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USAID FINANCIAL SECTOR TRANSFORMATION PROJECT

IMPACT OF NEW LEGISLATION ON PAYDAY LENDING MARKET

REPORT ON SHORT-TERM, HIGH-COST LENDING
IN UKRAINE (2ND WAVE)

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Kyiv, Ukraine

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GLOSSARY OF TERMS

“**Agreement**” means a consumer loan agreement.

“**FSR Methodology**” means a methodology for calculating the real annual percentage rate (RAPR) under a consumer loan agreement, as approved by the Order No. 3238 “On approval of the Methodology for calculating the total loan cost for a consumer, the real annual percentage rate under a consumer loan agreement” of the National Commission for State Regulation of Financial Services Markets dated 07/20/2017.

“**Law on Consumer Lending**” means the Law of Ukraine on Consumer Lending.

“**Law on Financial Services**” means the Law of Ukraine on Financial Services and State Regulation of Financial Services Markets.

“**Lender**” means a company that grants a loan.

“**Mystery Shopping**” means a marketing research method, whereby retail outlets (in this case — branches and websites of financial companies) are visited under a certain cover story (in this case — as borrowers who want to apply for a loan) in order to assess the visit according to the established parameters.

“**NBU**” means the National Bank of Ukraine.

“**NBU Methodology**” means a methodology for calculating the RAPR under a consumer loan agreement, as approved by the Resolution No. 16 “On approval of the Methodology for calculation by non-bank financial institutions of the total loan cost for a consumer and of the real annual percentage rate under a consumer loan agreement” of the Board of the National Bank of Ukraine dated 02/11/2021.

“**Payday loan**” means a loan granted in the amount below one minimum wage and for a period less than one month.

“**RAPR**” means real annual percentage rate.

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I KEY SURVEY FINDINGS

The Financial Sector Transformation project conducted two surveys of micro lenders (defined as short term, high cost small personal loans) using “mystery shopping” by researchers who actually signed loan agreements. The first wave of the survey was carried out in November-December 2020, before the new amended Consumer Lending Law entered into force. The second wave was conducted in May – June, 2021, after the effective date of the Law in January 2021.

Payday lending is significant in Ukraine. The current amount of outstanding loans to individuals is about UAH 14.8 billion. This is seven times the amount of outstanding loans of all credit unions in Ukraine. According to NBU data,¹ the number of financial companies with valid licenses to lend funds at the end of Q2 2021 is 755. The main borrowers appear to be young people and members of other vulnerable segments of the population. These are mostly people who, because of their unstable financial position and low education levels, are poorly versed in the overall specifics of financial services, including lending.

ANALYSIS OF INTEREST RATES AND PAYMENTS

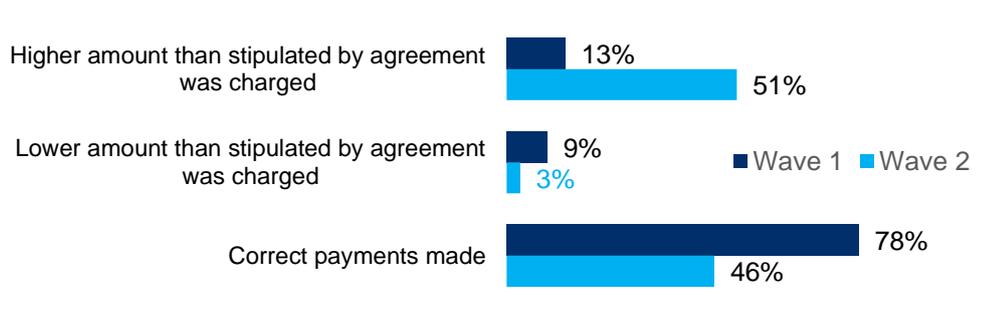
The entering into force of the amendments to the Law on Consumer Lending in January 2021 has not significantly changed the practices of the micro lenders. In Wave 2 of the Financial Sector Transformation (FST) Survey there were minor improvements in informing consumers about RAPR (informing about RAPR before concluding the agreement and the presence of RAPR in the agreements) and in the correctness of the calculations of RAPR.

However, in terms of companies charging extra fees for repaying the loan and including illegal provisions in the agreements, the situation worsened. Thus, the issue of implementation of the provisions of the Law and imposing sanctions for violations is as relevant as ever.

In the course of the survey, new and repeat loan applications were also analyzed for the terms of granting the loans. As in Wave 1 of the survey, **new clients were generally loaned funds on better terms**, i.e. at lower interest rates and under promotional offers. As a result, consumers may develop a distorted view of the low cost of such loans, encouraging them to borrow again. However, rates increase upon repeat applications.

The average RAPR specified in the agreements with mystery shoppers (consumers) was 22,679% p.a. However, the average RAPR recalculated by our analysts, under the NBU Methodology, is 28,671% p.a. which shows that, **on average, lending companies charge more in reality than they indicate in the agreements.**

Compared to Wave 1 of the survey, the percentage of visits where companies charged clients extra fees for repaying the loan **increased significantly - 51%** of such cases were observed (in Wave 1 such discrepancy in payments in favor of lending companies was observed during 13% of visits). All increased payments related to charging extra interest: in 3% of cases - for two days, in the rest of cases - for one additional day. It is a very difficult task for an average microloan borrower to calculate this on his own and understand that he is overpaying for an already expensive loan.



¹ https://bank.gov.ua/files/stat/Financial_companies_2021-07-01.xlsx

ADVERTISING AND INTERACTION AT A PRE-CONTRACTUAL STAGE

Potential borrowers are likely to get initial information from the websites of online lending companies. This information is often hard to distinguish from advertising. Comparison between the Wave 1 and Wave 2 findings suggests that the **websites have not changed their approaches to information/advertising** — attention is focused on promotional rates (zero or close to zero), whereas no RAPR details are provided next to such rates and are instead “hidden” somewhere at the bottom of the page or in other website pages.

Certain **positive trends were observed in achieving compliance with the Law on Financial Services**, according to which, companies should provide clients with a certain amount of information prior to concluding an agreement — a number of companies added relevant information to their websites and, compared to Wave 1, finding such information was simpler. Nevertheless, **the proportion of companies that publish all the required information was almost identical in the two waves of the survey**— all the necessary information could be found in 19 out of 41 sites (46%) during Wave 1, and in 13 out of 29 sites (45%) during Wave 2.

The proportion of instances when **discrepancies were identified between the information declared in the agreement and oral information** was essentially unchanged in Wave 2. Differences were detected in 28% of the Wave 1 visits and **27%** of the Wave 2 visits. However, the number of instances when **discrepancies were identified between the signed agreement and the written pre-contractual information** grew from 23% in Wave 1 to **53%** in Wave 2. The discrepancies mostly concerned the nominal rate, RAPR as well as the nature and amount of fines in the event of delays in loan repayment.

ANALYSIS OF THE AGREEMENTS

83% of the agreements signed by mystery shoppers contained all the required information. In particular, **88% of the agreements indicated the RAPR.**

However, **86% of the agreements contained clauses that may be regarded as illegal.** Companies would most often include in the agreements provisions that stipulate higher interest rates in the event of the consumer’s failure to discharge obligations (as found in **64%** of the agreements as well as 64% in Wave 1). **24%** of the agreements (21% in Wave 1) contained the provision on imposing fines and default interest for the same violation. **22%** of the agreements (12% in Wave 1) contained a restriction on the right to repay the loan early, while **20%** of the agreements (3% in Wave 1) — a restriction on withdrawal from the agreement.

ENFORCEMENT

The Consumer Lending Law cannot enforce itself. The purpose of creating a fair and orderly retail lending market requires adequate enforcement by the regulator. The companies that breach consumer protection laws and regulations should be held accountable, and the penalties should be stringent enough to stop unlawful conduct and prevent future violations, including banning the companies from future participation in the marketplace. The Law on Financial Services vests the NBU with powers to demand that companies remedy violations and the reasons for them, as well as powers to fine lenders in the amount of up to UAH 119,000. However, there is very limited public information on whether the NBU took any enforcement actions on the violations. It is, therefore, not possible to assess whether the violations described in this report were or will ever be subject to investigation and enforcement.

II INTRODUCTION

The Financial Sector Transformation project conducted two surveys of micro lenders using “mystery shopping” by researchers who actually signed loan agreements. The first wave of the survey was carried out in November-December 2020, before the new amended Consumer Lending Law entered into force. The second wave was conducted in May – June, 2021, after the effective date of the Law in January 2021.

Payday lending is significant in Ukraine. The current amount of outstanding loans to individuals is about UAH 14.8 billion. According to NBU data,² the number of financial companies with valid licenses to lend funds at the end of Q2 2021 is 755. The main borrowers appear to be young people and members of other vulnerable segments of the population. These are mostly people who, because of their unstable financial position and low education levels, are poorly versed in the overall specifics of financial services, including lending.

The Consumer Lending Law states that payday loan users should have access to full and accurate disclosure of loan terms, agreements should be concluded in compliance with applicable laws and regulations, lenders should provide borrowers with accurate RAPR and total loan cost calculations, etc. The Law on Financial Services vests the NBU with powers to demand remedies for violations from companies and powers to fine lenders. In particular, non-compliance with the requirements set by the law regarding consumer loan agreements can result in a fine in the amount of up to UAH 119,000, whereas provision of untruthful information about a financial service may result in a fine in the amount of up to UAH 10,200 for each case of such untruthful information disclosure.

Since January 8, 2021, **Micro-Lenders are required to calculate the real annual percentage rate (RAPR)** and include information about it in agreements and advertising materials. A new methodology for RAPR calculations developed and mandated by the National Bank of Ukraine (NBU) has been in effect since February 13, 2021. Financial companies had three months to bring their calculations in line with the NBU Methodology.

The results of Wave 1 of the survey demonstrated that financial companies charged extremely high interest rates. The average RAPR, calculated according to the NBU Methodology (the compound interest method) was more than 54,000% p.a. In the second wave, FST applied the NBU methodology to the signed agreements and calculated an average RAPR of over 28,000% p.a. – better but still usurious.

Wave 2 of the survey on the microlending market in Ukraine was conducted in **May-June 2021** and was intended to find out the extent of financial companies’ compliance with the new legislative requirements.

Starting from January 2021, **payday loan agreements must contain:**

- the RAPR and the total loan cost for the consumer;
- the procedure for loan repayment and payment of interest for using the loan, including the number of payments, their amount and frequency in the format of a schedule of payments;
- information about consequences of late payments, including the amount of penalties, interest rate, other charges;
- the procedure for early loan repayment, etc.

The Law also **prohibits lenders from including in the agreement** clauses that stipulate:

- changes to the interest rate, the procedure for calculating the interest rate and the procedure for interest payments, which prejudice the consumer for violating his/her obligations;
- imposing fine and default interest for the same violation of his/her obligation by the consumer;
- restricting the consumer’s right to an early loan repayment in whole or in part at any time;
- restricting the consumer’s right to withdraw from the agreement within a 14-day period from concluding it.

The RAPR calculation methodology introduced by the NBU uses a compound interest formula (through a formula for discounting all future payments on an annual basis).

The objectives of the survey included: monitoring real annual percentage rates and the total cost of loans; comparing their actual values against the advertised or declared ones; analyzing approaches taken by financial

² https://bank.gov.ua/files/stat/Financial_companies_2021-07-01.xlsx

companies to determine interest rates and the cost of payday loans for new clients, and for those clients who have a record of borrowing from the same company; and assessing compliance by financial companies with the Law on Consumer Lending and other laws and regulations in this field.

III SURVEY METHODOLOGY

Wave 2 of the survey comprised the following components:

MYSTERY SHOPPING

Specially trained employees of *Info Sapiens* visited branches of financial companies (in person or online), posing as individuals interested in taking out a consumer loan. Mystery shoppers made **59** visits to **29** financial companies, resulting in signed consumer loan agreements. **8** visits were made to the branches of **4** financial companies in person, and **51** visits were made online (via websites of **26** companies). The average amount borrowed by a mystery shopper was UAH3,400; all loans but four were granted for a period up to one month. 3–8 days after the date of the agreement, mystery shoppers would repay loans ahead of schedule.

The mystery shopper profile

16 mystery shoppers were involved in the survey, with each one making 3–4 visits on average. Different mystery shoppers in terms of gender, age, financial position, and employment status were involved.

1. Women were more frequent visitors than men;
 2. Mystery shoppers' age — from 19 to 64 years;
 3. Employment status — officially employed, unofficially employed, unemployed;
 4. Average income monthly (among employed individuals) — UAH10–12 thousand.
-

Survey sample

The survey sample included those financial companies that were visited during Wave 1 of the survey (with certain exceptions). Financial companies were personally visited in Kyiv.

27 financial companies were visited twice, first — by a new client of the financial company, and then — by a previous client of the same institution. One of the institutions could not be visited a second time because of the large number of refusals to mystery shoppers. Four visits were made to a company that lends both online and offline.

Specifics of the survey's field stage

1. Mystery shoppers were denied loans without providing reasons in about 25% of all loan applications. This mostly happened online automatically – before the contact with the consultant the borrower received the following message “An automatic check was done: the loan was denied”. Sometimes the loan was granted only on a second-to-fifth attempt (and such companies are featured in the analysis). In certain instances, no loans could be obtained from the companies included in the initial sample (including some of those in Wave 1 of the survey, when 35 companies were visited).
2. The lending license of one of the financial companies covered by Wave 1 of the survey had been voluntarily surrendered, and therefore it was excluded from wave 2. Another company visited by mystery shoppers during Wave 2 of the survey was stripped of its lending license after the field stage of the survey was over (the license was revoked because of the company's refusing the NBU in holding an inspection).

DESK STUDY OF OUTCOMES OF THE VISITS AND AGREEMENTS

Outcomes of the visits were comprehensively analyzed, in particular for the advertising information obtained, the information that could be obtained in writing (at the branches and/or on the lender's website), and for the

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information provided by the consultants orally (at the branches and via messengers/telephone). As part of the survey, the existence of contradictions between any such information and concluded agreements was investigated.

Agreements concluded by mystery shoppers were analyzed for their content and conformity to applicable laws and regulations; the procedure for executing agreements in the format of electronic documents was also examined.

DESKTOP COMPARISON OF REAL ANNUAL PERCENTAGE RATES ON LOANS

Real annual percentage rates and total loan costs were calculated, and their actual values, as determined by the research company's experts, were compared against those indicated in the agreements. Analysis was performed of the approaches taken by financial companies to calculating interest rates and the cost of payday loans granted to new clients and the clients who have a record of lending from the same company.

IV ANALYSIS OF A PAYDAY LOAN COST

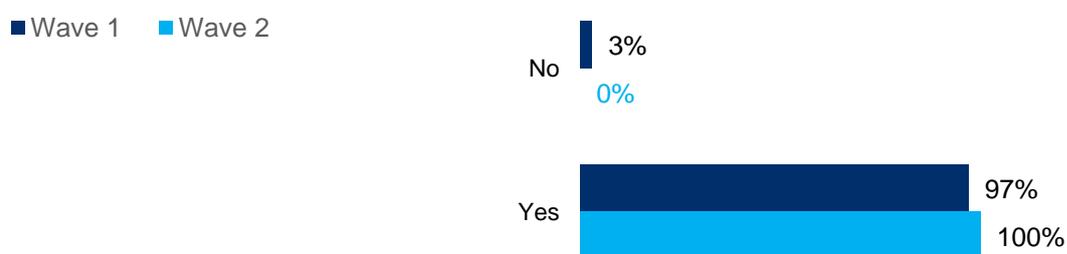
During Wave 2 of the survey, the following information concerning interest rates and loan costs was analyzed and compared against Wave 1 of the survey:

- Annual and daily nominal interest rates and commissions specified by lenders in the agreements;
- The RAPR specified by financial companies in agreements and the RAPR calculated by analysts for schedule loan repayment under the NBU Methodology effective as of 02/13/2021;
- Payments charged on overdue debt on the loan;
- Actual payments made by the mystery shoppers on the loan, and their conformity to the concluded agreements.

NOMINAL INTEREST RATES, COMMISSION

All financial companies specify in the agreements the amount of daily nominal interest rate on the loan. 59% of the agreements contain information about both the daily and annual nominal rates.

Diagram 4.1. Availability of information about daily nominal interest rates in the agreements (Wave 1 N=90, Wave 2 N=59)



In two agreements, the daily nominal rate was not set for the relevant period and instead was shown in the calculation tables in absolute amounts for each day (with both the amount and percentage of the loan amount being different for each day of the loan period).

The **nominal annual interest** rates specified in the agreements were from **0% to 912%**, while the **daily** interest rates — **between 0% and 2.5%**. These indicators generally do not differ from those in Wave 1 of the study.

Under the concluded agreements, the borrower would generally have to pay the interest only. About 8% of the agreements stipulated payment of commissions by the borrower (for granting a loan or for other services from the company). Unlike Wave 1, when payments in favor of third parties were stipulated in one agreement, no such instances were identified in Wave 2.

ANALYSIS OF THE RAPR SPECIFIED IN AGREEMENTS

Since the nominal rate does not provide comprehensive information about the loan cost for the borrower, the Law on Consumer Lending obligates lenders to indicate the tentative real annual interest rate (RAPR) in their agreements.

This rule was not yet in force during Wave 1 of the study. Nevertheless, a significant number of companies were already informing their clients about the tentative RAPR — 76% of all agreements contained this information. In Wave 2 of the survey, information about RAPR was indicated in **88%** of the agreements. This means that although awareness of RAPR has increased, 12% of the agreements violated the relevant provision of the Law on Consumer Lending.

VERIFICATION OF RAPRS SPECIFIED BY FINANCIAL COMPANIES

In order to determine the correctness of the RAPR calculation by financial companies, analysts calculated the RAPR payable by the borrower if loan funds were used during the loan period. In view of the fact that financial companies were visited after the expiration of the three-month period during which the non-bank financial institutions had to bring their activities in line with the provisions of the NBU Methodology, calculations were made under the NBU Methodology.

Table 4.1 lists average RAPR for each company over all visits made to it — both the one specified in the agreement and the one verified under the NBU Methodology.

Table 4.1. Verification of RAPR values (specified in agreements³ vs calculated by analysts under the NBU Methodology)

Company	RAPR	
	Specified in the agreement	Calculated under the NBU Methodology
Company 1 ⁴	296%	1,450%
Company 2 ⁵	621%	12,642%
Company 3	649%	8,756%
Company 4	657%	405%
Company 5	657%	23,575%
Company 6	730%	722%
Company 7	730%	53,573%
Company 8	778%	679%
Company 9	834%	121,280%
Company 10	1,833%	2180%
Company 11	8,804%	8,804%
Company 12	10,988%	20,603%
Company 13	13,504%	13,268%
Company 14	16,682%	16,874%
Company 15	17,357%	34,805%
Company 16	17,807%	17,807%
Company 17	18,669%	18,569%
Company 18	20,621%	25,916%
Company 19	22,202%	22,202%
Company 20	22,966%	22,966%
Company 21	24,432%	16,033%
Company 22	26,753%	31,048%
Company 23 ⁶	27,833%	20,437%
Company 24	30,884%	29,732%
Company 25	43,180%	31,891%
Company 26	60,096%	59,996%
Company 27	104,139%	89,402%
Company 28	105,533%	105,433%
Company 29	148,018%	14,518%

The average RAPR indicated in the agreements was **22,679%** p.a., compared to 559% p.a. during Wave 1. This is because the companies are now required to use the NBU Methodology (based on compound interest versus the previous FSR Methodology based on simple interest). However, when our analysts recalculated the contractual RAPR in Wave 2, it turned out to be **28,671%** p.a. In Wave 1 the recalculation of RAPR resulted in a cost of 54,354% p.a. (calculated by our analysts for the comparison purpose even though the NBU methodology was not mandatory at that time).

³ For companies where RAPR was not mentioned in the agreement, the table includes calculations based on the daily nominal rate and made under the following formula: $(1 + \text{loan term} * \text{nominal daily rate})^{(365 / \text{loan duration})}$

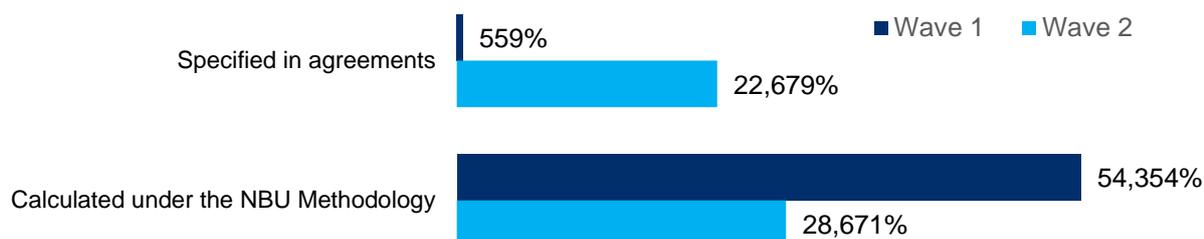
⁴ This color highlights companies that loaned offline only

⁵ This color highlights companies that loaned online only

⁶ This color highlights company that loaned both online and offline

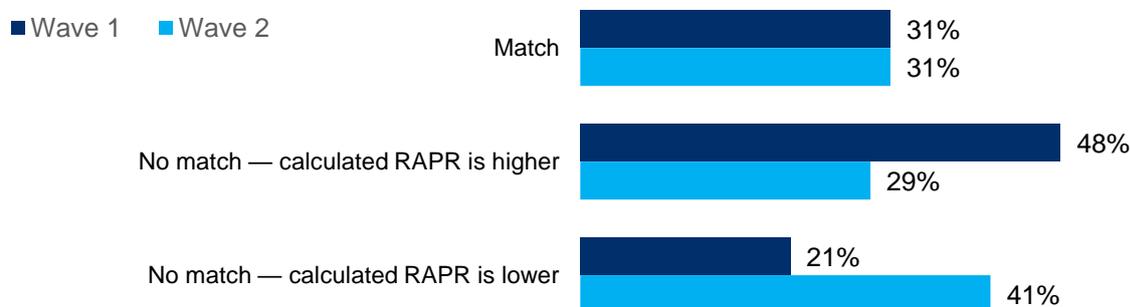
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Diagram 4.2. Average RAPR specified in agreements and calculated under the NBU Methodology



The RAPRs provided by the financial institution and calculated within the survey coincide in about a third of the agreements (see also Diagram 4.3)⁷. Compared to Wave 1 of the study, this proportion remained unchanged. **The percentage of the agreements where the calculated RAPR is higher was 29%** and, in 41% of the agreements, the calculated RAPR is lower than the one indicated in the agreement. The situation has changed, as compared to Wave 1 of the study — a growing number of companies currently indicate in their agreements higher RAPRs than those calculated within the survey. We do not know the exact reasons for these discrepancies. One may assume that the lending companies are not particularly concerned about the correctness of calculations for two reasons: their customers do not understand and do not pay much of the attention to the numbers, especially when they are desperate to borrow; there is little enforcement and the imposed fines, if any, are not persuasive.

Diagram 4.3. Percentage of agreements where the contractual RAPR matches the RAPR calculated by analysts (under the FSR Methodology in Wave 1 (N=68), and under the NBU Methodology in Wave 2 (N=52))



In August 2021, the NBU for the first time ever applied enforcement measures against 8 financial companies (including 3 companies in the Wave 2 of the survey) that failed to comply with the NBU Methodology⁸. The NBU demanded that the companies remedy the violations and remove reasons causing such violations by September 6, 2021. If a company fails to comply with the NBU’s demand by this deadline, it may be fined for up to UAH 17,000.

COMPARATIVE ANALYSIS OF INTEREST RATES FOR NEW AND RETURN CLIENTS

As in Wave 1 of the study, we compared the first and return visits by the same borrower to a financial company. Such visits were made to 28 companies (one company could be visited only once). Findings show that, in 62% of cases, new clients were mostly loaned funds on better terms — in particular, they were offered lower interest

⁷ We assumed that the rates were the same if the difference in the modulus did not exceed 0.5%

⁸ <https://bank.gov.ua/ua/news/all/do-vosmi-nebankivskih-finansovih-ustanov-zastosovani-zahodi-vplivu-za-porushennya-zakonodavstva>

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rates. Half of the companies offered a daily rate that was close to zero (no more than 0.01%) for a new borrower. During return visits to the same companies, the daily rate grew 80 to 1,000 times (in the latter case, from 0.001% to 1%). On the whole, daily rates grew in 61% of 28 companies during return visits. In 32% of the companies, daily rates did not differ between the first and return visits and amounted to 1.7%-2.2%, and in 7% of the companies the rates for repeat clients were even lower (rate decreases from 2.0%-2.5% to 1.0%-2.38%). 61% of the analyzed companies thus resort to a marketing strategy of attracting new clients with lower loan costs (welcome bonus).

Furthermore, the calculated RAPR for the first and return visits was lower during first visits in 64% of the cases. The same RAPR was offered to clients by 11% of the companies and, in 25% of the companies, a lower RAPR during the return visit was offered to clients compared to the initial visit.

Table 4.2. Average RAPR under the NBU Methodology, first and return visits

Title	Average RAPR (calculated)	
	First	Return
Company 1	0%	2,899%
Company 2	4%	37,133%
Company 3	4%	17,507%
Company 4	4%	1,355%
Company 5	4%	195%
Company 6	4%	17,605%
Company 7	4%	26,533%
Company 8	4%	35,610%
Company 9	4%	51,828%
Company 10	4%	32,062%
Company 11	4%	37,116%
Company 12	4%	29,032%
Company 13	46%	25,238%
Company 14	101%	242,460%
Company 15	405%	(no return visit)
Company 16	707%	737%
Company 17	3,500%	58,596%
Company 18	9,090%	38,061%
Company 19	16,874%	16,874%
Company 20	20,603%	20,603%
Company 21	22,597%	21,807%
Company 22	23,811%	22,122%
Company 23	24,966%	29,032%
Company 24	36,238%	33,373%
Company 25	50,935%	56,211%
Company 26	59,996%	59,996%
Company 27	62,290%	1,491%
Company 28	100,841%	77,963%
Company 29	119,701%	91,165%

ANALYSIS OF PAYMENTS CHARGED ON OVERDUE DEBT

Since financial companies lend to high risk borrowers (such as individuals without proven income⁹), they stipulate various sanctions for a failure to repay the loan. Often, information about the scope of such sanctions

⁹ Despite the fact that most borrowers provide information about their employment and personal income when applying for a loan, the companies verified this information (by approaching in any manner the contact persons indicated in the application) only in three instances

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is available even before the agreement is signed, i.e. at the borrower's decision-making stage (69% of the visits), and is contained in 100% of the agreements.

Lenders impose **several types of penalties simultaneously**. One out of four agreements (24%) contained references to fines and default interest for the same violation, and in 10% of the agreements there was a combination of a fine, a default interest and a higher interest rate. This situation is similar to the one observed during Wave 1, when the lender would charge a fine and a default interest (21% of the visits), and in particular a combination of a fine, a default interest, and a higher interest rate (16% of the visits). Charging such "double or triple" liability is prohibited by the Law on Consumer Lending (see in Section VII below).

Some companies impose higher interest rates in the event of failure to repay the loan promptly on new clients only, without applying them to repeat clients. In some other companies, the rate increases in the event of delayed repayment is different for new and repeat clients (for example, the rate "upon discharge by the Borrower of obligations within a period other than the scheduled repayment date specified in Article 2.1 of the Agreement" increases from 0.01% to 2.2% per day for a new client, and from 2% to 2.2% for a repeat client).

ANALYSIS OF LOAN PERIOD CALCULATION BY FINANCIAL COMPANIES

When calculating the RAPR, the term of the loan is calculated from the day following the date of granting the funds until the date of full repayment of the principal amount of such loan under the agreement. However, financial companies often ignore this and include the actual date of granting funds in the calculation, forcing the borrowers to overpay for the actual term of using the loaned funds.

Such cases were observed less frequently during Wave 2 of the survey. Differences in the number of days, which would benefit the lender, were registered during 48% of the Wave 1 visits, compared to such differences **only in 19% of the Wave 2 visits**. The discrepancy between the term of use calculated by the institution and the actual term of use in Wave 2 was one day (a two-day difference was registered during a Wave 1 visit).

ANALYSIS OF CONFORMITY OF ACTUAL LOAN PAYMENTS MADE BY THE MYSTERY SHOPPERS TO THE TERMS AND CONDITIONS OF THE CONCLUDED AGREEMENTS

Compared to Wave 1 of the survey, **the percentage of visits where companies charged clients extra fees for repaying the loan increased significantly - 51%** of such cases were observed (in Wave 1 such discrepancy in payments in favor of lending companies was observed during 13% of visits). All increased payments are related to charging extra interest: in two cases - for two days, in the rest of cases - for one additional day.

V ANALYSIS OF CONSUMER LOAN ADVERTISING

Financial companies aggressively advertise their services — their advertising is often seen on television, in the subway, at public transport stops, in social networks, etc. These services are advertised by both Ukrainian celebrities (pop stars, etc.) and “ordinary” people who talk about their positive impressions of the ease and speed of taking out a loan and of what they were able to buy with the borrowed funds.

We analyzed for compliance with the Law the following: 1) advertising materials received when visiting in person the offices of financial companies that lend offline (booklets, calendar cards) and 2) information presented on the websites of financial companies that lend online. Under Article 8 of the Law on Advertising, information posted on the website of the financial company that lends online is not regarded as advertising¹⁰. Accordingly, we reviewed only such information on the financial companies’ websites that the consumer is likely to perceive as advertising (i.e. information about terms and conditions of loans, presented in bright colors and/or images and/or with the cost of loan highlighted in much larger fonts).

STATUTORY REQUIREMENTS FOR CONSUMER LOAN ADVERTISING

Under Article 7 of the Law on Consumer Lending, if consumer loan advertising refers to an interest rate or any other details relating to total loan expenses, such advertising should contain standard information. Such standard information in payday loan advertising includes details of:

- maximum loan amount;
- RAPR amount;
- maximum loan term.

An important provision of the Law on Consumer Lending is the prohibition of advertising an interest-free loan or loan at zero interest, as well as the obligation to use uniform font size for standard information and to present it in the main body of advertisements.

MATERIALS PROVIDED DURING OFFLINE VISITS

Two of the four financial companies visited by mystery shoppers in person provided them with printed advertising products in the form of booklets and calendar cards. These advertisements contained information about the daily rate, RAPR, maximum loan amount and term. Standard information was presented in a much smaller font than the information about the nominal daily rate (0.01% for new clients); this can be viewed as a violation of the Law.

MATERIALS AVAILABLE ON THE WEBSITES OF FINANCIAL COMPANIES THAT LEND ONLINE

Materials posted on 10 websites of financial companies were analyzed. All the materials contained information about the loan cost. Most often it indicated the nominal daily interest rate and referred to various promotional offers (intended mostly for new customers), such as:

- 0.01% per day on the first loan;
- 0.47% per day;
- 0.01% in the first 7 days for new clients.

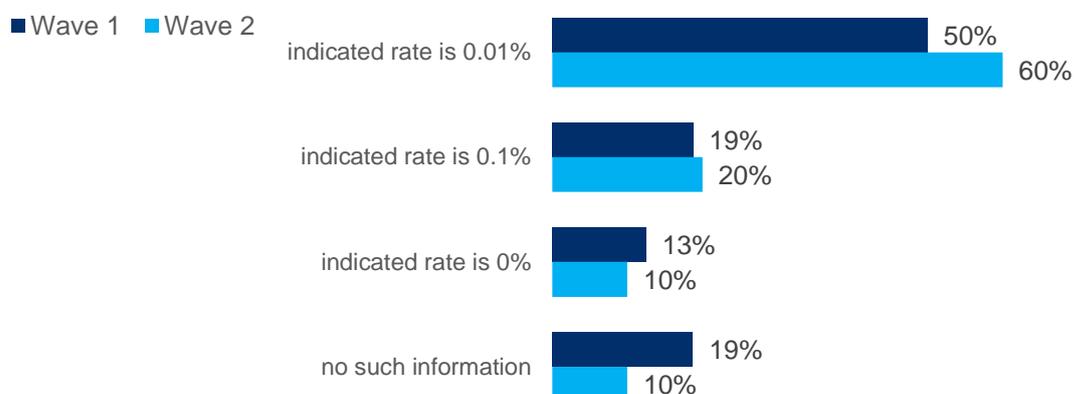
Information about the maximum loan amount is posted next to such daily rates by less than half of the websites (4 out of 10). None of the websites provides information there about the RAPR and the maximum loan term. Various font sizes are typically used in the analyzed materials, with promotional interest rates always highlighted by larger fonts.

¹⁰ Article 8.8 stipulates that placing information about the manufacturer of the goods and/or goods in places where the product is sold or provided to the consumer shall not be regarded as advertising.

IMPACT OF NEW LEGISLATION ON PAYDAY LENDING MARKET SURVEY OF SHORT-TERM, HIGH-COST LENDING IN UKRAINE (2ND WAVE)

One company advertises a loan offer “starting at 0%.” Another 8 companies indicate a rate close to 0% (0.01% or 0.1%). This was true for new clients, except one instance where the rate offered to a new client was 2% per day under the agreement.

Diagram 5.1 Presence of information that the loan is provided at 0% or at a rate close to 0% in advertisements (% of the websites with advertising information, Wave 1 N=16, Wave 2 N=10)



A comparison of Wave 1 and Wave 2 findings suggests that **the websites have not changed their approaches to informing potential customers** — attention is focused on promotional rates, whereas RAPR details are not provided next to such rates and are instead “hidden” somewhere at the bottom of the page or in other website pages. To change this situation, we suggest that the regulator make it mandatory¹¹ for financial companies to provide standard information directly opposite any loan cost information that is posted on website homepages and attracts customers.

¹¹ By including the relevant obligation in the Regulation on information support of consumers by financial institutions in the provision of consumer lending services, which is in the process of being adopted by the National Bank of Ukraine

VI INTERACTION OF THE CONSUMER WITH THE FINANCIAL COMPANY AT A PRE-CONTRACTUAL STAGE

The Law on Consumer Lending does not make it mandatory for the lender to provide a consumer loan passport before signing a payday loan agreement. However, it stipulates the lender's obligation to assess the consumer's creditworthiness before concluding a consumer loan agreement, and to provide the consumer with a draft agreement at his/her request.

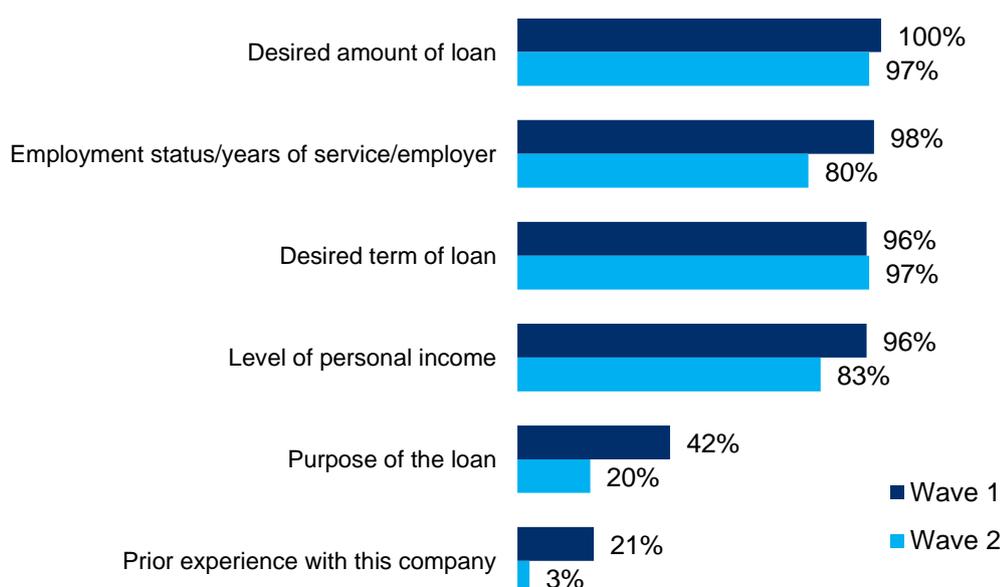
The following pre-contractual information was analyzed during the survey:

- Information provided by the consumer to the financial company when filling in a loan application, and information obtained by the consumer while communicating with consultants face to face or remotely (via messengers and telephone);
- Any written information available on the financial companies' websites (both for online and offline visits);
- Any written information provided by representatives of the financial companies during visits to their branches (for offline visits).

OBTAINING INFORMATION FROM A BORROWER

Approaches to obtaining information from a borrower in Waves 1 and 2 remained the same. As before, companies would often inquire about the borrower's employment status and monthly income, and would almost universally ask about the desired loan amount and term. Compared to Wave 1, companies cared less about the loan purpose or previous experience of taking out loans during Wave 2. As before, borrowers do not have to provide these details again if they had applied previously. During subsequent visits, it is sufficient to confirm the relevance of any previously entered data.

Diagram 6.1 Information requested by consultants prior to processing a loan (% of companies' new clients, Wave 1 N=52, Wave 2 N=30)



CONSULTATIONS TO THE BORROWER AND AVAILABILITY OF INFORMATION ABOUT ESSENTIAL TERMS AND CONDITIONS OF THE LOAN

Mystery shoppers sought advice from the financial companies' employees about the terms and conditions for granting a loan. Consultations took place in person during physical visits to the branches, while in the case of online lending they were predominantly held in the format of communication via messengers and telephone. Mystery shoppers also browsed websites for information about essential terms and conditions of loans.

Information about percentage rates and penalties

In 7 out of 8 offline visits, the consultant provided the borrower with information about the **nominal interest rate** (as a daily rate in most cases). The absolute amount of payments (UAH1,400 for 14 days for a loan of UAH5,000), rather than the interest rate was indicated by the consultant during one offline visit.

Information about the nominal interest rate was also almost universally available to mystery shoppers during online visits: it could be easily found on the website or was reported by a consultant in 96% of cases, including half of online visits (53%) when the rate was both available on the website and reiterated by consultants via messengers, chat rooms or telephone. Only in the course of two visits did this information become available only upon submitting a loan application.

Some **positive trends were observed in the context of disclosure of information about RAPR**. While such information was accessible only in 54% of all the visits made during Wave 1 of the survey, **RAPR details were made available in 88% of the Wave 2 visits**. In particular, 90% of online lending companies have added this information to their websites.

Mystery shoppers report:

"The consultant said that there was no real annual percentage rate and that loans are only granted up to 30 days with optional extension."

"When asked about the real annual percentage rate, the manager said, "we don't have it here, all loans are short-term."

In the vast majority of visits, consultants provided information about the consequences of delays in loan repayment, or such information could be found on the company's website. Notably, **informing on these issues has improved compared to Wave 1 of the survey**. As before, attention was mostly drawn to the amount of fines, default interest and higher interest rate for late payments — this information was available in 69% of the visits. During 16% of the visits, no information was available about the amount of penalties or higher rates, and more general information was offered instead, such as the notice — posted on some financial companies' websites — that fines and default interest do not accrue during the quarantine period.

Discrepancies between oral information and concluded agreements

The number of visits when discrepancies were identified between the information contained in the agreement and oral information stayed more or less constant in the two surveys — these differences were detected in 28% of the Wave 1 visits and **27%** of the Wave 2 visits. The discrepancies mostly concerned the nominal rate, RAPR (7 visits) as well as the nature and amount of fines in the event of delays in loan repayment.

ANALYSIS OF WRITTEN PRE-CONTRACTUAL INFORMATION

Analysis of information on the financial companies' websites in terms of conformity with the Law on Financial Services

Article 12.2 of the Law on Financial Services contains a list of information that the company must provide to the client prior to concluding the agreement. A website, rather than a visit, is regarded as a unit of analysis for this report. The situation has not changed between Wave 1 and Wave 2 of the survey — while during Wave 1 our analysts found the required information on 19 of 41 websites (46%), the legally required information could be found on 13 of 29 sites (**45%**) during Wave 2. Another 9 websites post almost all the necessary information (except one or two items).

IMPACT OF NEW LEGISLATION ON PAYDAY LENDING MARKET

SURVEY OF SHORT-TERM, HIGH-COST LENDING IN UKRAINE (2ND WAVE)

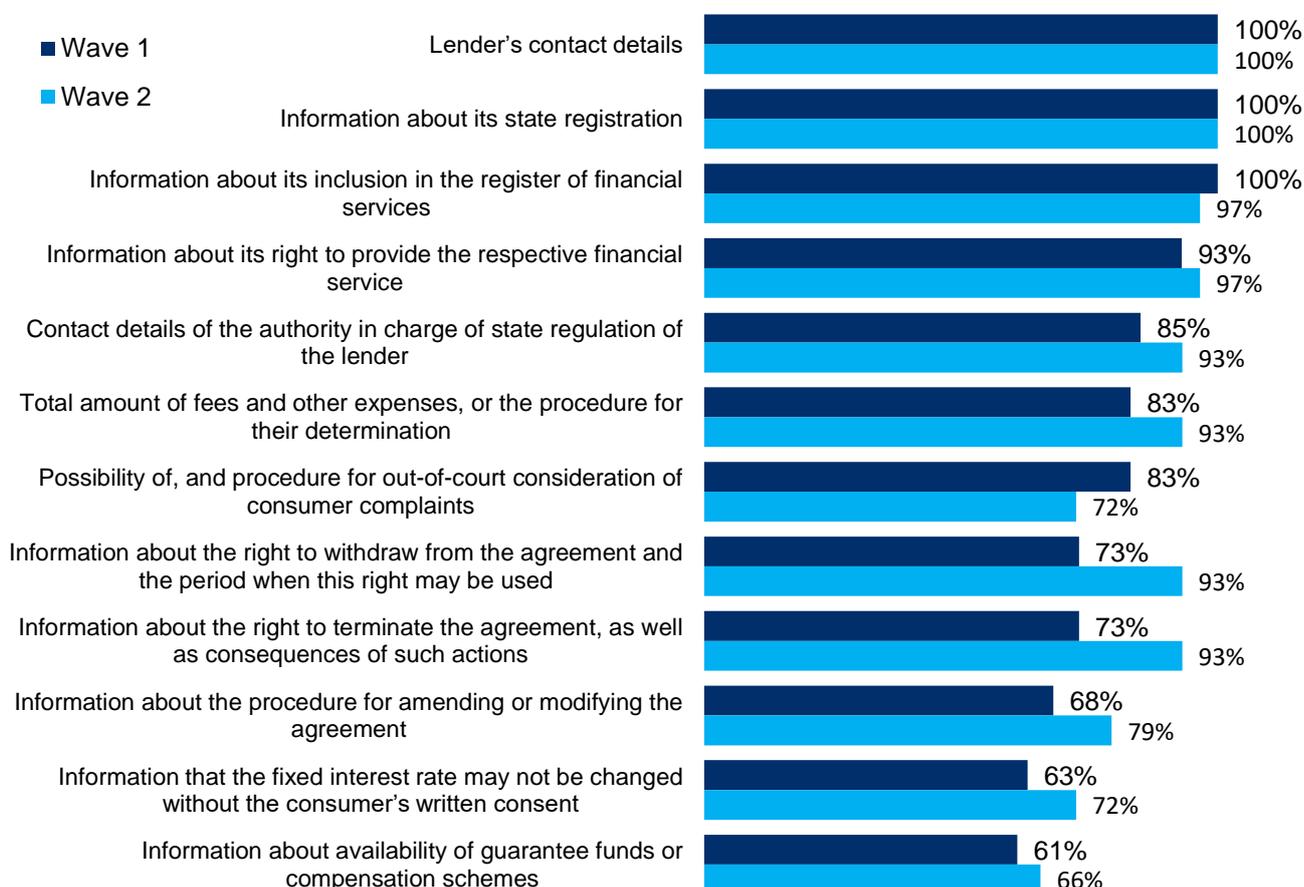
Contact information, details of state registration, as well as information about the inclusion of the company in the register of financial institutions could always or almost always be found. In the vast majority of cases, contact information of the authority that carries out state regulation of the lender, information about the financial service (the total amount of payments to be made by the borrower), and information about the client's right to withdraw from the agreement and the period of exercising such right is available. It is also often indicated whether the client is allowed to terminate or suspend the agreement.

Provisions of Article 12.2 of the Law on Financial Services, which are most often neglected when posting information on the website, include the following:

- Availability of guarantee funds or compensation schemes that are applied according to laws and regulations;
- Information that the fixed interest rate may not be changed under the agreement without the consumer's written consent;
- The procedure for making amendments and modifications to the agreement;
- Information about the possibility of, and procedure for, out-of-court handling of consumer complaints.

The situation with posting the information under Article 12.2 of the Law on Financial Services has thus remained virtually unchanged compared to Wave 1 of the survey. It is worth noting, however, that finding such information on websites has become somewhat easier for users. Some companies have created dedicated pages and/or documents containing information that is subject to disclosure. Availability of information accumulated in one place facilitates its search and allows a potential borrower to review all the terms and conditions at once. Nevertheless, the problem of finding posted information is still a concern. Sometimes information is scattered across numerous pages or shown in small print at the bottom of website pages, and may thus escape the consumer.

Diagram 6.2 Availability of information under the Law on Financial Services (% of websites, Wave 1 N=41, Wave 2 N=29)



Discrepancies between written pre-contractual information and concluded agreements

In **53%** of visits, several discrepancies were identified between the signed agreement and the written pre-contractual information. These discrepancies mostly concerned information about the amount of rates (RAPR and nominal). The percentage of visits when discrepancies were recorded has increased from 23% in Wave 1 of the survey. If a consumer addresses the NBU with a complaint that s/he was provided untruthful information about the financial service and is able to prove it, the NBU may fine a lender in the amount up to UAH 10,200 under Art. 41¹ of the Law on Financial Services.

VII ANALYSIS OF PAYDAY LOAN AGREEMENTS

Mystery shoppers concluded 59 agreements, 8 — in paper form and 51 — in an e-document form. As in Wave 1 of the study, agreements were analyzed under the following criteria:

- Observance of the procedure for concluding an agreement in an e-document form, as stipulated by the Law of Ukraine on Electronic Commerce;
- Required information present in the agreement, as prescribed by laws and regulations;
- Presence of illegal terms and conditions;
- Presence of provisions that entail certain risks for the borrower or establish an imbalance of contractual rights and obligations to the borrower's prejudice;
- Presence in the agreement of provisions that contradict each other or may be interpreted ambiguously, and of provisions that contradicted the advertising, the obtained oral or written pre-contractual information.

ANALYSIS OF THE ONLINE PROCEDURE FOR CONCLUDING AGREEMENTS

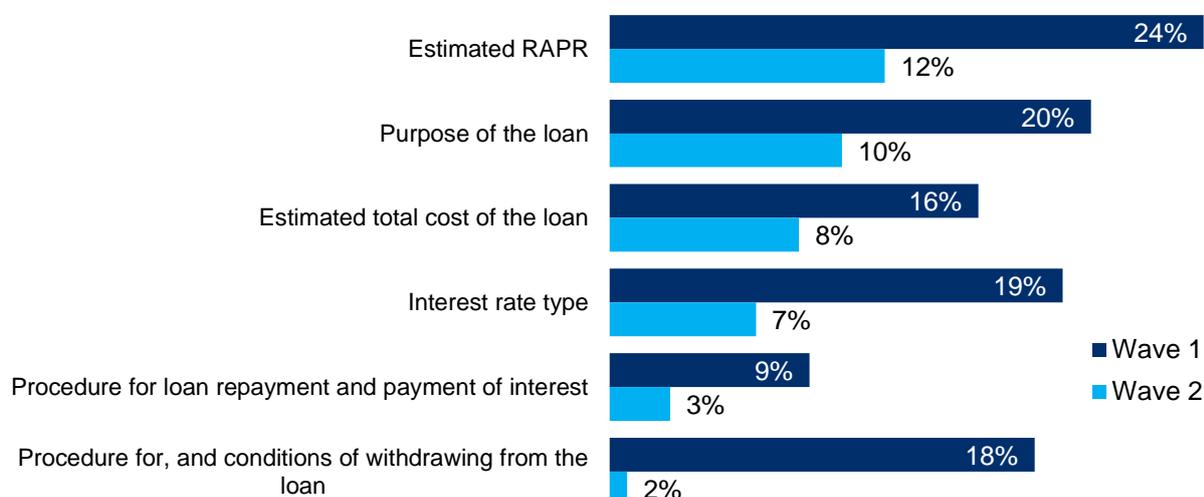
51 agreements concluded with 26 companies were analyzed for observance of the procedure for entering into agreements in the form of an e-document. Unlike Wave 1, when mystery shoppers did not receive confirmation of an electronic transaction in the form of an electronic document — an electronic agreement — from one company, all financial companies took the mandatory steps required by laws and regulations for concluding such agreements during Wave 2.

REQUIRED INFORMATION PRESENT IN THE AGREEMENT

As in Wave 1 of the study, almost all the agreements (97%) contained all the information that had to be included in a financial services agreement under the Law on Financial Services.

As regards the provisions stipulated by Article 12 of the Law on Consumer Lending, **83% of the agreements contain all the information**. In particular, **88% of the agreements indicated RAPR** — an improvement compared to Wave 1, when RAPR was mentioned in 76% of the agreements. Among the information that was most frequently missing in the agreements (Diagram 7.1) is the estimated RAPR (missing in 12% of the agreements), the estimated total cost of the loan (8% of the agreements), purpose of the loan (10%) and the interest rate type (7%).

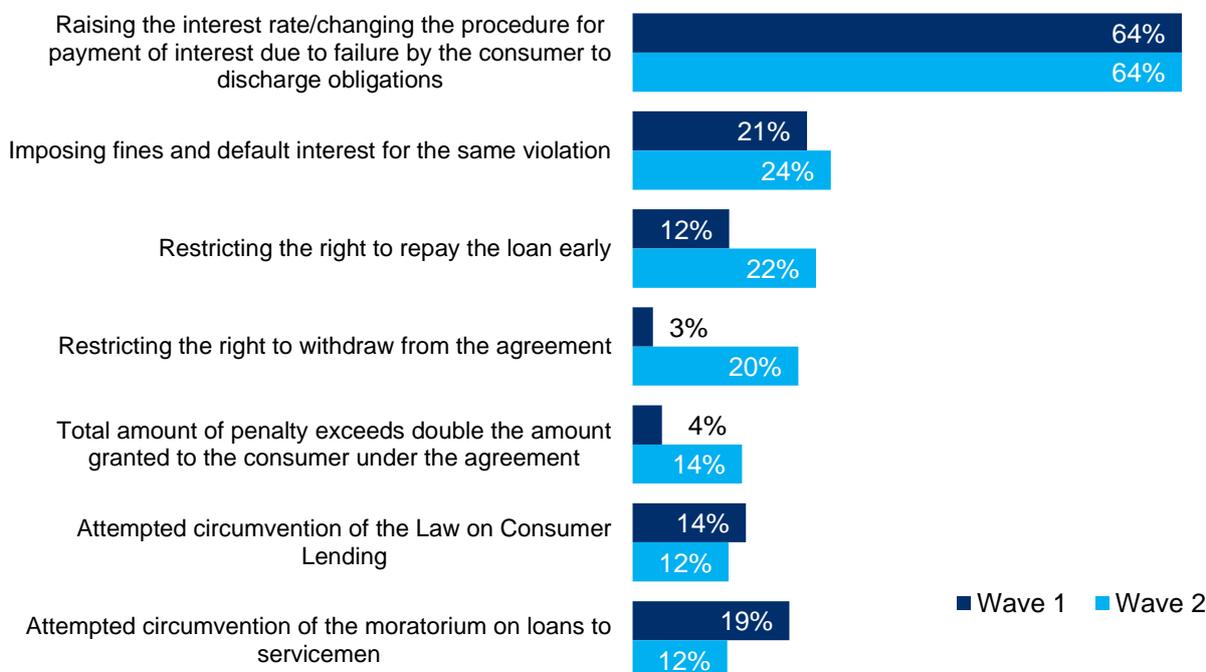
Diagram 7.1 Required information under the Law on Consumer Lending, which was missing in the agreements (Wave 1, N=90, Wave 2, N=59)



CLAUSES THAT MAY BE CONSIDERED AS VIOLATIONS OF LAWS AND REGULATIONS

During Wave 2 of the study **86%** of the agreements were found to contain clauses that may be regarded as illegal.

Diagram 7.2 Clauses that may be considered as violations of laws and regulations (Wave 1, N=90, Wave 2, N=59)



Changes to interest rate/procedure for interest payments that prejudice the consumer for violating his/her contractual obligations

Under Article 21.3 of the Law on Consumer Lending, the interest rate on the loan, the procedure for calculation thereof, the procedure for paying interest, may not be worsened for the consumer because of his failure to discharge obligations under the payday loan agreement.

In the survey, provisions that may be regarded as stipulating higher interest rates in the event of the consumer's failure to discharge obligations were found in **64%** of the agreements (64% in Wave 1 as well). As in Wave 1, such clauses are more frequently included in the agreements concluded by new customers (73% of the agreements signed by such customers), as opposed to the agreements concluded by the customers who have a record of lending from the same company (55%).

Half of the agreements containing a clause about changing the interest rate stipulate recalculation of interest for the previous period if the loan is not repaid during the promotional period/loan term.

It should also be noted that, to justify higher interest rates, certain lenders have started referring to Article 625 of the Civil Code. Thus, 21% of agreements referred to this article, according to which the agreement may set the interest to be paid by a debtor who is late with fulfillment of a monetary obligation.

Imposing fine and default interest for the same violation

Imposing fine and default interest for the same violation is prohibited under Article 21.4 of the Law on Consumer Lending. **24%** of the agreements in Wave 2 of the survey (21% in Wave 1) contained wording that may be regarded as imposition of fine and default interest for the same violation. Sometimes these clauses in the agreements are explicitly formulated as such, while sometimes lenders use other wording to refer to a fine and/or default interest in order to circumvent prohibition. For example, they would refer to a default interest as

a fine and stipulate two fines for the same violation, or refer to a fine as a commission or “fee for managing the renewal by way of post-payment.”

Example 1. Imposing fine and default interest for the same violation

4.3. In the event of delay in performance under this Agreement, the Borrower shall be required to pay 4.00% of the loan amount for each day of delay from the first day of delay.

4.3.1. In the event of delay in paying the amount due under this Agreement for more than 30 calendar days, the default interest under Article 4.3 of this Agreement shall increase by 2%. That is, the total amount from the 31st day of delay will be 6% of the loan amount for each day of delay until the date of full repayment of the loan, including the day of repayment, which the Borrower undertakes to pay to the Lender.

4.3.2. In the event of delay in paying the amount due under this Agreement for more than 61 days, the Borrower undertakes to pay an additional fine of half (50%) of the Loan amount determined according to Article 1.1 of the Agreement. The fine includes the expenses incurred by the Lender in notifying the Borrower in various ways (by phone, SMS, mail or e-mail messages) of the amount due, finding the Borrower for pre-trial settlement of the dispute, and other expenses related to the protection by the Lender of its rights.

Restrictions on the right to repay the loan early

Under Article 16 of the Law on Consumer Lending, the consumer is allowed to repay the consumer loan in full or in part at any time. Furthermore, the interest should be paid only for the period of actual use of the loan, and the lender is not allowed to charge the borrower any fees for early repayment of the consumer loan. **22%** of the agreements contained terms and conditions that may be regarded as violations of such rights of the borrower. The percentage of such agreements almost doubled compared to Wave 1 of the study. Such growth is likely caused by the absence of detailed legislative rules that would provide for all respective rights of a borrower.

For example, one of the agreements stipulates that the borrower may not repay amount earlier than three days of using the loan. Under some other agreements, the borrower is required to pay interest for a longer period of using the loan than the actual one — either for a certain fixed number of days (for example, five days) or for the entire loan term. The practice of charging a commission for early repayment of the loan is also sometimes encountered. Such cases are also a violation of Article 12.5 of the Law on Financial Services.

Example 2. Violations of the borrower’s right to repay the loan early

Should the borrower perform in full under the loan agreement earlier, within a period that is shorter than the period preceding the due date, the amount of full performance shall be credited by the lender as at the due date. In this case, the borrower must pay interest for the entire period preceding the due date.

Restrictions on the right to withdraw from the agreement

Article 15 of the Law on Consumer Lending stipulates that the consumer is allowed to withdraw from the consumer loan agreement within 14 calendar days from the date of the consumer loan agreement without providing any reasons for it, even if the funds were received. In the event of withdrawal, the consumer must pay interest for the period between the date of receipt of funds and the date of their repayment, and shall not be required to make any other payments in connection with the withdrawal from the agreement.

Findings of Wave 2 of the study indicate a significant increase, compared to Wave 1, of instances when the terms and conditions that violate such rights of the borrower are included in the agreements — **20%** against 3%.

Discussion of other unlawful provisions and provisions that entail heightened risks for the borrower can be found in Annex to this report.

Enforcement

Under Art. 41¹ of the Law on Financial Services, non-compliance with the requirements set by the law with regard to consumer loan agreements may trigger a fine in the amount of up to UAH 119,000 by the NBU. The NBU, in its most recent quarterly report on consumer complaints¹², reports 612 complaints (out of total 6,131 complaints relating to financial companies-lenders) that indicated consumer rights were being violated. The NBU highlights as the most problematic issues the following: 1) charging interest in excess of the loan term; 2) violations of the law applicable to loans to servicemen; and 3) fraud in entering loan agreements online (lenders fail to comply with client identification and verification procedures, so fraudsters are able to borrow using someone else's personal data). Information on whether the NBU applied enforcement measures (demands to remedy violations or fines) to offending financial companies is not provided in the report.

¹² <https://bank.gov.ua/ua/news/all/zvit-pro-robotu-zi-zvernenniyami-spojivachiv-finansovih-poslug-za-ii-kvartal-2021-roku>

VIII CONCLUSIONS AND RECOMMENDATIONS

Financial companies have generally failed to bring their loan agreements in line with the Law on Consumer Lending, in effect since January 2021. Among the agreements concluded during Wave 2 of the survey, 86% contained provisions that may be regarded as illegal. Such provisions primarily concern (1) changes to the interest rate, to the procedure for its calculation and the procedure for interest payments, which prejudice the consumer for violating his/her obligations; (2) impose fines and default interest for the same violation; (3) restrict the right to repay the loan early; and (4) limit the right to withdraw from the agreement.

As far as the RAPR calculation is concerned, the financial companies should observe the statutory methodology for calculating the RAPR, because, as evidenced by our survey, the RAPR indicated in the agreements frequently do not match independent calculations of RAPR (in 69% of the visits).

Informing potential borrowers has improved slightly. Some companies have taken measures to make it easier for users to find mandatory information (that the company must communicate to the client under Article 12.2 of the Law on Financial Services prior to concluding the agreement); for example, they have posted all the required information in the same section of the website or as a single document. Nevertheless, the problem of finding posted information is still a concern. Improvements were also observed in disclosing RAPR and the consequences of late payments.

Given this, the key recommendations to participants in the consumer lending process remain unchanged compared to Wave 1 of the survey:

RECOMMENDATIONS TO FINANCIAL COMPANIES:

- improve the quality of advertising and online materials in order to provide the consumer with more information about the payday loan costs and, most importantly, with information about the RAPR charged;
- correct the RAPR calculation formulas to ensure their conformity with the applicable methodology;
- raise the quality of information communicated to consumers in oral and written form about the RAPR charged and the consequences of failure to discharge obligations (on websites, during consultations, in passports and agreements);
- ensure that agreements contain all the terms and conditions referred to in Article 12 of the Law on Consumer Lending;
- delete from agreements illegal terms and conditions, including those that are ostensibly legal, but conceal illegal terms and conditions;
- assess objectively the terms and conditions that entail higher risks for the consumer (such as the disclosure of personal data in an unlimited number of cases) and modify them in a way that would eliminate the imbalance of contractual rights and obligations between the lender and the borrower;
- prevent discrepancies between the RAPR and the total loan cost for the consumer, as declared in advertisements/on the website/during consultations or indicated in the agreement, and their actual values.

RECOMMENDATIONS TO CONSUMERS:

- be careful — although the loan amount may seem small, these are very expensive financial products that can lead to accumulation of a huge debt quite quickly;
- review carefully all the documents that are posted on the financial company's website or provided for signing (statements of disclosure of personal data, which are pre-ticked on the website, etc.);
- survey in detail all the terms and conditions of the prospective loan, paying particular attention to the nominal interest rate, the RAPR, the total loan cost, and the loan repayment schedule. Pay attention to the consequences of failure to discharge obligations under the agreement, as this may entail a significant increase in the amount due;
- demand clarifications of any incomprehensible or contradictory information, but rely on the terms and conditions of the agreement, as it is the agreement that gets signed and must be performed by the borrower, rather than messages from a consultant;

- upon concluding the agreement, make sure that you know the amount and schedule of all payments to be made and all your other obligations under the agreement. You should also make sure that you are perfectly aware of all the repercussions from the failure to discharge obligations, including any fines/default interest and the lender's right to engage a collection company. Please remember that a signed agreement must be fulfilled, otherwise you can significantly increase the amount of your debt compared to the loan amount and put your private life and reputation under risks.

RECOMMENDATIONS TO THE NATIONAL BANK OF UKRAINE:

- continue active efforts to inform consumers about their rights and obligations under laws and regulations;
- review standard agreements of financial companies for presence of illegal terms and conditions. Pay special attention to variously worded clauses that actually violate Article 21 of the Law on Consumer Lending that prohibits raising the interest rate and imposing fines and penalties for the same violation. For example, it would be advisable to prohibit references to Article 625 of the Civil Code in order to circumvent prohibition on raising the interest rate under a payday loan agreement;
- monitor proactively the observance by lenders of the statutory methodology for calculating the real annual percentage rate;
- consider setting restrictions on the maximum real annual percentage rate in order to protect borrowers, as is the regulatory practice in many other countries;
- consider introducing the concept of “responsible lending” in Ukrainian laws and regulations by detailing, in particular, rules for assessing the borrower's creditworthiness and the acceptability of the loan for him/her (assessment not only from the lender's standpoint, but also from that of the borrower); restrictions on the number of possible loan renewals and/or the number of payday loans that a single borrower may be allowed to have simultaneously;
- consider extending the consumer loan advertising rules, as set by the Law on Consumer Lending, to the information posted on lenders' websites (as regards, for example, the prohibition of advertising interest-free loans and the obligation to include standard information next to the information about loan costs);
- inspect the information posted on websites in view of the significant number of discrepancies observed between the information posted on lenders' websites/consumer loan passports and that in the concluded agreements. Consider also initiating amendments to the Law on Consumer Lending in order to extend to payday loans the requirement to provide a consumer loan passport prior to signing an agreement.
- post enforcement actions at the NBU web-site, including the names of companies and case descriptions, following best practices of other countries¹³

RECOMMENDATIONS TO ASSOCIATIONS OF FINANCIAL COMPANIES:

- conduct outreach among members of associations on the importance of responsible lending, including on transparent disclosure to consumers of information about the cost of loans and the RAPR amount;
- facilitate participation by financial companies in mechanisms that help address consumer complaints and disputes;
- consider integrating payday loan issues in educational programs and initiatives of associations and their individual members, which are focused on consumers, including such vulnerable social groups as low-income, young people, and pensioners. Among educational initiatives, the following stand out:
 - support the public (especially young people) in developing positive financial behavior and attitudes;
 - promote the habit of making savings as a way to avoid borrowing to cover unexpected expenses;
 - explain how credit history can be influenced to improve access to cheaper forms of borrowing;
 - encourage consumers to compare credit products and make informed choices by supporting existing or creating new digital platforms or other comparison tools;
 - give advice to debtors who find themselves in a difficult financial situation or under a heavy debt load, etc.

¹³ See, e.g. <https://www.consumerfinance.gov/enforcement/actions/>

ANNEX

CLAUSES THAT MAY BE CONSIDERED AS VIOLATIONS OF LAWS AND REGULATIONS

Exceeding the restriction on the maximum amount of payments in the event of violation

Under Article 21.3 of the Law on Consumer Lending, the total amount of the penalty (fine, default interest) and other charges to be paid by the consumer for failure to perform obligations under the payday loan agreement may not exceed the double amount received by the consumer under such agreement. In violation of this restriction, **14%** of the agreements stipulated a higher amount of payments. For example, certain agreements stipulate a fine of UAH10,000 against a UAH2,000 loan for failure to provide certain information or for provision of false information. The percentage of such agreements has grown compared to Wave 1 (4%).

Attempted circumvention of the Law on Consumer Lending

12% of the agreements indicate that a natural person is granted a non-consumer loan or that the Law on Consumer Lending does not apply to the agreement.

Attempted circumvention of the moratorium on charging interest and fines on loans to servicemen

12% of the agreements contain provisions intending to circumvent the moratorium, as stipulated by Article 14.15 of the Law of Ukraine on Social and Legal Protection of Servicemen and Their Family Members, on charging of interest, default interest and fines on loans to servicemen.

Example 3. Attempted circumvention of the moratorium on loans to servicemen

Notwithstanding any other provisions of this Agreement, the Parties have agreed that if the Borrower is a serviceman as at the date of the Agreement, the subject of this Agreement shall be the provision of funds for fixed-term use in the amount indicated in Article 1.1 of the Agreement, and the Borrower undertakes to repay the Company fivefold the amount indicated in Article 1.3 of the Agreement. The amount to be repaid to the Company and indicated in this Article of the Agreement constitutes the principal obligation between the Parties and is not a fine.

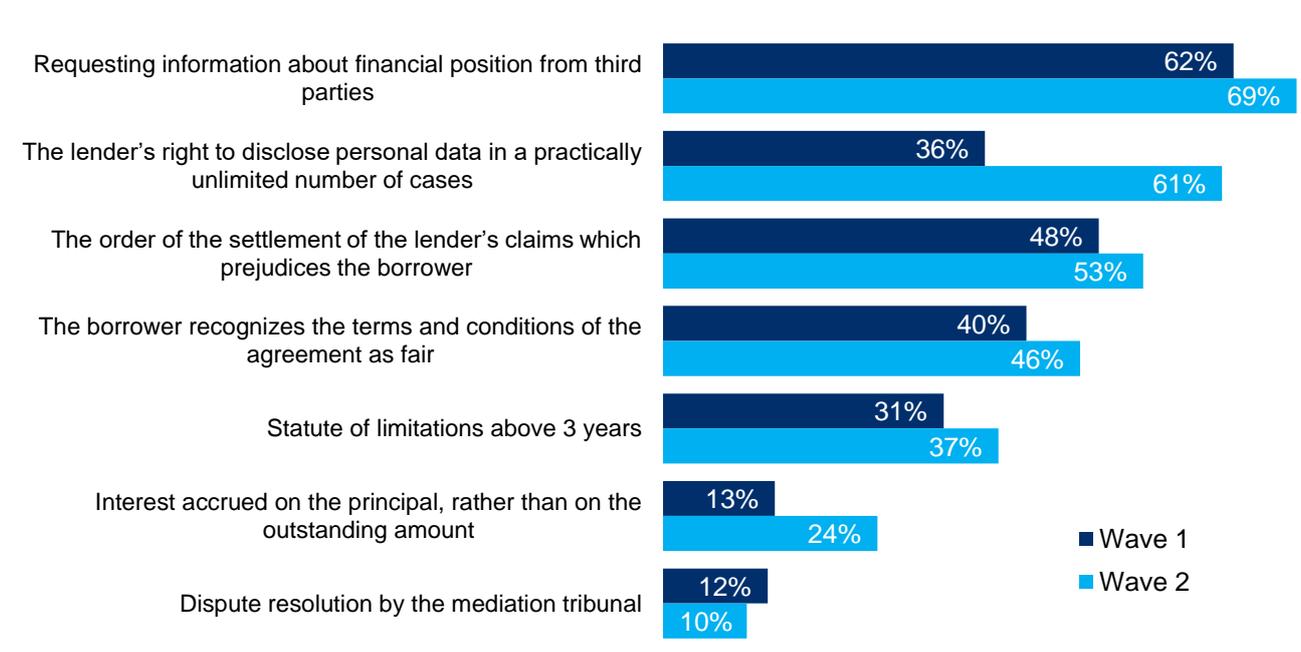
Other violations of laws and regulations

Isolated instances were also detected of inclusion in the agreements of other clauses that would violate laws and regulations. For example, **3%** of the agreements set out, in violation of the prohibition under Article 6 of the Law on Financial Services, the lender's right to demand early repayment of the unpaid portion of the loan and to terminate the agreement unilaterally in the event of the borrower's rejection of the lender's proposal to raise the interest rate or other payments under the loan agreement. In violation of Article 549 of the Civil Code, **7%** of the agreements stipulate that the fine and/or default interest are charged on the principal amount of the loan, rather than on the amount of the obligation that is undischarged, improperly discharged or discharged with delay.

TERMS AND CONDITIONS THAT ENTAIL HEIGHTENED RISKS FOR THE BORROWER

All the agreements contain one or more provisions that create higher risks for the borrower (such provisions were discovered in 97% of the agreements in Wave 1).

Diagram 1. Clauses that may be considered as risky for the borrower (Wave 1, N=90, Wave 2, N=59)



Requesting information about the borrower's financial position from third parties

69% of the analyzed agreements contain a clause that allows the lender to request information about the borrower's financial position* from any third party. In particular, this provision is risky for the borrower because, based on it, the lender may disclose to any person the borrower's personal data and information about his/her loan application or a loan granted to him/her. Compared to Wave 1 of the study, the percentage of such agreements has grown slightly (then it was in 62% of the agreements).

Disclosure by the lender of the borrower's personal data

61% of the analyzed agreements contain clauses that allow the lender to disclose personal data in a wide and practically unlimited number of cases. The percentage of such agreements has increased significantly compared to the previous wave of the study (36% of the agreements). Sometimes the lender has the opportunity to disseminate, among other things, photos of the borrower. In some instances, provisions of the agreement do not regulate at all the manner in which the data received from the borrower is to be used.

Complicating the order of the settlement of the lender's claims

53% of analyzed agreements set a different order of the settlement of the lender's claims than stipulated by the Law on Consumer Lending. Default interest/fine for delays in the loan repayment are often charged first. Such provisions are now found in the financial companies' agreements marginally more often than during the previous wave of the study (48% of the agreements).

Recognition by the borrower of the fairness of the terms and conditions of the agreement

46% of the analyzed agreements contain a clause whereby the borrower confirms fairness of the terms and conditions of the agreement. This clause is risky for the consumer, since it precludes application of the Law on Consumer Protection in the event that violated rights need to be protected in court. For reference, such clauses were identified in 40% of the agreements during the previous wave of the study.

Statute of limitations

Statute of limitations means the period during which a person whose right has been violated may demand protection or enforcement of his/her right in court. Under Article 257 of the Civil Code of Ukraine, the general

statute of limitations is 3 years, and 1 year — for penalty recovery claims. The statute of limitations established by law may be extended by arrangement between the parties.

37% of the agreements extend the statute of limitations. The period of extension generally varies between 5 and 10 years, but may be much longer in certain cases. Besides, 8% of the agreements contain clauses that extend the statute of limitations for collection of penalties. The percentage of such agreements was 31% and 18%, respectively, in the previous wave of the study.

Interest accrual on the principal amount (of the loan granted)

24% of the agreements stipulate that interest is accrued on the principal, rather than on the outstanding amount of the loan. This means that, for the borrower, there is no point in repaying portions of the loan early, because, regardless of the amount repaid, he/she would always have to pay the same large interest (for example, 2% per day of the amount of the loan granted). Besides, this may mean that in the event of failure to repay a portion of the loan on time, interest at a higher interest rate will accrue not only on the unpaid loan amount, but also on the amount that was repaid promptly. The percentage of the agreements where such clause was identified has grown compared to Wave 1 (13% of the agreements for that period).

Consideration of disputes by the arbitration tribunal

The Law of Ukraine on Arbitration Tribunals removed from the arbitration tribunals' jurisdiction the disputes related to consumer protection (including those concerning financial services). Certain lenders continue to include an arbitration clause in their agreements¹⁴ (present in **10%** of the Wave 2 agreements and 12% of the Wave 2 agreements analyzed by the study). This entails additional risks for the borrower, since his/her ability to appeal the decision will be limited.

CONFUSING TERMS AND CONDITIONS OF AGREEMENTS

27% of the agreements contain provisions that contradict each other or may be interpreted ambiguously. This indicator remained almost at the level recorded during Wave 1 of the study (29%). For example, certain agreements fail to make it clear what the order of the settlement of the lender's claims is if the borrower does not repay the entire loan on time. Other agreements stipulated that the interest rate was variable, although in fact it was fixed (no link to any index was present). Some other agreements are ambiguous as to whether the borrower must pay interest only for the actual period of using the loan in the event of early repayment.

Example 4. Provisions contained in the same agreement

*5.2. Where the amount paid by the Borrower is insufficient to repay the current debt, then:
in the first order of priority, the overdue loan amount and overdue interest for using the loan shall be paid;
in the second order of priority, the loan amount and interest for using the loan shall be paid;
in the third order of priority, a penalty and other charges under the consumer loan agreement shall be paid.*

6.8. Should the borrower fail to comply with the term, as indicated in Article 2.1 of the Agreement, for performance of obligations, the Lender's claims shall be settled according to the order of priority established under Article 534 of the Civil Code of Ukraine¹⁵.

7.4. In the event of failure to pay the Debt under this Agreement promptly, repayment of the loan to the Lender and payment of interest shall be made according to the following order of priority: in the first order of priority, the Borrower shall pay fines; in the second — the interest accrued.

¹⁴ For instance, by referring disputes to the Permanent Mediation Tribunal at the Association of Ukrainian Banks or Permanent Mediation Tribunal at the Ukrainian Bar Association.

¹⁵ This article provides the following order:

1) first order of priority – lender's claims related to getting the agreement performed (e.g., court expenses);
2) second order of priority – interest and default interest/fine;
3) third order of priority- principal debt amount.