneylending industry body, says the approval rate for new loans in May this year fell to 26.3%, meaning three out of every four loan applicants were rejected.

The introduction of quantitative lending restrictions is expected to further prompt lenders to reject low-income and other higher-risk borrowers. Under the restrictions, everyone is barred in principle from taking loans beyond one-third of annual income. A consumer who borrows more than 500,000 yen from one company or more than 1 million yen from multiple firms is required to submit annual income verifications to the lenders.

Lending to housewives (or househusbands) is limited to one-third of their annual income or that of a married couple combined. When obtaining loans, borrowers are required to submit their spouses’ written consent or marriage certificates. Housewives and househusbands are legally allowed to borrow money with these documents. But not a small number of housewives borrow without notification to their husbands. A growing number of housewives are reportedly calling at NPOs or law firms to question how they should respond to sudden requests from credit card companies for their husbands’ income verifications.

Half of Borrowers beyond Lending Limits

The Financial Services Agency (FSA) says some 12 million people use unsecured loans from consumer loan companies or credit card-based cash advances in Japan. One out of every 10 Japanese uses these loans. Many of them borrow to cover the cost of living just days before payday or for extra spending such as education and healthcare expenses, making repayments honestly and diligently. The problem is that these people have not correctly been informed of the revised lending regulations.

A poll by the JFSA from February to March this year found that 51% of consumer loan borrowers responding to the poll already had loans exceeding one-third of their respective annual income levels. Nevertheless, only 49% of the respondents were aware that the revised moneylending business law would take full effect. Of fulltime housewives among the respondents, 63% did not know or understand the revisions.

Half of respondents with loans beyond quantitative lending restrictions said they would have to borrow more money to support their livelihood. In reality, however, their loan applications may not be accepted. In the wake of the regulatory revisions, large consumer loan companies have suspended lending services for fulltime housewives that have become bothersome due to the extra procedures required to check documents. Some credit card companies are excluding cash advance services from new credit cards issued.

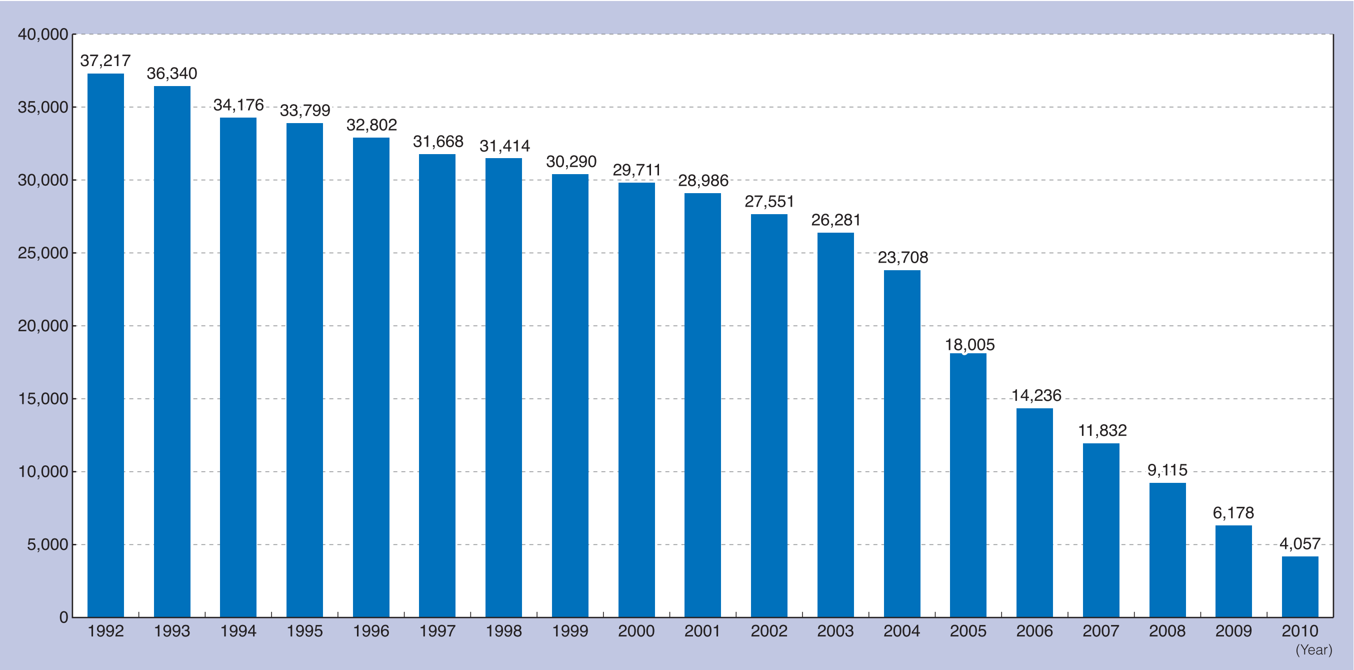
As the employment situation remains severe, choices for millions of people failing to get additional loans are limited. They would have to give up spending, depend on relatives and friends for loans, or borrow from loan sharks and other irregular lenders. The revised lending regulations are also expected to affect tourism, entertainment and other industries dependent on consumer spending.

Small Business Owners Voice Fears

Small businesses that have difficulties in raising short-term loans from banks are voicing fears over the moneylending business law revisions. In a poll by Hiroshi Domoto, associate professor at Tokyo University of Information Sciences, covering owners of small businesses with five or fewer employees, the second most frequently cited providers of short-term bridge loans for these respondents were “consumer loan and credit card companies,” following “relatives and acquaintances.” They have strong needs for expeditious loans despite higher interest rates.

Corporations are exempt from the quantitative lending restrictions. Business owners can borrow unsecured loans beyond the quantita-

Number of registered moneylenders shrinking



Note: At the end of March each year
Source: Financial Services Agency

tive restrictions by submitting corporate financial statements or business plans. But the authorities have strictly instructed moneylenders to comply with the requirement for checks on borrowers' loan repayment capacity. Lenders seem to be less swift or positive about providing loans to small businesses.

A poll of about 10,000 companies conducted by credit research agency Teikoku Databank Ltd. in May before the full implementation of the regulatory revisions found that 3% of these companies anticipated these revisions to affect their cash flow. "The percentage, though looking small, is tantamount to about 6,000 companies if simply calculated," a Teikoku Databank official said. "We cannot deny that bankruptcies could increase."

Desperate Borrowers Shifting to Loan Sharks

The gradual regulatory enhancement over a period of three years and a half has brought an about-face to the business environment for the moneylending industry. On top of that, the industry has been plagued with increasing interest refund claims from borrowers since the Supreme Court ruled lending rates in the gray zone as invalid in January 2006. Even major consumer loan companies have seen their cash flow deteriorating. Another credit researcher, Tokyo Shoko Research Ltd., said outstanding loans from the nine publicly traded consumer loan companies in Japan halved from 6.3 trillion yen at the end of March 2003 to 3.1 trillion yen at the end of the same month this year.

The FSA gave the number of registered moneylenders in Japan as 4,057 at the end of March this year. Over the past decade, more than 25,000 moneylenders disappeared on bankruptcies, voluntary closures or mergers. "Things may not turn better in the coming several years," JFSA Chairman Iwao Iijima told a press conference in June. "The number of registered moneylenders may be halved."

The tougher regulations on small credit supply to borrowers who cannot get loans from banks are feared to trigger a rise in loan sharks prepared to swallow desperate borrowers who are barred from legal borrowing. The underground financing market, which had once been beleaguered with violent loan collection, has reportedly become deeper and more invisible through a switch to softer lending practices.

A fraudulent means to get around the law takes advantage of shopping quotas for credit cards to provide cash. A fraudulent lender may lead credit card holders to purchase goods and sell them back at lower prices to get cash, or may take fees for such procedures. Shopping quotas, unlike cash advances, are left out of the quantitative lending restrictions, allowing many fraudulent lenders to solicit borrowers through the Internet. Desperate borrowers are believed to have increasingly used these questionable fundraising services.

Credit card holders can get cash in this way. But they effectively obtain high-interest loans. When receiving bills from credit card companies one or two months later, they will find that they paid illegally high interest on effective loans. But they have no means to get such unjustifiably costly interest payments refunded. Although the use of credit cards for such cash-raising purposes clearly violates membership rules for card holders, an industry source says there is no effective way to prevent such violation except simple warnings.

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