

Judicial Rules of Private Lending Interest Rates

Liping Hoo

Ph.D. Candidate of China University of Political Science and Law, Beijing 100088, China

Abstract: The interest rate is the core issue that regulates the private financing. The regulation of interest rate is protection, also is the limitation. It is a ruler to measure the market position. Recently, Supreme People's Court issues the judicial interpretation related to private lending. the interpretation clearly defines the boundaries of the judicial protection of private lending interest rates. Whether the introduction of the interpretation can standard the current private financing market? The author believes that it has the short-term performance, but the fundamental regulation and governance to the private financing market should be incorporated into the financial market overall planning of state. Open, fair are the basic principles to improve the market competitiveness, the equal protection to the market participants is their basic rights and integrity is the cornerstone of the market. In the process of economic transition, the market players need the equal of market participant opportunities. In the current financial international economic environment, through the system excitation of legal innovation, giving it equal competitive opportunity with formal financial institutions, to guide the optimal allocation of the financial resources.

Keywords: Private Lending; Interest Rates; Autonomy; Interest Balance; Judicial Rules

1. Introduction

Party A signs the RMB loan contract with Company B, agreeing the borrowing rate is 2 % a day, the way of paying interest is daily summary. If Company B does not repay the loan capital, the penalty should be calculated as the 130% of the borrowing rate from the overdue date to the date that the capital and interest are paid off. And the compound interest should be charged for the unpaid interest from the next day of settling interest. The load is overdue and Company B doesn't pay off the money in the agreed time. Party A makes the collection and Company B pays a part of interest according to the agreement. Later, the two sides have a lawsuit, and in the lawsuit Company B proposes that the agreement interest in the contract exceeds the rules of the law and requires to offset the capital with the paid interest.

The key of the case is that the interest calculation standard agreed by the private lending parties significantly exceeds the maximum limit stipulated by the law, how to apply to the law. The handling of the case from "prepaid" and "unpaid" two levels to make discretion. First, for the unpaid interest, generally the courts carry on the judicial intervention, not supporting for the part that over the four times of the bank's similar load benchmark rate. As for the high interest which has been paid, the case adopts voluntary disposition principle. If the voluntary part is the true meaning of parties, to maintain the status quo, the paid interest beyond the statutory part is no need to postpone as the later interest [1].

Interest calculation is the core issue of trialing lending disputes and it is the starting point for the regulation of private lending. Recently, Supreme People's Court issues the judicial interpretation related to private lending. The private lending which walks in the gray area for a long term has get the operation and it is no longer just an expectation, which is hoped to make up for the blank of system supplying. This judicial interpretation makes a provision for the private lending interest rates specifically. It stipulates that the part which exceeds the annual interest rate 36% is invalid, the already paid part should be refunded. The new judicial interpretation crosses the part exceeding the annual interest rate 36%, compared the past "4" times to now "36%", the author think that no matter what latitude the red line draws, in the perspective of economics, it has its rationality. But, for the clear definition in the judicial interpretation that "The part which exceeds the annual interest rate 36% is invalid, the already paid part should be refunded", the author has different attitude in law. It should be discussed with the academics and practice circles.

2. The Importance of Private Lending in Institutional Aspect of Market Economy

Private lending is an indispensable part of market economic activities. The nation controls the formal finance and private finance by two aspects: market access of main body and control of interest rate. In the end of 20 centuries, the Americans including Clive Bell explained the main reasons of the existence of private finance in the

view of needs. They thought that the products of financial institutions can't satisfy the effective demand of market, therefore, the excess demand of financial products "overflowed" to private finance market[2]. From the legal perspective, private lending is the lenders demising the right of fund use for a period, and in expire date, borrowers return the fund with interest. It is also said that the ownership is transferred once the currency is delivered, that is the principle of conformity between ownership and possession[3]. Private finance is the beneficial and necessary supplement of formal finance, which is reasonable in the institutional aspect. As the reasonable supplement of formal finance, private lending has already became the capital source for production and life and the important channel for investment interest of main market participants, because of its simple procedure, increasing active loan and expanding lending scale. However, private lending is the products when social economy develops to a certain level. Industrial capital transfers to the financial capital, so the national can't satisfy the effective needs or other factors. The emergence of private lending is necessary to history and society.

2.1. Legal Regulation's Process of Private Lending in China

There is a long history of regulation for private lending in China. Throughout the history of economic development in China[4], we can find that there was a record in History of Han Dynasty that "one who wants to withdraw interest according to the law". While from Tang Dynasty to Qing Dynasty, there was a regulation that "the interest should not be higher than the capital". During the Republic of China, the interest, which is less than the benefit of industry and commerce and also beneficial to expand the reproduction, was protected by the law. In the early period of China, it practiced the policy of free interest rate. There is no limitation for the interest rate of private lending; the standard of interest rate was agreed by the borrowers and lenders according to the lending interest rate of national financial institutions.

However, there was a mess in the interest rate market, because it was abnormally high, then the nation began to control the interest rate market strictly. The primary target of national interest rate policy was to reduce the level of interest rate, and the development of private lending was restrained by it. Since the Reform and Opening-up in 1980s, the government continuously heightened the loan interest rate for several times to develop economy and stimulate the credit market. China is gradually becoming the capital great power, so the scale and influence of private lending is quickly expanding to the concern of the society. Both *Some Suggestion to Encourage and Guide the Private Lending for Healthy Development*, published by the State Council in May, 2010 and *Some Suggestion to the Twelfth Five-Year Plan for Economic and Social*

Development, published by the Central Committee of the Communist Party of China in Oct.2010 encourage private capital enter into financial field.

2.2. Legal Status of Private Finance in National Economy

Now, China is in the process of economic transition, so it is primary to adjust the market structure and allocate asset. Some scholars proposed that China should improve the leverage ratio of economy, and the key is to adjust the structure of debt. We should transform part of the investment of public consumable infrastructure from bank loan to government loan or government guaranteed loan with low interest rate to release the potential of bank loan. Then the financial institutions serve more enterprises[5]. Deposit and loan are the basic business of commercial banks. It is explicitly stipulated in Commercial Bank Law that no entity or individual can engage in the business of commercial banks such as absorbing public savings without the approval of the banking regulatory authority under the State Council[6]. To avoid risks, the financial institutions including banks benefit few to small and medium-sized enterprises, especially less in private enterprises, but they still strengthen risk control continuously. Small and medium-sized enterprises can't acquire effective fund support, so they transform into private finance. Effective demand creates and develops the market. In 2014, three private banks got approvals to manage, which brings new power to financial market, but the limitation of their business scope didn't solve the problem of capitalization in enterprises. This year, the release of approval for private bank management used to be a hot issue in this field. Private finance is an organic component of financial market with diversification and multilevel[7].

Private finance develops rapidly in our country, but it also brings some negative influences with the promotion for economy development. In the view of changes law of financial system, China's private lending is in the process of transaction from the stage with marketized obvious credit to the stage with standardization reasonable credit. Some scholars suspect that not all form of private credit can be accepted in to the law system to be regulated. Small-scale private creditor debtor organizations in some areas are more suitable to be existed in private way to satisfy the finance demand of different people[8].

Private finance is out of the formal financial system, so its embarrassing legal status leads to many judicature difficult positions in the long periods. It is very important to guide and regulate private lending so that they can develop orderly and favorably. In recent years, managements devote themselves to promote the development of private finance to have a better regulation for it in the legal level. There are more questions in how to regulate the interest rate of law. The author suggests that we can

solve negative problems of private finance through system promoting of legal innovation and self-regulation of market to guide the optimize allocation of financial resources.

3. National Legal Regulation of Interest Rate

Interest rate is forbidden in the history of religions. In many Islamic nations, debit and credit are free of interest. While in the nations with financial regulations, it is ubiquitous of interest rate regulation. The national top leaders designed a innovative plan of financial liberalization, and interest rate liberalization is an very important part.

3.1. Interest Rate Regulation for Formal Financial Institutions

Commercial Banks Law regulated that commercial banks should set the deposit-loan interest according to the ups and collars of the People's Bank of China's regulation[9]. In the reform of interest rate liberalization, they reformed the interest rate of loan and deposit in commercial banks. Formal financial institutions reform loan interest rate according to the market demands. The nation unified the loan interest rate, and they set the floating rate according to the national standard. The upper limit of floating loan interest rate was cancelled in 2004, while the bottom limit was cancelled in 2013. It is explicitly stipulated in Commercial Banks Law that borrowers who didn't return the credit loan should take responsibility for the contract. The agreement of deposit-loan interest rate and the loan interest rate accelerate the marketization. While the private lending is out of national formal finance, there is a system blank of how to regulate the interest rate of private finance. The judicial interpretation about private finance, recently published by the Superme People's Court, may make up it hopefully.

3.2. Interest Rate Regulation of Private Finance

Regulation of interest rate is the core issue of private finance. The interest and interest rate of private lending is one of the important events of the Supreme People's Court's judicial interpretation. Of course, interest rate liberalization doesn't mean interest is infinite or disordering. The starting point of judicial interpretation is to control the ceiling of interest rate of private lending. The basic principle of the regulation considers not only about the convenience of supervise for the government and financial regulatory administration, but also the real demand of borrowers and lenders, which are market participants.

In the past judicial practice, benchmark loan rate, published by central bank, was common used as the "loan interest rate of similar banks" in judgment. As for the interest of private lending, the former Several Opinions of the Supreme People's Court stipulated it as the red

quadrupling line. Commercial banks adjust the loan interest rate according to the benchmark rate of People's Bank of China, while the private lending sets the maximum of quadruple interest of the similar banks. About the regulation of private lending interest, the judicial interpretation of the Supreme People's Court is not the only source of law, but used to the applicable foundation of many former economic adjudication.

The new judicial interpretation breaks through the former red quadrupling line, and it is imperative to change the judicial policy that quadruple benchmark rate is the upscale protection of interest rate. They set two baselines of 24% and 36% "If both borrowers and lenders agree that the annual interest rate is not in excess of 24%, then the lenders are entitled to ask the borrowers to pay the interest according to the due interest rate; if they agree that the annual interest rate is in excess of 36%, the part in excess of 36% is deemed void, and the borrowers are entitled to ask the lenders to return the part excess of 36%, which are paid."

People's Bank of China also stressed that the problems of private lending should be treated differently and managed according to the categories. The history of China's private lending interest rate regulation is transformed from unified strictness and tightness to compound interest rate liberalization. The boundary of private lending interest rate regulation depends on whether it is an obstacle of national economy or suitable to the interest rate liberalization[10].

Author suggests that status equality of market participants is in favor of a fair and free order of market. While, the interest is the main measuring standard. The new judicial interpretation can solve pressing problems of debt-credit dispute, but cannot fundamentally resolve the conflicts between financial supply and needs of real economy. Economic law can only adjust or protect a part of social public interest, such as order involved with fair and free, and environment and order of macro economy operation [11], but it can't treat the whole social public interest as the range of its adjustment. Interest regulation embodies the social consideration in private law [12]. Both of them are the main body and the participants of market, but they are in different position, which disobeys the fairly and orderly market order. In the traditional economic environment, the capital mobility is relatively low, and the investment selection is limited, so interest regulation can transfer wealth to a large extent. But with the development of social economy, especially the foundation of company system, investment ways are increasing diverse, and interest regulation is becoming weakened in social security. Regulation is protection as well as limitation. Free market needs equal competition regulation, so in the current environment of financial globalization, the nation should lead the private finance into the

market competition and give them equal opportunity as well as China's financial institutions.

4. Application of Principle of Benefit Counterbalance in Private Finance

Benefit counterbalance is an important principle for a judge to exercise his discretion in commercial case. The principle of voluntariness is the basis of private law and footing stone of civil and commercial law. The judicial intervention in private law embodies the socialization of private law. The new judicial interpretation sets two baselines of 24% and 36%, which is reasonable to eager for quick success and instant benefit, and I won't judge it. As far as I concerned, economics can't be deliberated. It provides few foundations to understand economic behaviors and lacking theoretical support to improve economic policies. In empirical research, it's easy for us to discover that the publication of economic policy is not elaborate empirical research but rough induction. While the law is just arrange the finance structure, which is proved to be the most efficient by thousands of repeated sales, to rules of law, then it can establish the market expectation and reduce transaction cost[13].

4.1. Value Orientation of Interest Balance

Discretion of the judges is the process of interest balance, which is the balance based on the law. The two baselines 24% and 36% of new judicial interpretation have already provided the limitation for judges' discretion. The author suggests that the civil law treats the principle of voluntariness as the basic principle of law. Meanwhile, according to the law, it can be repealed, if someone takes advantages of another's perilous state to show the justice of the law. In this case, shall the high interest rate of contract agreement of private lending be protected by law? Taking advantages of another's perilous state and obvious unfairness are the premise of juristic act revocation. In private lending, borrowers borrow money to solve the financial problems, so it's hard to affirm whether they are taking advantages or obvious unfair according to these things. Judicators should try their best to explore the facts with contract text and seek for the balance between autonomy of will and fairness and justice[14]. Taking advantages from another's perilous state, obvious unfairness and public custom have deep value consideration, and the justice of civil law has a strong sense of social ethics, it shows a lot in equalitarianism. While the justice of commercial law stress more about economic justice, and it embodies in equal opportunity and protection. Treated as reasonable economic man, businessman can independently judge risks and take the consequence of trades[15]. The financial risk of private lending is much higher than professional institution. For investors, agreed high interest rate can be explained as the consideration of high risk, which also embodied in the equivalence between risk and

benefit in current economic environment. On 17th, Nov. 2012, the Supreme People's Court pronounced the judgment of "the First Case of Valuation Adjustment Mechanism", which provides reference for autonomy problems of regulation intervention in contract in financial creative activities.

In this case, here is the dispose of interest. Firstly in the view of freedom of contract, the nature of the paid interest, which are quadruple of the benchmark rate for loan of the People's Bank in the corresponding period, is willing to accept the deposition. Meanwhile, the risk and the benefit of economic activities are symmetrical, so it's not suitable for the judiciary to enforce the intervention. However, "exorbitantly high" is not in the list. In this case, judicial intervention is necessary, which is consistent with the idea of new judicial interpretation.

4.2. Trans-boundary Issues in Judicial Discretion

Financial crime is very common in private lending. In the process of dealing with disputes of private lending, we should protect the reasonable and lawful private lending; according to the law, local governments and financial regulatory sectors should strengthen the supervision and direction for lending in the institutions such as consultants companies and bonding companies. As for the cases of lawsuit, we should solve the dispute in the premise of keeping the stability of local economy; about the suspected delinquency, the police and judicial department should intervene in and crack down it. The formulation and execution of the new judicial interpretation offers help for empirical survey and research for financial crime of private lending, and also provide more comprehensive information for economic decision-making and macro-control. Therefore, they can standardize the financial system for common development between regular finance and private lending.

4.3. The Limitations of Judicial Interpretation Need Interests Balance

Judicial interpretation has the lag of inherent quick success, whether the empirical study or the summary of phenomenon, in judicial practice, the discretion of interests balance is very necessary. The interests balance of justice first need the correct understanding to China's economy. In the early period, a lot of experts and scholars have devoted lots of energy in the legal research of economic transition. Most of the writings of Professor Li Shuguang cries China's economic transformation. He thought that China's economy had undergone great changes and it had transferred from the demand-based economy into the supply-based economy. But China's economy has not completed its "transformation" and it is still in the transition process[16]. The author believes that the establishment of a modern market economy needs the equal market participation opportunities, and the equality of oppor-

tunities is gradually implemented in the process of economic transition. In the transition process, the new problems require market self-regulation, but also need the intervention of government and regulation of law.

5. Conclusion

Financial innovation should meet effective demand of the market, and the legislation has a lag nature. How to deal with the agreed interest of private lending fairly from the fundamental is still the current difficult problem in the justice. In this paper, the relevant law sources of private financing are sorted out and it perspectives the ruler role of interest rate in the financial market from the perspective of justice. "Notch the moving boat to find the lost sword", is sometimes it is difficult to avoid the rational Legal areas. Judges should also explore the legal truth through contracts to seek a balance between meaning autonomy and fairness and justice to make judicial intervention. The referee result is not only involved in case fair, but also it is good for the guidance of the orderly development of China's current economic activity. Free market requires equal competition rules, in the current financial international environment, the state should give them the equal competition opportunities which are similar to the formal financial institutions to establish a fair and just financial order truly.

References

- [1] Refer to Shijiazhuang Intermediate People's Court (2013) Shi Min San Chu Zi No. 00129 civil judgments.
- [2] See Bell, C., Interaction between Institutional and Informal Credit Institutions in Rural India, *World Bank Economic Review*, 4(3):297-327,1990.
- [3] Liu Baoyu: *Property Law*, China Legal Publishing House, 2007, 242-243.
- [4] Qian Mu: *Chinese Economic History*, Ye Long documenting, Beijing Joint Publishing Company, the first edition of January 2014.
- [5] Li Daokui: China Should Increase Leverage Ratio, in *Capital Market*, 2014 (11).
- [6] Refer to Article XI of People's Republic of China Commercial Bank Law.
- [7] Qing Li: Legal Problems of Chinese Private Financing Rate Regulation, in *China University of Political Science and Law Journal*, 2012 (5).
- [8] Wang Shuguang: *Evolution of Financial System in the Economic Transformation*, Peking University Press, 2007, 78.
- [9] Refer to Article 31 and Article 38 of People's Republic of China Commercial Bank Law.
- [10] Wang Linqing: Private Lending, in *Comparative Law*, 2015 (4).
- [11] Fu Qilin, Luo Jinjing: Social Public Interests and Economic Law, in *Hebei law science*, July 2007, Vol 25 (7).
- [12] Xu Defeng: Discussion on Legal Regulation of Interest ", in *Peking University Law Review* (2010) Vol 11, No. 1 edition.
- [13] Ellis •Phelan: *Corporate Finance Legal Principle*, translation by Luo Peixin, Peking University Press, 2012 , 622.
- [14] Yang Lingyun: Discussion on the Private Gambling Agreement's Law Nature Analysis and Legality Contending, in *Chinese commercial legal network*.
- [15] Yang Hongqin, Zhang Cen: Study on the Legal Nature and Effectiveness for the Gambling Agreement – Based on Fuhai Investment Case, in *Jiangxi University of Finance and Economics Journal*, 2013, (5), 124.
- [16] Li Shuguang: China's Economic Transformation: Success or Failure, in *Strategy and Management*, 2003, (3).