

INTEREST RATE REGULATIONS

On Wednesday, 25th November 1981, the Government gazetted regulations designed to limit increases in lending interest rates.

The Regulations are by way of amendment to the Financial Services Regulations 1979 and require financial enterprises employing funds of more than \$2,000,000 to give the Reserve Bank fourteen days notice of a proposed increase in the price of any 'specified financial service'. A rate increase can be implemented at the end of fourteen days if the Bank takes no action but if the Bank raises an objection the increase can be implemented only to the extent authorised by the Bank. In deciding particular cases the Bank must have regard to the Government's economic policy and may have regard to the profitability of the financial enterprise. Decisions by the Bank are subject to appeal to the Commerce Commission.

In announcing the move, the Prime Minister, the Right Hon. R. D. Muldoon, said the Regulations had been made necessary by the practice of financial institutions disregarding repeated Government warnings to hold interest rates down.

The principal sections of the Regulations are:

2. Interpretation

- (2) " 'Specified financial service' means —
 "(a) The lending of money or granting of credit (other than normal trade credit);
 "(b) The buying or discounting of any credit instrument, whether as principal or agent:".

4. Notification of proposed increases in prices of specified financial services —

The principal regulations are hereby amended by revoking regulation 5, and substituting the following regulation:

"5. (1) Before any supplier, who, at the end of the supplier's immediately preceding financial year, employed in the supplier's business funds of \$2,000,000 or more, increases the price of any specified financial service, that supplier shall forward to the Reserve Bank a notice in writing stating the reasons for the price increase and itemised details of the financial figures on which the calculation of the price increase is based.

"(2) Where the Reserve Bank does not, within 14 days after receiving a notice pursuant to subclause (1) of this regulation, notify the supplier that the Reserve Bank objects to the proposed price increase, the supplier may increase the price to the extent so notified; but, if the Reserve Bank so objects within that period, the supplier shall not increase that price except to the extent approved by the Reserve Bank.

"(3) In considering any proposed increase in the price of any specified financial service, —

"(a) The Reserve Bank shall, in addition to such matters as it is empowered or required to have regard to by any other Act, have regard to the economic policies of the Government which, in relation to the economic stability of New Zealand, are transmitted in writing from time to time to the Reserve Bank by the Minister of Finance; and

"(b) The Reserve Bank shall, if it thinks fit, take into account —

"(i) The profits of the supplier in relation to the shareholders' funds of, or as the case may be, to the equity capital invested by the proprietor or partners in, the whole of the supplier's business (or, if the Reserve Bank thinks fit, any particular section of it); or

"(ii) The assets employed in, or the annual sales of, the whole of the supplier's business (or, if the Reserve Bank thinks fit, any particular section of it); and

"(c) The Reserve Bank shall, if it thinks fit, take into account the extent to which the profits of the supplier in relation to the items mentioned in subparagraphs (i) and (ii) of paragraph (b) of this subclause could be limited without the financial stability and economic viability of his business (or, if the Reserve Bank thinks fit, of any particular section of it) being affected.

On 4th December 1981, the Reserve Bank issued the following press statement clarifying some aspects of the regulations:

"The Bank stated that the Government has now established the criteria which are to be followed in the administration of the regulations. The essence of these is that loan charges should not be increased beyond the level of those being imposed on 25th November 1981 unless exceptional circumstances exist.

The Bank has discretion in deciding what are exceptional circumstances. In general it will give approval to increases in loan charges if the liquidity or profitability effects of refusing an increase would jeopardise the viability of the lender. The Bank will also give consideration to cases where a lender's charges were substantially below those being applied by competitors for similar transactions at the time the regulations became effective.

Many loan contracts contain a condition that the interest rate will be reviewed at certain intervals. The Bank stressed that the regulations do not prevent a lender from adjusting the charge on such a loan up to the charge being imposed for similar loans on 25th November.

The Bank also draws attention to the fact that it is not only interest and discount rates that are covered by the regulations but all charges imposed in connection with a loan, including placement fees, commissions, etc.

The Bank has received some enquiries which indicate a belief that only financial enterprises are caught by the regulations. In fact, any supplier of credit or purchaser of a financial asset which employed more than \$2,000,000 of funds at its last balance date is subject to the regulations. Thus trading companies may be subject to the regulations as may the purchasers or discounters of commercial bills.

The commercial bill market presents a particular problem in that it operates on what is essentially an auction system, a system which is not readily amenable to price control. The Bank and the merchant banks are consulting in an endeavour to arrive at an arrangement which will not unduly distort the market but which will achieve the Government's intent as expressed in the regulations."