

Japan to Scrap “Gray Zone” Lending Rates

— Law Passed to Toughen Curbs on Moneylenders —

By Aoki Masaru

JAPAN'S parliament has passed legislation to amend lending industry laws to toughen regulations on consumer loan companies and other moneylenders and help prevent borrowers from becoming heavily indebted. Japan has had two laws to govern lending rates. While the Investment Deposit and Interest Rate Law sets an interest rate ceiling at 29.2% backed by criminal penalties, the Interest Rate Restrictions Law fixes a ceiling at 15%, 18% or 20% according to loan amounts without penalties. The legislation to amend these laws will lower the 29.2% ceiling of the investment deposit law to the 15-20% range of the interest rate law within 30 months, or two years and a half, after the legislation takes effect. The amendment is to be enforced within one year after its promulgation. The so-called “gray zone” lending rates between the highest ceiling of 20% under the interest rate law and 29.2% under the other law is thus expected to be eliminated in 2009.

Moneylenders have been required in principle to honor the 15-20% ceiling under the interest rate law. Since the separate Moneylending Control Law has the so-called “deemed repayment” provision authorizing moneylenders to receive interest rates above the 15-20% ceiling as paid voluntarily by borrowers, most moneylenders have levied lending rates close to the 29.2% ceiling under the investment deposit law. Movements to reform the present lending rate ceiling system have gained momentum since the Supreme Court gave a ruling in January 2006 to effectively invalidate the gray zone rates. The amended Moneylending Control Law under the just-enacted legislation will be implemented within one year after its promulgation to eliminate the

deemed repayment provision.

In November, the Financial Services Agency (FSA) published consumer loan companies' outstanding unsecured loans broken down by lending rates for the first time ever. According to the data based on 98 consumer loan firms' financial statements for fiscal 2005 that ended in March 2006, gray zone rates were imposed on 47.14 million loans, or 76% of their total outstanding unsecured loans. In value, gray-zone-rate loans totaled ¥11,409.5 billion, accounting for 73% of the total.

A draft of the legislation had had a special measure to tolerate a lending rate of up to 25.5% on small-amount, short-term loans for a transitional period even after the elimination of the gray zone rates. But the ruling Liberal Democratic Party and its junior coalition partner, New Komeito, eventually dropped the special measure that had been designed to ease the impact of the lending rate ceiling reduction on moneylenders and came under fire for favoring the industry. They also rejected another measure to effectively favor moneylenders in the draft, which had called for reclassifying loan amounts for the three ceilings under the interest rate law. Of the three ceilings, 15% is for a loan worth ¥1 million or more, 18% for between ¥100,000 and ¥1 million, and 20% for less than ¥100,000. The measure had sought to quintuple these loan amounts. The ruling parties plan to revisit the two measures before the gray zone rates are actually eliminated.

By amending the Moneylending Control Law, the legislation limits loans per borrower to prevent borrowers from becoming heavily indebted. In principle, it prohibits any moneylender from providing loans to a per-

son if his total loans from one or more lenders exceed one-third of his annual income. The amended law also requires moneylenders to investigate customers' loan repayment capacity. If a moneylender were to lend more than ¥500,000 to a customer or allow a customer to expand his total loans beyond ¥1 million including those from other firms, the moneylender would have to require the customer to submit a certificate of income and withholding tax.

The legislation substantially toughens penalties on offenders. In one month after the legislation's promulgation, the maximum penalty on unregistered commercial moneylenders will be raised from five years in prison or ¥10 million in fine to 10 years or ¥30 million. Later, a new provision will take effect to levy a fine of up to ¥100 million on a company that lends money at an interest rate above the 109.5% ceiling under the initial Investment Deposit and Interest Rate Law. At present, the maximum fine under this law is at ¥30 million. The tougher penalty is designed to help expel black-market lenders. The maximum penalty on an individual who levies an extra high rate above 109.5% on loans will be raised from five years in prison or ¥10 million in fine to 10 years or ¥30 million.

On moneylenders who make false statements on applications for moneylender registrations, the maximum fine will be raised from ¥1 million to ¥3 million, with a new optional prison term of up to two years created. The maximum penalty on offenders against business suspension orders will be increased from two years in prison or ¥3 million in fine to five years or ¥10 million.

The new legislation introduces a business practice improvement order as regulatory authorities' administra-

Photo: Kyodo News

tive action. Regulators will be authorized to order board members to be dismissed if they are found engaged in illegal practices. An industry association that moneylenders will be required to join may be ordered to fire its executives if they take advantage of illegal means to obtain their posts or are engaged in illegal practices.

Under the legislation, the minimum net asset requirement now at ¥5 million for lending entities and ¥3 million for individual moneylenders will be raised to ¥20 million for both entities and individuals within 18 months after implementation of the legislation. The minimum requirement will be increased further to ¥50 million upon the lending rate ceiling's reduction within 30 months after implementation. The substantial increase in the minimum net asset requirement is expected to help expel malicious moneylenders. Under the current low requirement, malicious loan companies that lose registrations due to their illegal loan collection practices may easily obtain new registrations by replacing their representatives.

The FSA estimates that the number of moneylending companies may plunge to 3,700 from the present 14,000 due to the minimum requirement hike. Firms that fail to meet the requirement may have to merge with each other. The minimum requirement hike may thus lead to the industry's reorganization. Tougher regulations on entries into the moneylending business under the new legislation will include the introduction of qualification tests for licensed loan officers. The employment of licensed loan officers at each office is cited as one of conditions for moneylender registrations.

The legislation also prohibits moneylenders from purchasing life insurance policies for borrowers in order to receive insurance money if borrowers die. The FSA said 17 consumer loan companies that purchase such insurance policies received ¥30.2 billion in insurance money for 51,997 cases due to borrowers' deaths in fiscal 2005.



A notice is put up at an Aiful branch to announce the major moneylender has been ordered to suspend business for questionable lending practices.

Their insurance money receipts on borrowers' suicides accounted for ¥4.3 billion (for 4,908 cases) or 14.2% of the total. The life insurance practice has come under fire for prompting moneylenders to pressure borrowers into killing themselves to repay loans. In late September, Promise Co. became the first Japanese consumer loan firm to terminate the practice. All 16 other major Japanese moneylenders have offered to end the practice.

In September, the Japanese Institute of Certified Public Accountants said it would ask consumer loan companies to strictly book reserves for returning gray zone interest payments as overpayments to borrowers in and after fiscal 2006 including the April-September first half. Specifically, the JICPA has requested these firms to book losses as provisions for overpayment returns regarding borrowers' possible future claims as well as pending and fixed out-of-court settlements of lawsuits.

By booking massive losses in this respect, four major Japanese consumer loan companies all posted group net losses in the first half for the first time since their respective initial public offerings. Group net losses came to ¥282.1 billion at Acom Co., ¥144.2 billion at Takefujii Corp., ¥179.5 billion at Aiful Corp. and ¥159.4 billion at Promise. For the whole of fiscal 2006, the four expect to incur more than

¥700 billion in their combined group net losses — ¥257.3 billion at Acom, ¥109.5 billion at Takefujii, ¥185.4 billion at Aiful and ¥154.1 billion at Promise. In the previous fiscal year, all booked consolidated net profits between ¥40 billion and ¥60 billion.

The consumer loan industry is losing customers as its image has deteriorated on the problem of heavily indebted borrowers. The number of new borrowers in fiscal 2006 may be halved from the previous year to some 260,000 at Aiful. For fiscal 2006, all the four expect to see falls in their operating revenues that amount to sales.

In response to the business environment deterioration, these companies have launched restructuring. Acom plans to reduce its workforce by 700 from about 4,100 at present through a voluntary retirement program, the number of manned branches by 100 from 242 at the end of September 2006, and the number of unmanned branches by 76 from 1,802 within fiscal 2006. Takefujii is considering consolidating 100 out of its 1,372 unmanned branches and cutting the number of manned branches within the current fiscal year. **JS**

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