TAKING ON THE MONEY LENDERS: LESSONS FROM JAPAN

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Introduction

There has been a lengthy debate concerning how best to regulate high cost consumer credit markets in the UK in recent years, and we have consistently argued that this should include the capping of interest rates and the imposition of stricter responsible lending requirements, including limits on the volume of lending relative to a borrower's income[1].

This debate has now arrived at a critical juncture. Over the course of the next few weeks we expect:

- The publication of research commissioned by the Department of Business, Innovation and Skills ('BIS') concerning the potential impacts of introducing caps on the total cost of credit; and

- The Office of Fair Trading ('OFT') to release the outcomes from the recent review of payday lender compliance against its Irresponsible Lending Guidance.

These reports will feed into Parliamentary debates concerning the future regulation of consumer credit. The Financial Services Bill is currently at Report Stage in the House of Lords. As it currently stands, the Bill will establish a new regulator, the Financial Conduct Agency ('FCA') in 2013, and Government intends to transfer the responsibility for the regulation of consumer credit from the Office of Fair Trading ('OFT') to the FCA from April 2014 onwards[2].

The Bill also proposes that the FCA will be able to place requirements on any lender to which it grants permission to provide consumer credit. This is taken to include the power to place requirements on lenders with respect to the prices that they can charge. However the power to cap prices has not been made explicit. On 24th

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[1] Our prior publications on these issues include:

- Protecting low income borrowers in the credit crisis (2008);
- Memorandum of evidence to the Financial Services Bill Committee (2010);
- Payday lending in the UK: a review of the debate and policy options (2010);
- Can consumer credit be affordable to households on low incomes? (2011);
- How to regulate payday lending: learning from international best practice (2011).

[2] Government response to the Business, Innovation and Skills Committee dated 24th May 2012, available at http://www.publications.parliament.uk/pa/cm201213/cmselect/cmbis/301/30105.htm

October 2012, the House of Lords discussed an amendment to the Financial Services Bill from Lord Mitchell which sought to clarify the position[3].

In the debate on this amendment, the Government's Deputy Chief Whip, Lord Newby, declined to specifically mention whether or not the FCA would have the power to cap prices, but stated:

> *"The Government and I are extremely sympathetic to many of the things that the noble Lord seeks to achieve…The lack of specific provision on the face of the Bill in no way reflects how seriously the Government take these issues."*

Referencing the OFT's compliance review and the BIS commissioned research concerning the potential impacts of caps on credit prices, Lord Newby also intimated that Government may not wait until the establishment of the FCA to act on problems in the high cost credit sector:

> *"While we think that the transfer of powers to the FCA will enable a big improvement to take place, we cannot wait until April 2014 - when those powers move across - before we see any action…"*

To assist with the development of effective policy in this area, this report details the Japanese experience of money lending regulation[4]. This has been significantly strengthened in recent years. In particular, the Money Lenders Law that was passed in 2006 comprised a package of measures including the reduction of the legal interest rates that money lending companies can charge to just £20 for every £100 borrowed, and the limitation on total money lending to individuals at any one time to one third of the borrower's gross income. Although industry representatives in Japan argued that the 2006 Law would lead to an increase in illegal lending, the opposite has happened. In fact, levels of over-indebtedness and problems of loan sharking have both reduced significantly since the Law came into effect.

The remainder of this report is structured as follows:

Section two sets out the Japanese approach to money lending regulation. The section focuses on the campaign for more effective interest rate controls which took place from the late 1970s onwards through to the passage of the latest Money Lending Law in 2006 and its full implementation in 2010.

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[3] http://www.theyworkforyou.com/lords/?id=2012-10-24a.210.7&s=speaker%3A13286#g256.1

[4] The study trip involved meetings with members of the Japanese Federation of Bar Associations ('JFBA') on 25th October; attendance at the Cresala Taikyo ('National Coalition for Fair Consumer Credit') conference in Sapporo on 27th and 28th October; meeting with representatives from the Japanese Financial Services Agency, 29th October; meeting with the Credit Victims Group in Chiyoda District, Tokyo, on 30th October, and meetings with community workers in the Kamagasaki District of Osaka on 31st October.

Section three then presents empirical evidence concerning the impacts of the measures contained in the Money Lending Law of 2006. This is presented alongside the pro-industry arguments made at the time in Japan, which are echoed in debates in the UK today. The evidence presented provides a robust challenge to the claims made in the UK that caps on the cost of credit will lead to an increase in illegal lending.

Finally, **Section four** examines the parallels between Japan and the UK's money lending sectors and pulls together a number of conclusions and recommendations for the regulation of money lending in the UK based on the Japanese experience.

The Japanese Approach to Money Lending Regulation

This section sets out a brief history of the Japanese approach to money lending regulation from 1954 onwards but with an emphasis on the campaign for interest rate controls and responsible lending measures which began in the late 1970s and continued through to the passage of the Money Lenders Law of 2006. The section sets out details of the different measures adopted throughout this period, including those contained within the 2006 Law itself, whilst also presenting contextual information on the development of the money lending market during this time.

The regulation of Money Lending in Japan

Japan has a long history of usury laws dating back (Pardieck, 2008, p. 533) to at least the Kamakura Dynasty (1185 – 1336). However, in the modern period it has struggled to maintain effective control over its money lending market. This stems from the implementation of two different interest rate laws in 1954 and a lack of clarity concerning the enforcement of loans which breached the limits on one but not the other. Specifically, in 1954, Japan put in place the following two laws:

- A Capital Subscription Law[5] (with pre-cursors dating back to 1877), which established that any lending (whether by a bank or a money lender) with interest rates above 109.5%[6] constituted a criminal act, and carried with it the risk of imprisonment and fines; and
- An Interest Rate Restrictions Law[7] ('IRRL'), which set lower limits but carried no real penalties. In respect of money lenders, the IRRL set limits of 20% for loans of less than 100,000 Yen; 18% for loans between 100,000 Yen and 1 million Yen; and 15% for loans of 1 million Yen or more[8]. However, no penalties for breaching these limits were set out in the IRRL itself.

The result was the creation of a 'grey zone' between the limits set out in the IRRL and the criminal limit imposed by the Capital Subscription Law. Although the

[5] In the English language literature this is variously called the Capital Subscription Law or the Investments and Deposits Act. The Japanese is *Shusshi no Ukeire, Azukarikin oyobi Kinri nado no Torishimari ni kansuru Hōritsu.*

[6] It is important to note that the percentage figures used in Japanese laws are not APR figures, but are 'flat rates' or 'total cost of credit' limits – in this case, the Capital Subscription Law limited the costs that could be charged on a loan to 109.50 Yen per 100 Yen lent. In addition, all monies paid to the lender other than the return of the principal are included within the definition of 'interest'. There is therefore no means of evading the cap by charging separate fees.

[7] In Japanese the *Risoku Seigen Hō.*

[8] 100,000 yen equates to roughly £800 at today's interest rates and 1 million yen to around £8,000.

Japanese Supreme Court ruled in 1968 that interest charged above the limits set out in the IRRL but below the 109.5% stipulated by the Capital Subscriptions Law could be claimed back by borrowers, this did not prove an effective deterrent and consumer lending continued to expand at rates way in excess of the IRRL limits, particularly from the late 1970s onwards.

For example, Sato (1986, p.37) reports that in 1977 the total amount outstanding on loans made by money lending companies was just over 1 trillion yen but four years later (1981) this had more than doubled to 2.5 trillion. In part, this expansion was supported by the absence of bank provided alternatives, including lending on overdrafts and credit cards, which remained relatively undeveloped forms of credit provision throughout this period[9].

However, banks were also actively involved in the development of the consumer loans market because they were the providers of wholesale finance into the non-bank sector. As Sato (1986, p.40) notes, this also gave them a strong interest in opposing restrictions on credit charges:

> *"…banks do not wish to go 'retail' in the small consumer loans market and have instead found an alternative solution, to go 'wholesale' by lending to consumer finance companies at rates close to prime rates. A recent [Ministry of Finance] survey reports that banks and insurance companies had a total balance of 1.1 trillion yen with consumer finance companies as of March 1983, with the active participation of foreign banks…the rapid over competitive expansion of consumer finance companies has been made possible with the general support of financial institutions. It is thus not difficult to understand the influence of vested financial interests moderating the acceptance of revising legal control over usury rates. Consumer welfare is of secondary importance."*

In addition to the high cost of loans, there were public concerns about aggressive collection tactics associated with the sector. For example, Pardieck (2008, p.549) notes that during this period:

> *"Newspapers...published accounts of Sarakin [legal money lenders] financing destroying families; of overwhelmed borrowers fleeing their homes; borrowers committing suicide; borrowers killing their children and themselves; housewives arrested for burglarizing department stores to repay consumer debt; and debtors setting fire to their homes to collect the insurance and repay consumer loans."*

It was against this backdrop that consumers began to self organise to provide support to over-indebted individuals and to press for tighter regulation. In the late 1970's consumer credit victims groups emerged in Tokyo and Osaka, with the

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[9] For an explanation of the reasons of this see, for example, Mann (2002).

network quickly developed to cover the entire country[10]. These groups, comprised mainly of volunteers, successfully made links with lawyers from the Japanese Federation of Bar Associations ('JFBA'), and formed the Cresala Taikyo (the 'National Coalition for Fair Consumer Credit') from 1978 onwards. The Coalition pressed for legislative change; eventually resulting in the Japanese Diet passing a new Money Lending Control Law in 1983.

The Money Lending Control Law of 1983 started a process of incremental reductions in the interest rate cap imposed by the Capital Subscription Law. In 1983, the cap was lowered to 73%. This was followed by further reductions to 54.75% in 1986; to 40% in 1991; and to 29.2% in 2000.

The Law also required money lenders to assess the affordability of loans by making inquiries about the borrower's income and assets, outstanding loans, and plans for repayment and prohibited lending to people that could not afford to repay.

Finally, the Law also put in place criminal sanctions for loan sharking (a maximum prison sentence of up to 3 years or a fine of up to 3 million yen).

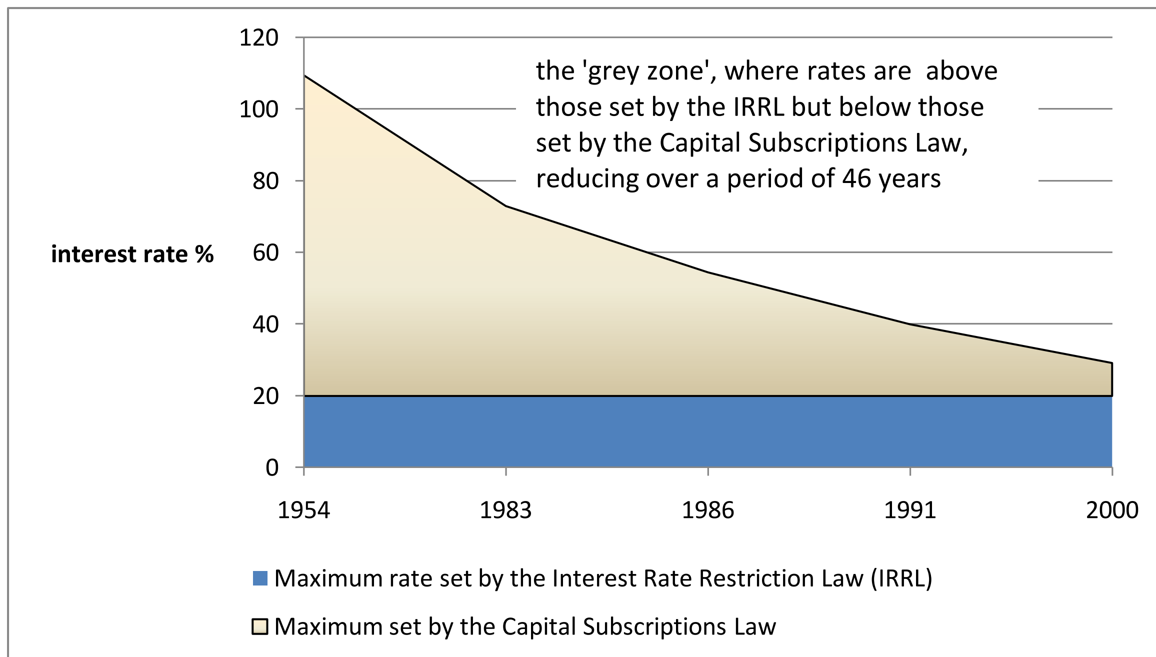
However, the Law did not amend the caps put in place by the IRRL and also stipulated that interest charged above these caps, but beneath those now stipulated in the revised Capital Subscription Law, could still be recoverable by lenders, provided that:

- The lender issued an appropriate form of contract documentation and 'immediate' receipts for payments; and
- That the excess interest was being paid voluntarily.

As there remained gaps between the level of the caps imposed by the Capital Subscription Law and the IRRL, the 1983 Law therefore left in place a 'grey zone' – albeit one that was reducing in size over time. This is illustrated for loans of up to 100,000 yen in figure 1, on the following page.

[10] These groups are organised as the All Japan Liaison Council of Victims of The Credit & The 'Sarakin' Consumer Loan with their head office in Kanda District, Tokyo.

Figure 1: The 'grey zone' on loans of up to 100,000 yen (1954 - 2000)



In addition, Pardieck (2008, p.553) notes that whilst the 1983 Law required lenders to assess affordability, it provided no clear definition of this (with lenders free to determine what they considered to be affordable following an investigation into the borrower's circumstances). Neither do there appear to have been any clear penalties for its violation.

As a result it failed to reign in the money lenders. By 2003, the volume of money lending rose to its peak at some 12 trillion yen (Japan Credit Rating Agency Ltd, 2012), up from 3.8 trillion yen in 1990, and over this period the moneylender's share of the wider unsecured consumer credit market grew to 43% (up from 18%).

In 2004, there were approximately 14,000 money lending firms in operation in Japan, and 'grey zone' lending was rife. Subsequent estimates from the Financial Services Agency indicate that 'grey zone' interest rates were charged on around 75% of all loans made[11]. Borrowers were typically on low incomes, with the majority having gross annual incomes of less than 2 million yen (around £15,000)[12].

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[11] 'Borrower reimbursement charge pushes Takefuji into first ever loss', Japan Times, 2/11/2006 available at http://www.japantimes.co.jp/text/nb20061102a3.html

[12] National Consumer Affairs Center of Japan, May 2006: http://www.kokusen.go.jp/e-hello/data/ncac_news18_1.pdf

It should be noted that the majority of this money lending expansion took place in a period when the maximum interest rate that could be charged in the 'grey zone' was 40%, and that the peak in money lending (in 2003/04) occurred three years *after* the maximum 'grey zone' interest rate had been reduced to 29.2%.

The money lending boom over this period has been attributed (Kozuka & Nottage, 2007) to four main factors:

- **Economic slowdown**: The unemployment rate has increased from 2.1% in 1990 to above 5% in both 2002 and 2003 and the rate has remained high by historical standards: falling below 4% in only one of the years since that time (2007 – 3.9%) and rising again to 5.1% in both 2009 and 2010[13]. The structure of the labour market also changed over this period, with increases in the proportion of workers in temporary and low paid jobs. Household disposable income growth posted an average growth of just 0.1% per year from 1995 onwards. The household savings rate has also declined dramatically over this period – from just under 12% in 1996 to little more than 2% at present.

- **Technological advances making for easy access to credit**: These included the development of un-staffed automatic loan dispenser booths from 1993 onwards. The booths, which are available 24 hours per day, allow borrowers to apply for loans by scanning in identification and contract documentation, which are then checked by a member of staff at a remote location. If approved, the loan is paid out instantly on a cash card provided by the dispenser. The average processing time for applications made in this way is approximately 30 minutes.

- **Expansion of advertising operations**: The period saw a considerable expansion in advertising by money lending firms following a 1995 rule change which allowed consumer lenders to broadcast commercials on day time TV[14]. Media campaigns were predominantly targeted to younger men in their twenties and thirties on relatively low incomes but in employment.

- **The development of a 'sweat box' approach to lending**: Featuring a high level of 'rollover' and repeat lending, where loan contract terms are extended at high cost or new loans are taken out in order to repay former borrowing. Larger money lending companies Japan also 'introduced' borrowers in financial distress to smaller lenders who charged even higher rates of interest and ultimately enforced their own debts more aggressively.

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[13] Source: Statistical Survey Department, Statistics Bureau, Ministry of Internal Affairs and Communications

[14] http://www.reuters.com/article/2010/09/27/takefuji-idUSTOE68Q01120100927

The boom in the Japanese money lending sector was also supported by the securitisation of consumer credit debts and the willingness of domestic and international investors to purchase bonds offered by money lending companies.

From August 1998 onwards consumer finance lenders were allowed to seek direct funding from the wholesale financial markets. The largest money lending firm of the time, Takefuji Corporation, was supported in this by the 'A' ratings provided on its bond issues by both Standard & Poors and Moodys[15]. In 1977 Takefuji extended 10 billion yen in loans, but by 2006 this had risen to over 1.5 trillion yen. In 1998, it became the first non bank consumer lending firm to be listed on the Tokyo Stock Exchange and in 2000, Takefuji was listed on the London Exchange.

However, the money lending boom was also accompanied by a sharp rise in over-indebtedness, personal bankruptcies, and debt related suicides, as borrower's found themselves having to continually borrow just to pay the interest on existing loans[16].

According to Pardieck (2008, p. 529 -531), between 1991 and 2006 the number of people in debt doubled to 14 million; 2.3 million of these were in debt to five or more lenders at the same time, and 2.7 million people were in arrears with money lender loans. Between 1990 and 2005, the number of bankruptcies increased sixteen fold to just over 184,000, and, in 2005 nearly 8,000 people committed suicide for economic reasons.

Despite the profusion of legal lending taking place during the period, illegal loan sharking also blossomed as over-indebted and desperate borrowers began to be targeted for more loans by illegal lenders. The tactics adopted by illegal lenders to obtain new borrowers during this period included[17]:

- Directly approaching people whose details had been posted in public bankruptcy registers;
- Obtaining lists of distressed borrowers from employees in the legal money lending firms; and
- Direct advertising for loans in low income neighbourhoods.

The growth in loan sharking over this period is reflected in statistics from the National Police Agency ('NPA'). In 1997 the NPA reported 103 arrests of illegal lenders; 42 of which related to organised 'Yakuza' mafia gang operations. In 2003,

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[15] See, for example, http://www.investegate.co.uk/articlePrint.aspx?id=200112190705118717O

[16] See for example, 'Consumer lenders dirty but open secret', Japan Times, 18th May 2006 at http://www.japantimes.co.jp/text/nn20060518f1.html

[17] Interview with Yoshio Honda, Secretary General, The All Japan Liaison Council of Victims of The Credit & The Sarakin Consumer Loans, 30th October 2012

this number was more than three times higher, with 388 arrested (including 140 Yakuza members).

The scale of some of these operations was huge, as Pardieck (2008, p.564) notes:

> *"In 2003, the police arrested Susumu Kajiyama, the 'king of the blackmarket lenders' and a couple of his twenty-one 'presidents.' Together, they oversaw a black-market lending operation run by the Yamaguchi crime family that included approximately 1000 offices and brought in profits of ¥10 billion annually. The investigation showed that consumer finance had become a principle source of funding for organized crime in Japan…black-market lenders began direct-mail advertising to large numbers of distressed borrowers and those that had filed for bankruptcy. Police investigations showed employees soliciting loans with interest rates over a thousand times the legal rate and working in offices constructed from karaoke boxes in order to muffle the sounds of their collection calls. Lenders would go to the debtors' homes, threaten to reveal their debts to their neighbors, and, absent payment, drive around the debtor's house broadcasting the debt over a megaphone."*

With public concern about the scale of illegal lending rising, the Diet took action in 2003 by increasing the criminal penalties for unregistered lenders to a maximum of five years imprisonment and 10 million yen in fines. As Japanese courts traditionally suspend prison sentences that are made for periods of less than three years, the increase in the maximum sentence therefore increased the chances of loan sharks actually serving prison sentences. In addition, the law provided for prosecutions to be brought more easily, for example where there was evidence lenders had been advertising illegal loans or had directly approached potential borrowers[18].

Activities by lawyers and debt self help groups also continued to highlight the extent of problems caused by the expansion of legal money lending and to press for improvements in the Money Lending Control Law:

- In April 2003, a group of lawyers and journalists published a book 'Exposing the dark side of Takefuji', which laid bare a number of unethical business practices, including allegations of poor treatment of its employees, and aggressive collection tactics[19]. The company responded with a defamation lawsuit against the four authors from which it claimed damages of 55 million yen each. The authors counter-sued on the basis that Takefuji's case sought to suppress freedom of speech, and the case, which raised the profile of the issues enormously, was finally decided in October 2005 when the Tokyo High

[18] 'Cops targeted loan sharks in September Crackdown', Japan Times, 17/10/2003 available at http://www.japantimes.co.jp/text/nn20031017a7.html

[19] http://www.japantimes.co.jp/text/nn20051020a5.html

Court ruled in favour of the authors and ordered the company to pay out 4.8 million yen in damages[20].

- Actions also continued with regard to the 'grey zone', with numerous court cases brought to demand the repayment of excess interest. Although the 1983 Law had sought to allow money lenders to keep 'grey zone' interest, from 1990 onwards cases brought by campaigning lawyers within the JFBA increased the number of requirements that lenders had to satisfy before this could be held to be legal. These included challenging the validity of receipts and contract documentation, and in a high profile case challenging the concept of 'voluntary' agreement to repay excess interest given the unequal bargaining power of the two parties to the contract. Cases reached the Supreme Court in January 2006, when a ruling was made which left money lending companies liable to repay excess interest over and above the 20 stipulated by the IRRL. A surge of law suits organised by members of the JFBA followed on behalf of borrowers, with national advertising taken out to encourage borrowers to come forwards. From that point onwards, the de facto cap in place in Japan has been 20% on loans of up to 100,000 yen and reducing to as low as 15% for larger loans.

- 2006 also saw a national demonstration organised by the Cresala Taikyo campaign, which was by this time also backed by the Japanese labour movement.

The high profile of problems in the legal money lending sector led to a Financial Services Agency review of the Money Lending Control Law, which reported in April 2006. This report recommended that:

- The 'grey zone' be eliminated but that care be taken to ensure that lenders were not driven from the market altogether;

- The total amount of lending to any one borrower be restricted;

- Lenders be made to share information about the credit history of borrowers;

- Improved regulation be put in place concerning the advertising and collection practices on non banks, and greater restrictions be put in place on those setting up in business;

- Financial education programmes be put in place; and

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[20] Further to this, in 2004 the Chairman and co-founder of Takefuji, Yasuo Takei, was convicted of ordering employees to illegally phone tap journalists that had been critical of the company. Takei received a three year suspended prison sentence for the offence and subsequently resigned as Chairman of the company.

- Debt counselling for borrowers who had taken out too many loans be improved.

The Money Lenders Law 2006

Responding to the report from the Financial Services Agency and the public campaign for tighter regulation, the Money Lenders Law of 2006 introduced a comprehensive package of measures designed to:

- Ensure appropriate money lending activities;
- Curb excessive lending;
- Ensure a fair price for credit, and
- Enhance consumer protection from loan sharking.

The specific provisions of the Law in respect of each of these objectives are now set out in turn.

Ensuring appropriate money lending activities

The Law imposed strict requirements on businesses seeking to undertake money lending operations, including that they hold a minimum of 50 million yen in assets (an increase from the prior requirement of just 3 – 5 million yen). In addition, the Law requires managers of money lending operations to have passed a qualification examination set by the Financial Services Agency and for a qualified manager to present in all money lender branch offices.

The Law also defines trade associations for money lending companies as legal entities under the supervision of the Financial Services Agency and *requires* these to establish self regulatory rules including in respect of the frequency of advertising and the prevention of excessive lending. The Code of Practice for these money lending associations was also enhanced by prohibiting debt collection during the night time and restricting persistent debt collection during the day. There is also a prohibition on lenders providing insurance contracts to borrowers from which the lender could benefit on the death of the borrower[21].

The Financial Services Agency is also now able to issue a 'Business Improvement Order' instructing firms to set right any breaches of the rules without the need for the Agency to proceed to the full process of revoking a licence to operate.

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[21] Consumer finance companies had been found to be benefitting from debt suicides. Pardieck (2008, p. 571) reports that for in 2005, seventeen consumer finance companies received a combined 4.3 billion yen in suicide policy payouts on approximately 4,908 borrowers.

Curbing Excessive Lending

The 2006 Law established 'Designated Credit Bureaus' on which all money lending loans must be registered. The Bureaus must be checked by lenders prior to making a loan in order for them to determine the total level of borrowing that is already outstanding for all loan applicants. Further to this, the Law imposes an 'Aggregate Debt Control', which limits the total value of money lending loans to one third of the borrowers' gross annual income, and lenders are placed under an obligation to keep track of income on an annual basis, including by seeking relevant tax documentation from the borrower for this purpose where loans exceed 500,000 yen.

It should be noted that this 'Aggregate Debt Control' applies only in respect of the total value of loans from money lenders and does not include borrowings from banks or other financial institutions. In addition, loans made in respect of housing and cars, or those secured on property are exempted from this control.

However, a separate amendment to the existing Instalment Sales Act was brought into effect in December 2010. This requires credit card companies to use the Designated Credit Bureaus as a means of information to establish a borrower's 'Credit Limit Amount' based on an investigation into the annual income, living costs, and existing debts of the borrower. Companies are then prohibited from offering credit to customers over the Credit Limit Amount (for instalment credit), or 90% of the Credit Limit Amount (for revolving credit lines made available to customers).

Ensuring a fair price for credit

The 2006 Act reduced the interest rate cap under the Capital Subscription Law from 29.2% to the 20% level contained in the IRRL, formally eliminating the 'grey zone', although in practice lenders had been forced into reducing rates to this level by the Supreme Court Decisions at the start of 2006. Although lenders protested that restricting rates to this level would make the business unprofitable and drive them out of the market, figures released by the Financial Services Agency in 2004 indicated that the major money lending companies were borrowing their capital from banks at just 2% whilst lending this onto to consumers at between 27% and 29%. In addition, each of the four main lenders had operating profits of approximately 1 billion yen[22]. As a consequence, there was little sympathy for lenders with this argument.

[22] See Pardieck, 2008, pg. 574

Enhancing consumer protections against loan sharks

Finally, the Act further increased the maximum sentence for Loan Sharking (defined as either making loans without a licence or breaching the interest rate cap) to 10 years imprisonment and/or a fine of up to 30 million yen.

Implementation of the Law

It is important to note that the provisions of the 2006 Law were phased in over a three and a half year period. The first measures to be implemented included the increase in the maximum sentence for loan sharking introduced in January 2007, whilst the reduction in the interest rate cap and Aggregate Debt Control were not put in place until June 2010. The full timetable of the implementation is set out in table 1, below.

Table 1: Implementation stages of the Money Lending Law 2006

	Jan 2007	Dec 2007	Jun 2009	Jun 2010
Increase in maximum sentence for loan sharking	✓			
Changes to debt collection rules, establishment of Money Lender Associations, Enhancement of self regulation		✓		
Qualification examinations for money lending managers and requirements for qualified managers to be present in all branches			Exams started	All branches required to have a qualified manager
Increase in asset requirements for money lending firms			Raised to 20 million yen	Raised to 50 million yen
Establishment of Designated Credit Bureaus			✓	
Introduction of aggregate debt control (limit on lending to one third of borrower's income)				✓
Reduction of interest rate cap to 20%				✓

The Impacts of the 2006 Law

Prior to the introduction of the 2006 Law there was considerable debate in Japan concerning the potential negative impacts of tighter money lending regulation. For example, Pardieck (2008, pp. 572 -573) reports that Japanese industry advocates, together with their international investors[23], argued that:

- Access to legal credit for low income borrowers would be reduced, leading to an increase in illegal lending;
- Money lending firms would go bankrupt, involving huge job losses; and
- Restrictions on consumer lending would affect household consumption and reduce Japan's Gross Domestic Product by over 2 trillion yen.

Similar arguments have been put forward in the UK on several occasions in recent years, including in reports commissioned by Government. For example, in a jointly authored report submitted to the then Department for Business, Enterprise and Regulatory Reform in 2006, Policis and the Personal Finance Research Centre at Bristol University conclude (p.89) that:

> *"…commercial lending to high-risk borrowers will invariably come at very high cost…however, the alternative may be unregulated black-market lending at much greater cost and on very significantly worse terms."*

And in another joint report, evaluating the operation of Illegal Money Lending Pilots for the Department in the following year, the same authors state (p.82):

> *"The most effective strategy for combating illegal lending would appear to be a regulatory environment which maximises legal, regulated credit options while seeking to provide alternative credit solutions for those unlikely to have access to legitimate credit."*

However, as this section now details, these arguments are not supported by the evidence from Japan. What is more, the evidence set out below directly contradicts the portrayal of the Japanese experience by Policis in at least one of their subsequent reports arguing against the imposition of rate caps (Ellison & Forster, 'The impact of interest rate ceilings', undated)[24].

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[23] Major players included Citigroup and foreign investors owned 20% to 34% of the stock of Aiful, Promise, and Acom. Takefuji, the largest finance company, had listed on the London Stock Exchange in 2000, and, by 2006, foreign investors owned 56% of its voting stock.

[24] The full title is 'The impact of interest rate ceilings: the evidence from international experience and the implications for regulation and consumer protection in the credit market in Australia'. The report does not contain a date of publication.

Has there been an increase in illegal lending?

The argument that tighter money lending regulation leads to an increase in illegal lending is contradicted by the empirical evidence from Japan. Firstly, it is evident that the illegal lending problems in Japan *grew alongside* the expansion of legal money lending. It did not expand in a 'credit vacuum' as Ellison & Forster (undated, p. 47) have argued when commenting on the Japanese experience:

> *"The most extreme example of illegal lending filling a credit vacuum arises in Japan where the Yakusa-run black market is large, sophisticated, highly visible and associated with highly aggressive collection methods."*

Rather, illegal lending in Japan peaked in 2003 (see page 12, above). In the period leading up to this the legal money lenders had significantly *expanded* the scale of their operations. That they were able to do so during a period in which the maximum interest rate that they could charge was being reduced incrementally (from 73% in 1983 down to 29.2% in 2000) was due to the very low interest rates at which they themselves could obtain capital.

For example, in 2000, the Economist[25] noted that Japanese money lending companies had 'flourished' over the very period in which price caps had been reduced, enjoying 'double-digit growth since the late 1980s':

> *"Although regulators recently cut the maximum interest rate that consumer-finance companies can charge from 40% to 29%, customers still pay on average around 25% for a loan, far higher than the 16% or so that is normal for similar borrowers in America…Better still, Japan's near-zero official interest rates mean that consumer-finance firms can borrow far more cheaply than in America to finance their loans. Profit margins are about 22% in Japan, compared with 11% in America."*

And in 2004, Bloomberg's Businessweek[26] reported the largest four consumer Japanese money lending firms (Takefuji, ACOM, Aiful, and Promise) to be 'heroes' of the stock markets, exhibiting 'stellar performance':

> *"With [central bank] interest rates near zero, they basically have a license to print yen. They can borrow money to fund their business at about 1%, then lend it at high rates to cash-strapped salarymen and housewives. Margins for the industry average about 25%."*

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[25] 'Gimme Credit', The Economist, 2/11/2000 available at http://www.economist.com/node/410743

[26] 'Japan's Dazzling but Dark Consumer Finance Firms', Bloomberg Businessweek, 28/3/2004 available at http://www.businessweek.com/stories/2004-03-28/japans-dazzling-but-dark-consumer-finance-firms

There is therefore no evidence of the interest rate cap of 29.2% creating a 'credit vacuum' and contributing to the high levels of illegal lending that were present in the early 2000s.

Further to this, illegal lending has continued to reduce significantly even as legal money lending volumes have reduced. Nottage and Kozuka (2012, p. 136) make the point:

> *"…reports of illegal lending have not grown…complaints were similar in 2008 compared to 2007 (and half the level recorded in 2003). This suggests that the capped interest rates have not resulted in high levels of excess demand, creating credit exclusion or forcing consumers into the black market to maintain their borrowing habits."*

More recent statistics continue to bear this out, with National Police Agency figures for the first half of 2011 indicating that loan sharking victims fell by over 25% on the same period compared to the previous year despite an 'enhanced crackdown'[27], and in April 2012, the then Minister responsible (Mr. Shozaburo Jimi) confirmed that the official position of the Japanese government is that the Money Lending Law has been successful in reducing illegal lending[28].

Yet Ellison & Forster (undated, p.47) have this to say about the Japanese experience:

> *"Anecdotal evidence on the streets and from those working with victims of illegal lenders, rapid rises in the numbers of enquiries to specialist agencies set up to support victims and sharp increases in the number of arrests for illegal lending point to a significant increase in illegal lending having followed the sharp reduction in lending by the Japanese consumer finance houses in the lead up to the well flagged legislation and in the year following the introduction of the new law."*

As we have reported, the official statistics on illegal lending are directly contrary to this version of events. What about the anecdotal evidence? Ellison & Forster support their statement by citing figures obtained from the Credit Victims Group in Chiyoda ward, Tokyo:

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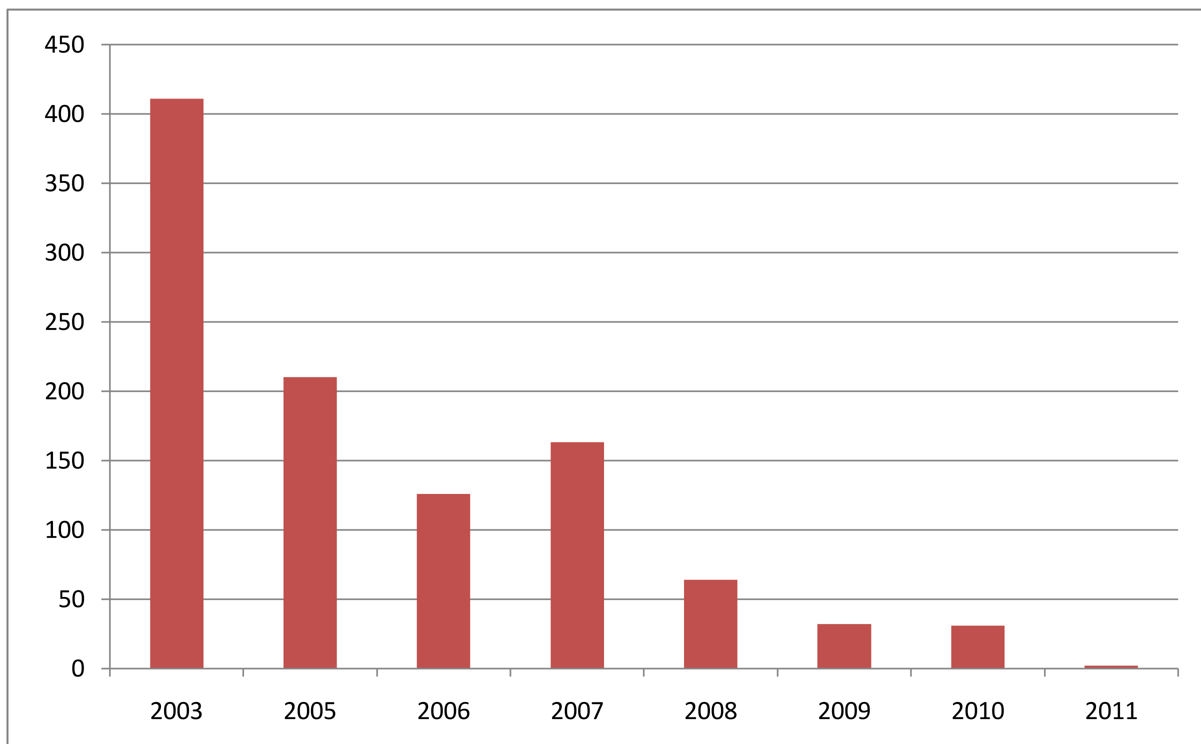
[27] 'Loan Shark Victims Decline 26%', Japan Times 2/09/2011, available at: http://www.japantimes.co.jp/text/nn20110902b2.html

[28] Statement made to the Committee of Audit and Oversight of Administration, House of Representatives, 2/4/2012 available at http://www.shugiin.go.jp/index.nsf/html/index_kaigiroku.htm

“The Council for Victims of Credit and Consumer Lenders based in Chiyoda ward Tokyo received 89 enquiries for help from victims of illegal lending in year 2007 to May, nearly double the number received in the whole of 2006”.

However, as figure 2, below indicates, Ellison & Forster’s use of figures from this Group was only partial. In fact the Group has reported a significant reduction in inquiries relating to loan sharking since 2003. In 2003 the Group reported a total of 422 such inquiries. However, this reduced by half in the following the two years (210 inquiries in 2005) and by a further third (163 inquiries) in 2007. This decline in inquiries has continued since, with the office receiving just 2 inquiries on this issue in 2011.

Figure 2: Loan Shark Reports to Credit Victims Association, Chiyoda Ward, Tokyo (2003 – 2011)[29]



None of this is to argue that we can afford to be complacent about illegal lending, but the experience of Japan suggests that there is a possible *causal* relationship between high levels of legal money lending and loan sharking that has been hitherto overlooked by researchers in the UK who have come at this question from a pro market liberalisation perspective.

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[29] No data is available from the Group for 2004

In addition, we also need to note what the Japanese experience implies about criminal sanctions for loan sharking. The maximum sentence for illegal lending in Japan was increased to 3 years imprisonment in 1983; to 5 years imprisonment in 2003; and most recently to 10 years imprisonment in 2007. Potential fines also increased over this period and are currently possible up to a limit of 30 million yen (equivalent to around £230,000). These penalties contrast sharply with the relatively light sentences available to courts in the UK for unlicensed lending of up to two years imprisonment or a fine of up to £5,000.

Prosecutions for illegal lending in Japan were also made easier in 2003, since which time evidence of advertising for, or directly approaching people in order to offer, loans has been sufficient to warrant an arrest. Again this contrasts with the UK approach where significant evidence gathering is required to demonstrate additional crimes (usually of violence) in order to bring forward a prosecution capable of securing a stiffer sentence than is available in respect of unlicensed trading alone.

Finally, in addition to the risk of criminal prosecution, loan sharks in Japan face the prospect of being sued by their victims for the return of all payments made in respect of their loans. For example, following his imprisonment for loan sharking, Susumu Kajiyama (see page 13, above) was ordered to pay back about 3.6 million yen per year to seven of his victims. This appears to have encouraged loan shark victims to come forwards and report loan sharks as well as to have had a deterrent effect.

Have money lending firms gone out of business?

It is undoubtedly the case there has been an increase in Japanese money lending firms going bankrupt and/or exiting the market in recent years. However, the provisions contained in the Money Lending Law of 2006 have only played a small part in this, with the majority of firms affected by:

- **The mass reclaiming of overpaid 'grey zone' interest** by borrowers which took place following the Supreme Court decisions in 2006. For example, the Japan Financial Services Association, which represents money lending firm interests, reports that money lending firms paid back 1.01 trillion yen in overcharged interest in 2008/09 (up by 460 billion yen on the previous year). Membership of the Association fell from over 4,000 to just over 2,300 in the same period.

- **Constraints on the ability of firms to obtain new capital from the bond markets following the collapse of Lehman Brothers in 2008.** For example, Takefuji's bond issues were consistently downgraded by ratings agencies as the financial crisis unfolded eventually forcing it into bankruptcy

in September 2010[30], whilst others in the market were forced into debt restructurings with major job losses[31] and in some cases mergers[32].

Where the Money Lending Law of 2006 is likely to have contributed to the reduction in the number of firms is through the imposition of asset and examination requirements. However, this appears to have been a deliberate policy of the Japanese authorities to 'weed out' smaller and less scrupulous firms. In 2006, there were approximately 14,000 money lending firms in Japan, but the largest seven firms in the market accounted for between 70% and 85% of the total value of loans made by the industry[33]. In this sense, reducing the number of small firms made the market more manageable from a regulatory perspective without necessarily impacting on the overall level of lending. In any event these provisions only became effective from June 2009 onwards, before which time the number of lenders in the market had been substantially reduced as a result of the above two factors.

Has there been a reduction in lending, and what are the impacts?

There is no doubt that the Money Lending Law *has* restricted the volume of legal money lending taking place since 2006 (Japan Credit Rating Agency Ltd, 2012). The *outstanding balances* of consumer finance companies peaked at 12 trillion yen in 2003 dropping to 11.7 trillion by 2006; to 7.2 trillion by 2009; 5.3 trillion by March 2010; and to 3.6 trillion in March 2011.

However, the *number of customers* in this market has not reduced as significantly. Between 2007 and 2011, the number of borrowers reduced from 11.7 million to

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[30] In its 2010 Annual Report, Takefuji Corporation itself explains: "Takefuji and its subsidiaries (the "Group") had procured funds through various channels, including loans from financial institutions, corporate bond issues, and securitization of loans receivable, that is, direct cash loans to consumers. But the September 2008 failure of Lehman Bros.— the "Lehman Shock"—changed that. The financial environment became increasingly severe and, with refund claims for interest received from customers trending high and market worries about the profit-squeezing impact of the new aggregate debt control, rating agencies subsequently downgraded Takefuji. This became a catalyst for early repayment of some loans, which only served to exacerbate an already challenging fund procurement situation for the Group.

[31] In December 2009, Aiful agreed to a debt restructuring plan with 65 creditors, which allowed it to defer payments on around 280 billion yen of loans and avoid bankruptcy. The plan required it to halv its 4,400 workforce: see http://www.rttnews.com/1165845/aiful-gets-approval-from-creditors-for-debt-restructuring-plan-quick-facts.aspx)

[32] For example, Promise merged with Sanyo Shinpan in 2007.

[33] The 70% figure is cited directly from 'Shark infested waters', The Economist, 10/8/2006 available at http://www.economist.com/node/7279297; However, comparing figures on the amounts outstanding to the seven largest companies in 2004 as provided by Domoto (2009) with those for the industry as a whole for the same year as provided by Kozuka & Nottage (2007), the figure appears to be closer to 85%.

approximately 8 million[34]. On this basis, the average level of outstanding debt per customer has been roughly halved over the period. The main driver behind this appears not to be the reduction in the interest rate cap (it is clear that small loans continue to be made by companies beneath the 20% ceiling), but the Aggregate Debt Control, which limits total borrowing from money lenders to one third of a borrower's income[35].

This constriction on the amount that can be borrowed per person has had major repercussions for lender business models, as the Japan Credit Rating Agency (2012, p.2), notes:

> *"Their traditional sales method was to increase the unit amount of loans by attracting customers through heavy advertising…however, consumer finance companies are now in the phase of changing their sales methods to a style in which, with the introduction of regulation which limit the total amount of loans to individual customers, they aim to acquire customers who need limited loans, but who will remain as customers for a long time, by applying more careful credit examinations."*

However, the same source, citing evidence that a number of money lending companies have secured the long term support of banking partners, indicates that:

> *"Over the medium to long term the consumer finance companies will be looking for the opportunity to restart active sales to halt the fall in the number of customers and the outstanding balance of loans."*

In any event, the reduction in lending volumes appears to have had *positive* effects:

- The number of debtors with at least five unsecured loans from consumer finance lenders fell from 2.3 million in 2006 to 440,000 in March 2011; and
- The number of bankruptcies have declined[36] from their peak of 242,000 in 2003; falling to 150,000 in 2006; to just over 126,000 in 2009; and to 100,000 in 2011.

Again, this evidence flatly contradicts the portrayal of the Japanese experience in Ellison & Forster (undated, p.4) who instead reported that 'bankruptcies have risen sharply as consumer credit has been withdrawn from higher risk borrowers.'

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[34] Of which 6.5 million are customers of the four largest firms (Japan Credit Rating Agency Ltd, 2012)

[35] See, for example, the emphasis placed on the Aggregate Debt Control as the prime reason for 'profit squeezing' in Takefuji's 2010 Annual Report, note 30, supra.

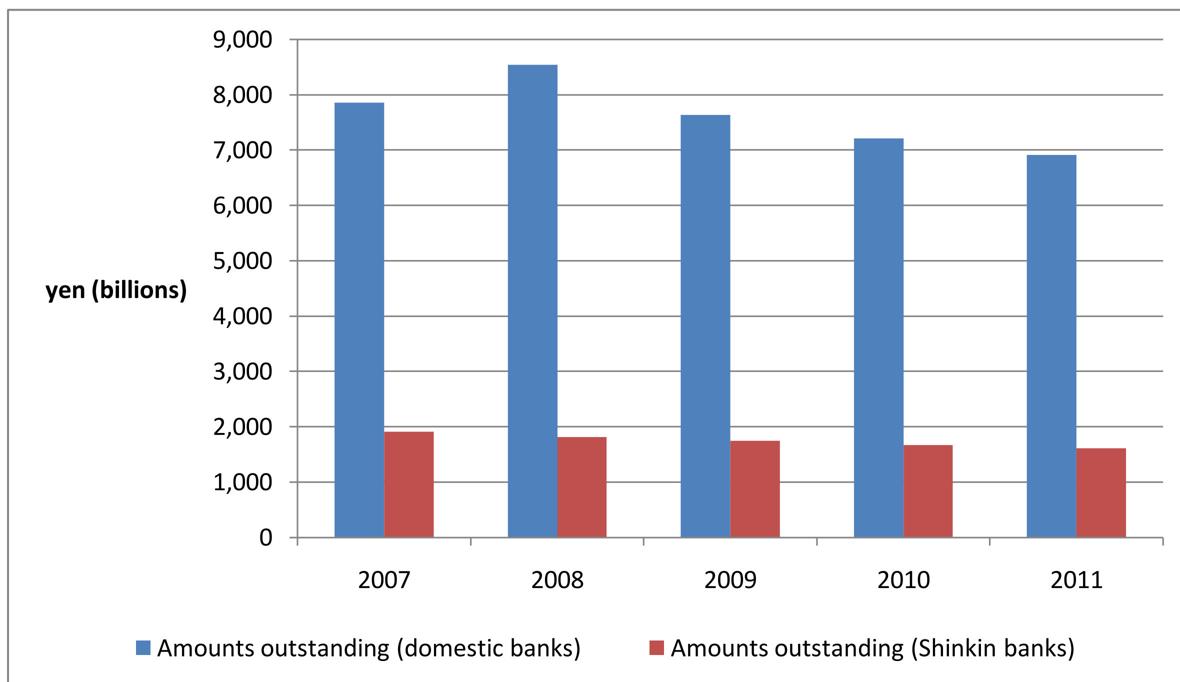
[36] See for example the report by Bloomberg 'Japan's Personal bankruptcies fall 2.5% as Consumer Debt Drops', 18/2/2010, at:

http://www.bloomberg.com/apps/news?pid=newsarchive&sid=acUmUAI2bbFY

Has borrowing from money lenders been 'displaced'?

If borrowing from money lenders has reduced, as it clearly has, then it is reasonable to ask whether or not consumers are going elsewhere to obtain credit. The Aggregate Debt Control of limiting total lending to one third of the borrower's income only applies to non bank money lending companies (although the interest rate cap of 20% applies across the consumer finance market and includes banks). It is therefore plausible that restrictions on money lending volumes to individuals have led to an increase in demand for credit from banks or other financial institutions. However, as shown in figure 3, below, this has not been the case either in respect of the major domestic banks or the *Shinkin* (regional co-operative banks which are similar in purpose to the UK's credit unions, and which provide small loan facilities to local residents and small businesses).

Figure 3: Bank lending to individuals (excl. mortgages), 2007 - 2011[37]



This indicates that overall levels of (non mortgage) borrowing have been in decline in Japan in recent years, and that restricting levels of borrowing from money lenders has not led to increased borrowing from these other sources, but has instead been part of a more general trend amongst Japanese households to reduce their use of credit over this period.

[37] Source: Statistics Bureau, Ministry of Internal Affairs and Communications: Statistical Yearbook 2011 and Japan Monthly Statistics

Has this affected economic growth?

One of the arguments put forward in opposition to the proposed tightening of money lending regulation in Japan in 2006 was that this would reduce the availability of credit; constrain consumer spending, and so impact negatively on economic growth. Similar arguments have been repeated outside Japan. For example, Ellison and Forster contend (undated, p.82) that:

> *"…the supply of credit plays an important role in fuelling consumption by households, which is itself one of the key is drivers of wider economic growth."*

And (p.83) that:

> *"Growth in personal prosperity has been significantly faster in the markets with faster credit growth."*

However, the empirical evidence does not provide much support for either of these positions. Appendix one to this report sets out a number of charts used to analyse this 'consumer credit/ economic growth hypothesis' by comparing the following indicators for Japan and the UK:

- Indices of total household consumption expenditure and non mortgage liabilities held by households as a percentage of disposable income;
- Gross Domestic Product ('GDP') per capita growth rates;
- Household net savings rates as a percentage of disposable incomes; and
- Levels of investment as a percentage of GDP.

This analysis indicates that:

(i) Japanese households substantially decreased their holding of credit liabilities over the period 2001 to 2010 compared to the UK[38]; and

(ii) This did result in a significantly lower growth for total household consumption expenditure in Japan compared to the UK[39]; but

(iii) This does not appear to have resulted in different patterns of GDP. In fact, the two countries have followed remarkably similar trajectories in GDP growth per capita since 2004 (see figure 4, on the following page).

A possible explanation for this lies in the fact that household consumption expenditure makes up a smaller proportion of GDP in Japan than it does in the UK.

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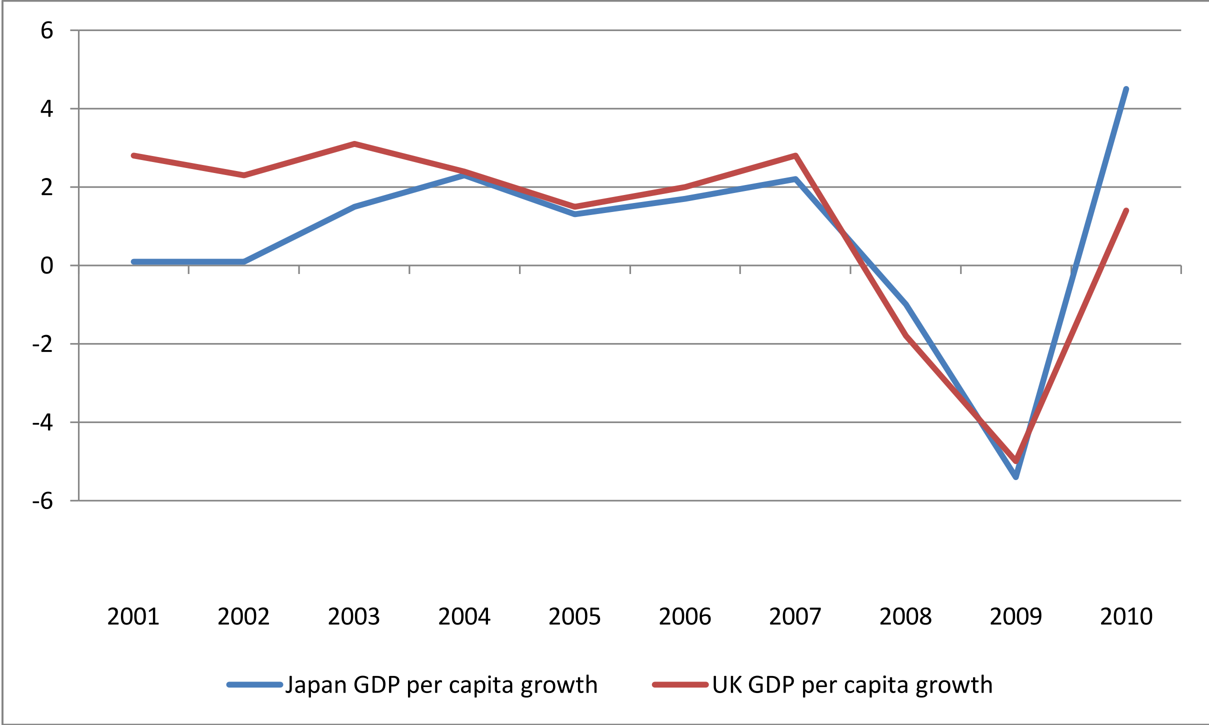
[38] See figures 1 and 2 in the Appendix

[39] Also in figures 1 and 2 in the Appendix

Over the four years from 2007 to 2010 household consumption expenditure averaged 58.5% of GDP in Japan compared to 64% in the UK[40].

Figure 4: GDP per capita growth rates, Japan and UK, 2001 to 2010

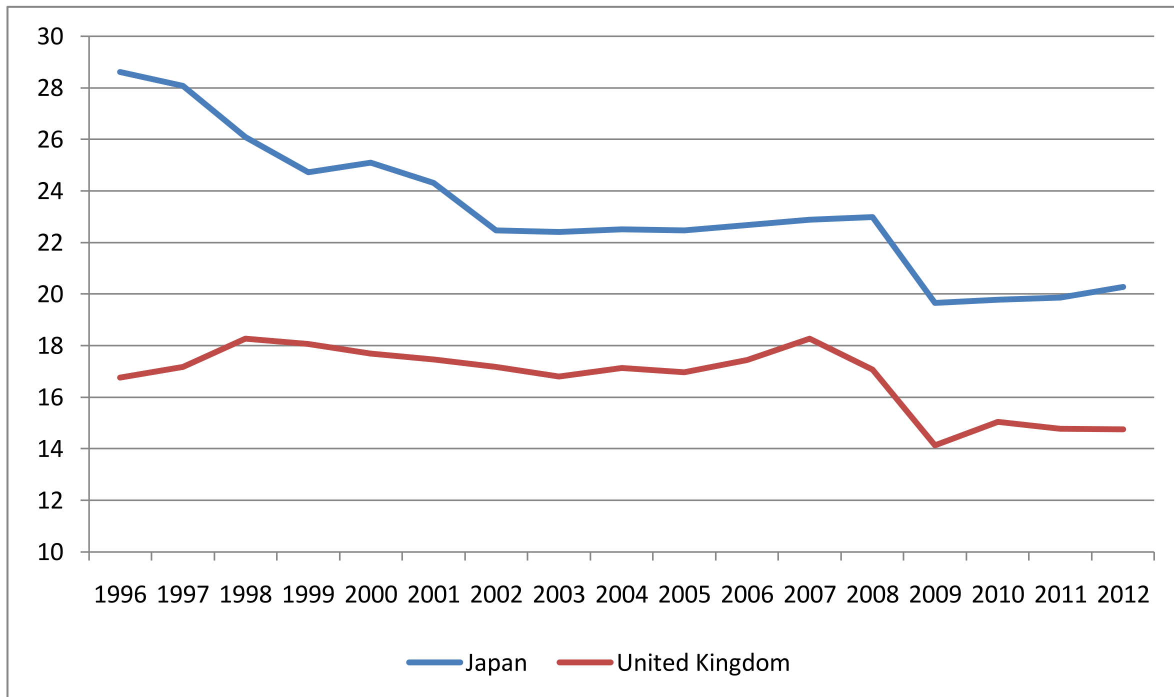


This lower level of household consumption expenditure may, in fact, be beneficial for economic growth, as it provides for a greater proportion of household income to be put toward savings which can then be intermediated by banks into investment in businesses[41]. As indicated by figure 5 on the following page, total investment as a percentage of GDP has consistently been higher in Japan than in the UK.

[40] Source: World Bank; http://data.worldbank.org/indicator/NE.CON.PETC.ZS

[41] The degree to which banks do this, as opposed to prioritising speculative activities is outside the scope of this paper.

Figure 5: Total investment as a percentage of GDP (Japan and UK, 1996 – 2012)[42]



Finally, the contention that 'prosperity' increases with credit growth is simply not plausible.

In support of this argument, Ellison & Forster reference Gross National Income ('GNI') per capita as their measure of prosperity. However, as figure 6 on the following page illustrates, GNI per capita grew more rapidly in Japan *after* the interest rate cap was reduced from 40% to 29.2% in 2000 and as money lending volumes reduced (notably between 2003 and 2007). And, although more recently affected by the world financial crisis from the end of 2007 through to 2009, GNP per capita *increased* in 2010/11, coinciding *with* the introduction of the 20% cap on loan rates.

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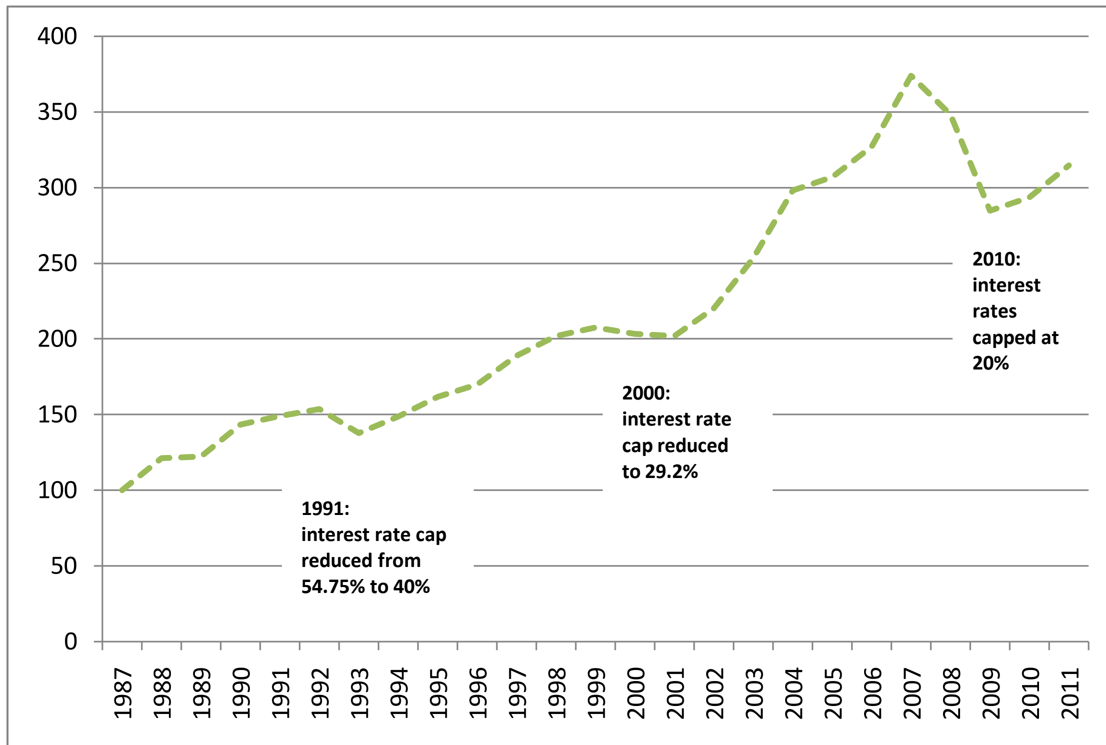
[42] Source: IMF; http://bit.ly/TByQZt

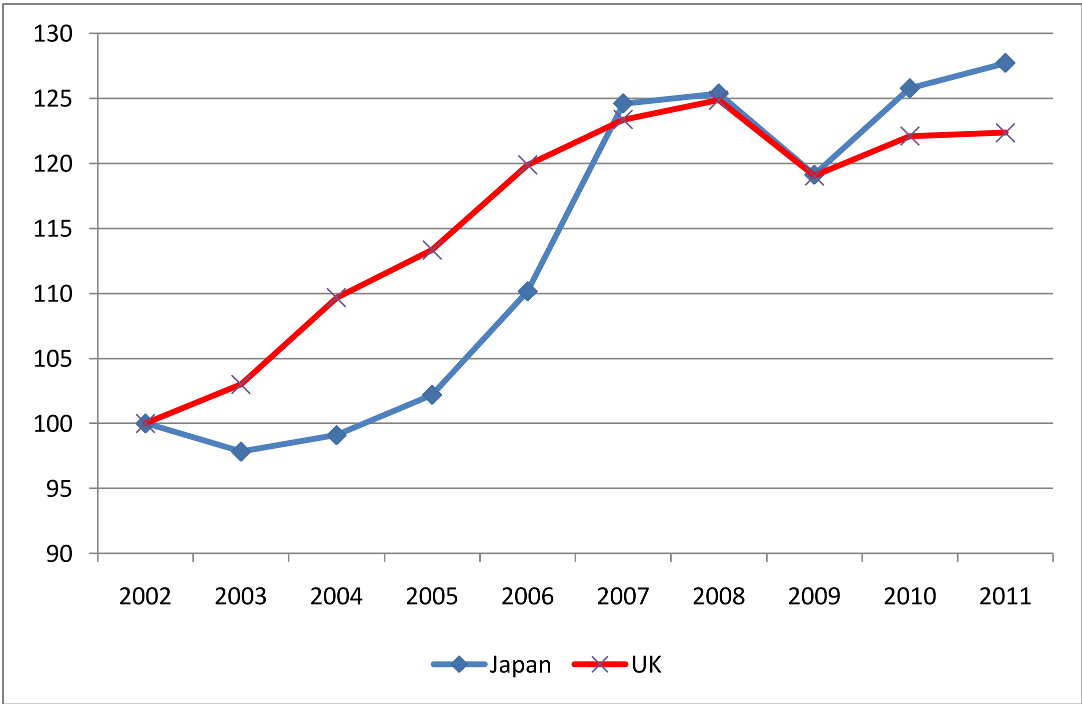
Figure 6: Growth of GNI per Capita in Japan (1987 =100)[43]; presented with dates of interest rate restrictions in force.



And by way of providing an international comparison, figure 7, on the following page, plots the index of GNI per capita in both Japan and the UK since 2002. This indicates that although the growth rate of Japan's GNI per capita was poor in 2003 and 2004 – both years when money lending volumes were high - performance on this measure then improved considerably such that Japan's GNI per capita had increased by the same amount as the UK's over the five year period through to 2007. Both countries then experienced a reduction on this measure as a consequence of the world financial crisis, but over 2009 to 2011, during which time the final provisions of Japan's Money Lending Act were being implemented and consumer credit lending volumes were reducing considerably, Japan's growth rate in GNI per capita was actually *higher* than that experienced in the UK.

[43] Source: World Bank; http://data.worldbank.org/indicator/NY.GDP.PCAP.CD?page=5

Figure 7: Index of GNI per capita, Japan and UK, 2002 - 2011[44]



[44] World Bank, GNI per capita, Purchasing Power Parity measure, current international $.

Conclusions and Recommendations

Japan has been engaged in a forty year long struggle to restrain both legal and illegal money lending operations. The rise of legal money lending from the late 1970s was associated with an increase in over-indebtedness and associated social problems, which in Japan included debt related suicides and the growth of Yakuza organised illegal lending. These problems continued to grow with the further expansion of legal money lending, fuelled by bank investment and the direct raising of finance from the wholesale money markets from 1998 through to 2003. However, a broad campaign led by the victims of credit lenders and with the support of lawyers from the JFBA, emerged to successfully press for tighter regulation. Important reforms were won by this campaign in 1983 but it was not until 2006, following Supreme Court decisions that allowed borrowers to reclaim overpaid interest to legal money lenders, that the industry was successfully restrained.

Of course, the UK is not Japan. There are clear differences between our two countries. In particular, there is, thankfully, an absence of large scale organised crime involved in loan sharking in the UK, and Japan also has a much higher suicide rate than the UK. But in many respects, the problems faced by the UK are similar to those experienced in Japan. As in Japan, the UK has witnessed the exponential growth of high cost money lending in recent years. As in Japan, this has been supported by capital investment from the banking and private equity sectors. And, as in Japan, lower income consumers in an economic downturn are being bombarded with advertising for instant cash, whilst lenders have also been identified as using the 'sweat box' approach – constantly recycling loans and trapping borrowers in an increasing debt spiral.

We therefore have much to learn from the Japanese experience. In particular:

- Our focus on responsible lending 'guidance'; relying on the industry to conduct robust 'affordability assessments' with no clear definition as to what is and what is not affordable echoes aspects of the initial failed attempt of the Japanese to address their problems in the Money Lending Control Law of 1983;
- We have elected to rely on voluntary codes of practice rather than directly intervening through the use of price caps and limits on total lending relative to the borrower's income. Yet it is precisely the combination of lower cost credit and limits on lending levels which has led to the reduction in over-indebtedness and bankruptcies in Japan;
- Just as the Japanese legal system provided borrowers with little support until the Supreme Court decisions of 2006, our own legal framework for

challenging money lending contracts remains weak. In the same year that Japanese borrowers got the green light to recover trillions of yen in excessive interest charges, the UK introduced a new Consumer Credit Act that provided for the courts to assist borrowers, for example by reducing the interest payable on a contract, where there is a finding of an 'unfair credit relationship'. However, since the introduction of these provisions very few cases have been brought to court and of these only a handful have been found in the debtor's favour[45];

The major lessons from the Japanese experience relate to arguments concerning caps on the cost of credit and the potential negative consequences of these. In this respect the Japanese experience indicates that:

- Caps on the cost of credit do not, by themselves, limit the expansion of money lending. The Japanese cap reduced from 40% to 29.2% between 1986 and 2000. Yet during this period, legal money lending increased dramatically. The reasons for this lie in the fact that the costs of capital paid by money lenders over this period were extremely low (at around 2%). From this experience we learn that caps need to be constructed which reflect the actual operating costs of money lending firms and can, in fact, be set at very low rates without putting lenders out of business at times when the cost of capital is low. There is no doubt that the reduction from 40% to 29.2% benefitted borrowers over this period by reducing the cost that they paid for credit;

- The dynamic between legal and illegal lending is more complex than pro-industry advocates would sometimes have it portrayed. Illegal lending in Japan grew alongside an expansion of legal lending. It did not arise from a legal 'credit vacuum' as some opponents to caps in the UK have previously stated. Rather, the Japanese experience indicates that legal money lending may *contribute* to a growth in severe over-indebtedness which then leaves some borrowers desperate enough to turn to the illegal loan sharks;

- Advocates against interest rate caps in the UK have also contended that interest rate caps would be bad for economic growth. However, we found no real evidence to support this argument. In fact, capping credit charges and reducing levels of over-indebtedness is just as likely to be good for growth by helping households build up savings which can then be used to fund investment. In short, there is more than one route to economic growth and the continued reliance on fuelling household consumption with credit is unlikely to be the best one to take;

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[45] For details of the 28 cases brought to date under these provisions see http://www.oft.gov.uk/about-the-oft/legal-powers/legal/cca/CCA2006/unfair/unfair-rel-full/

- Illegal loan sharking needs to be addressed by increased policing activities and supported by appropriately severe criminal sentences. The Japanese approach to defining illegal lending as lending without a licence to do so or lending above the allowable interest rate works. No further evidence should be needed in order to secure a conviction and the increase in the sentence for loan sharking to a maximum of 10 years or a fine of over £200,000 not only provides a clear deterrent but also appears to have incentivised the National Police Agency to prioritise action in this area. In contrast the UK's maximum penalties of a 2 year sentence and a fine of up to just £5,000 appear extremely weak in comparison.

In view of the above, this report makes the following **recommendations:**

1. That the Office of Fair Trading review the affordability assessment requirements of lenders contained in its Irresponsible Lending Guidance, and consult on a proposal to establish a total borrowing limit based on a set ratio of the borrower's income. In order to ensure that the borrowing limit is enforceable, all high cost lenders should be required to register their loans on a national database;

2. That Government increase the criminal penalties for unlicensed lending to at least 5 years imprisonment and substantially increase the maximum fine that can be imposed for this offence;

3. That the Department for Business, Innovation and Skills commit to introducing a cap on the total cost of consumer credit agreements, and establish an independent commission to advise it on the structure and level of this cap and, on an ongoing basis, to monitor its impact;

4. That the Department for Business, Innovation and Skills commission further research to examine the potential links between legal money lending growth, over-indebtedness and illegal lending;

5. That the Financial Services Agency investigate and report on the extent to which banks and other financial institutions have been funding the expansion of money lending in the UK. Such an investigation should also consider whether the level of this investment outweighs the investments made by banks in financial inclusion initiatives to provide people on lower incomes with access to affordable credit options.

Appendix one: exploring the 'credit expansion/ economic growth' hypothesis

Figure 1: Japanese households have significantly reduced their non mortgage liabilities since 2001 as a percentage of their disposable income, and total household consumption expenditure has been broadly flat over this period.

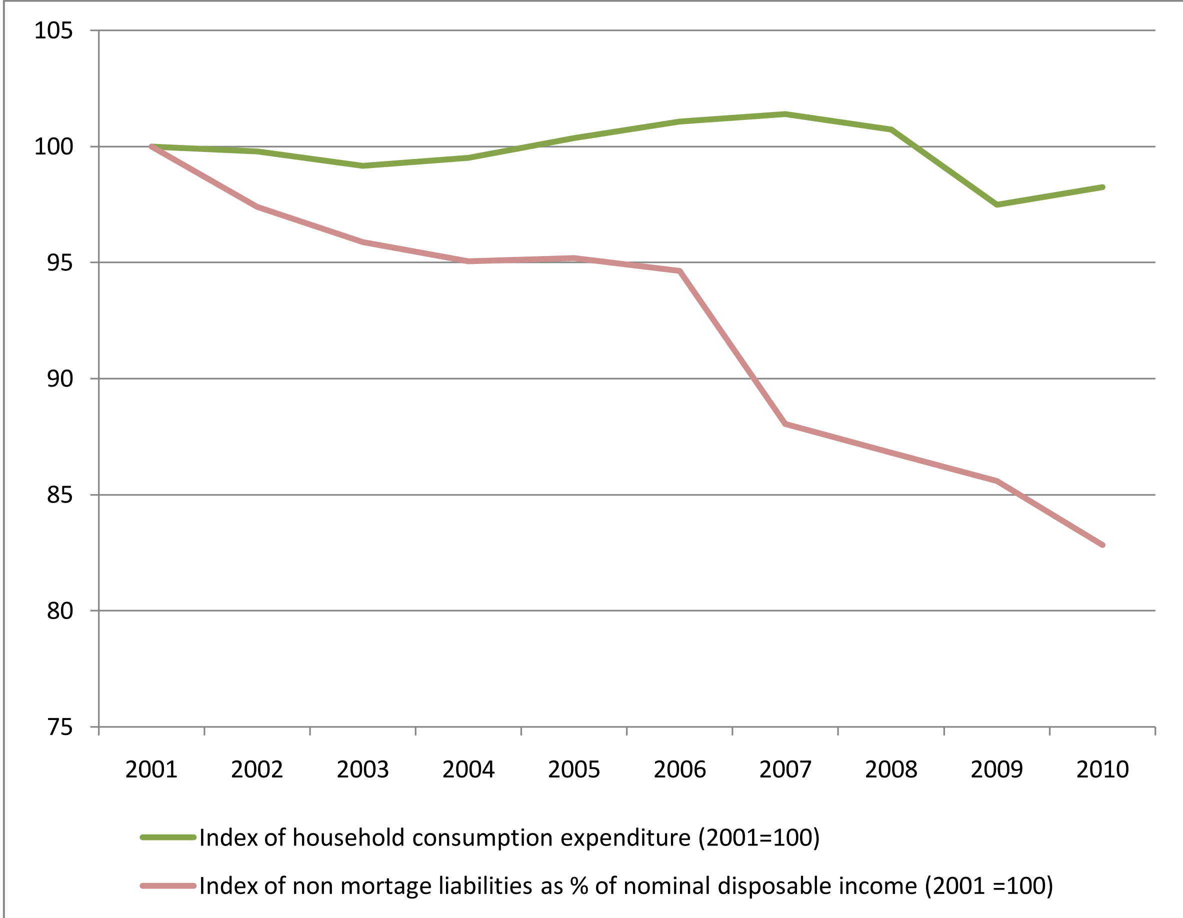


Figure 2: In contrast, in the UK household consumption expenditure rose significantly over the same period, as did the holding of non mortgage credit liabilities. Consumer credit use peaked in 2006 and, following the onset of the financial crisis in late 2007, the use of consumer credit has fallen sharply. However, the impact on total household consumption expenditure has been muted with only a slight reduction evident in 2009.

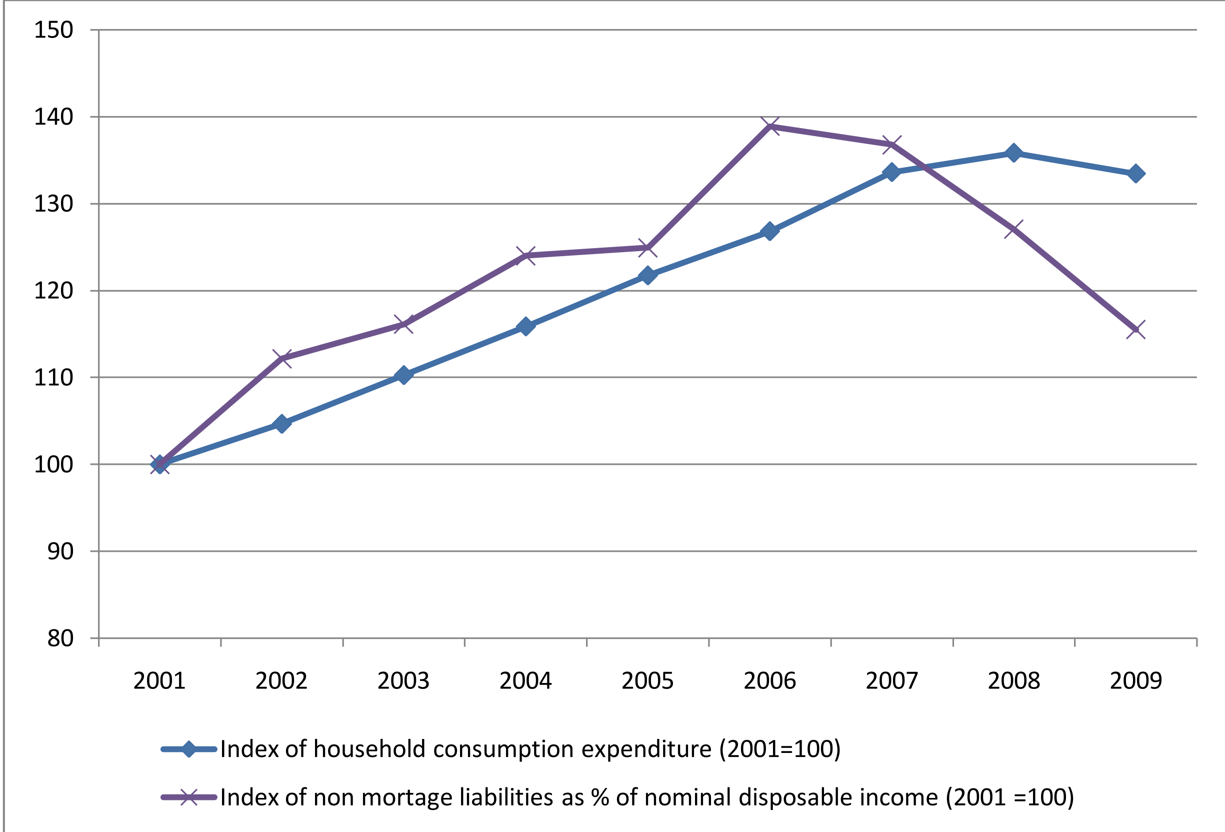


Figure 3: Despite these differences, economic growth patterns in the two countries follow the same course from 2004 onwards. In 2009/10 GDP per capita growth was also slightly stronger in Japan than in the UK in 2009/10.

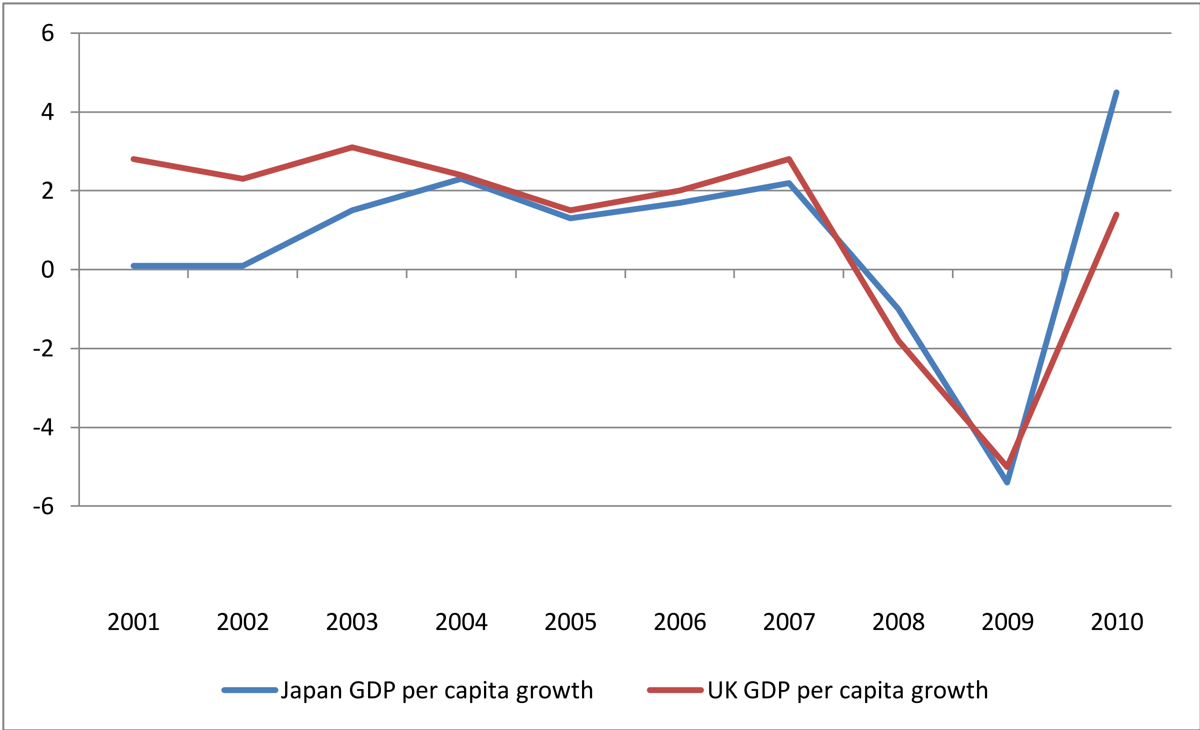
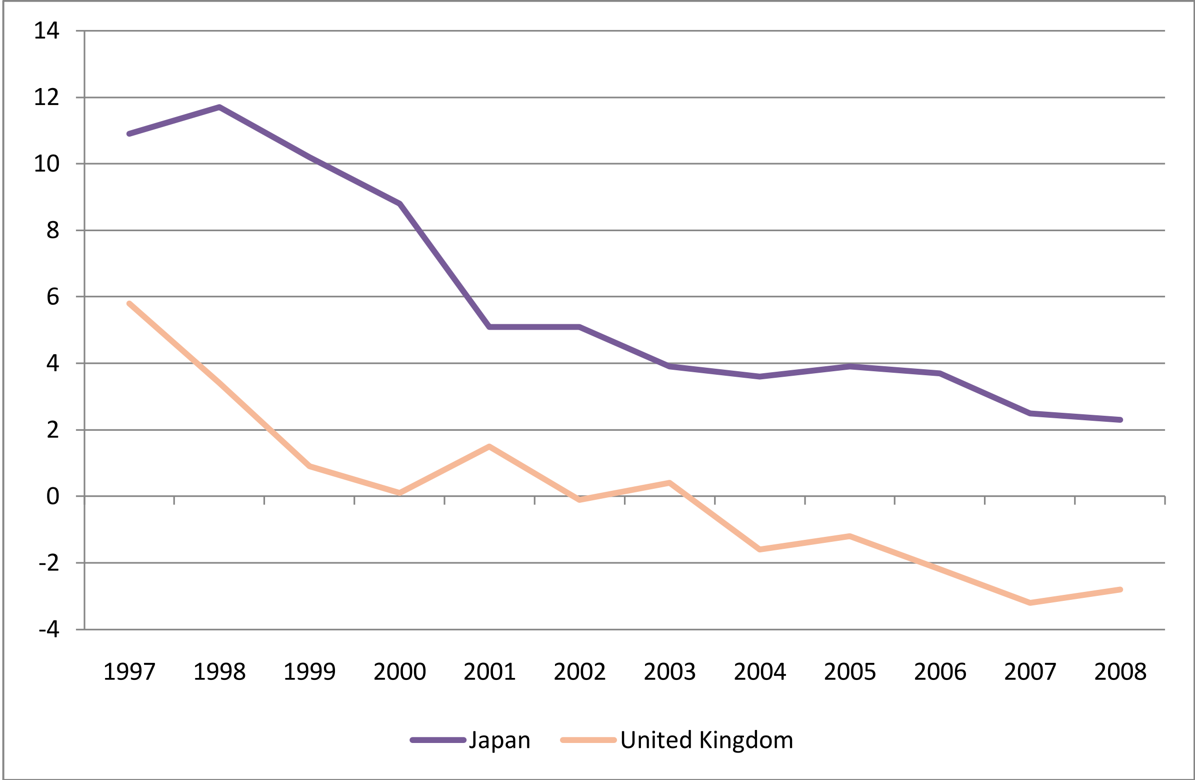
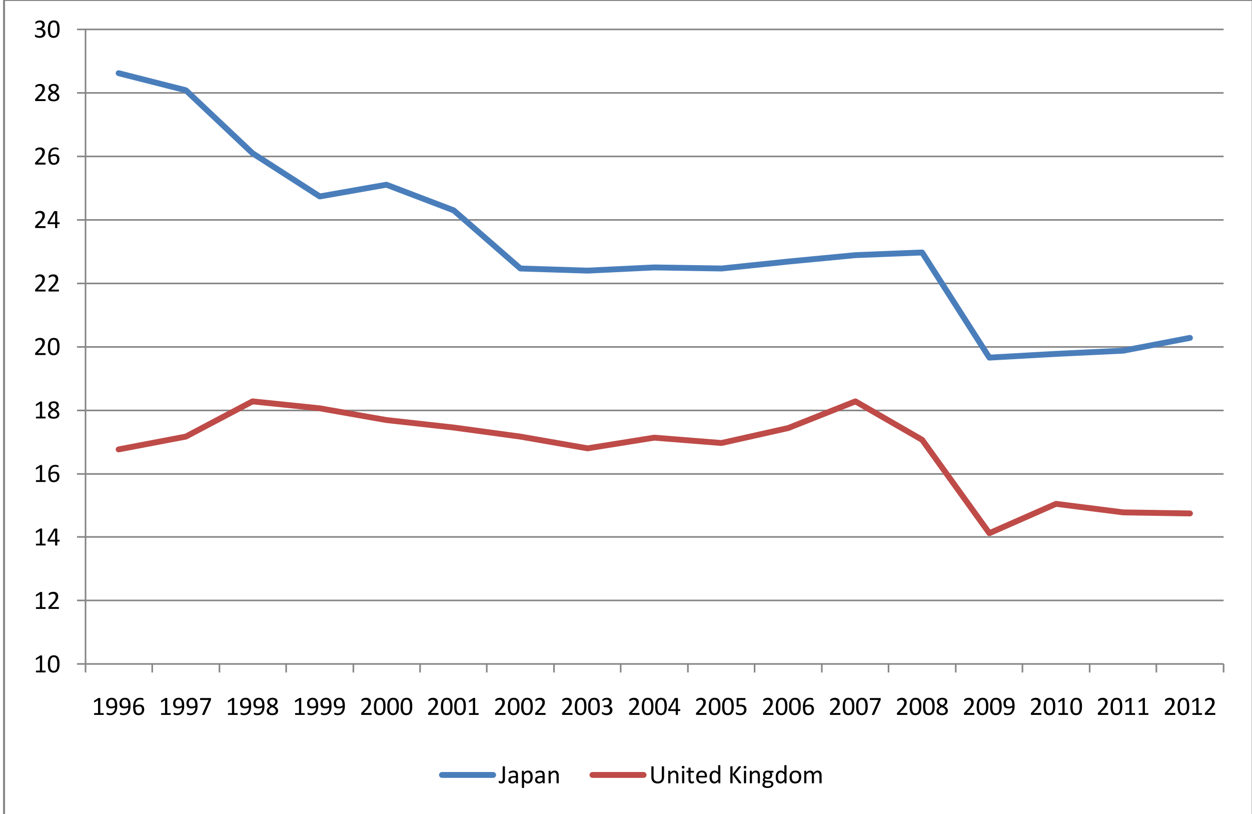


Figure 4: Household consumption expenditure is not as large a component of GDP in Japan as it is in the UK. Lower consumption expenditure leaves more disposable income for savings. Net savings rates as a percentage of household disposable incomes have been consistently higher than for the UK over the period. The rate is still positive in Japan despite a large drop during the period of the money lending boom (through to 2003). In contrast, in the UK this measure has been negative in all but two years since 2000[46].



[46] Source: OECD Factbook 2011/12; http://bit.ly/RxOozL

Figure 5: Household savings can be turned into investments by the banking system. Total investment as a percentage of GDP[47] has been consistently higher in Japan than in the UK over this period, and was 5% higher in 2012. This higher level of investment as a proportion of GDP offsets virtually all of the lower household consumption expenditure referred to on page 24 of the main report.



[47] Source: IMF; http://bit.ly/TByQZt

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