Effective Interest Charging – *legal implications*

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While the European Commission is currently assessing the impact of the Directive 2000/35/EC to combat late payment in commercial transactions, a Directive which has been transposed into Maltese law by Legal Notice 233 of 2005, the Malta Association of Credit Management (MACM) together with the Chamber of Advocates will be discussing this topical matter during a half-day Conference, which is being held on Friday, 26th September 2008.

The Maltese commercial arena is very much characterised by both trade and retail credit and its availability. Nowadays, it is commonly believed that, as an economy, we may be biting off more than we can chew, we may be living beyond our means and some belt-tightening may be required.

Despite the fact that this commercial scenario triggered the business community to invest more efforts in the credit management function, late payment is still one of the major difficulties for many local businesses. Firms across all sectors of the economy claim that they are facing liquidity problems due to late payment.

Owing to the small size of the Maltese economy, all sectors are highly competitive and fragmented. The business environment is characterised by a large number of businesses, trying to push their products and services to maintain their market share or to win new business.

Products and services provided can be described as homogenous with low or no differentiation features. A window shopping exercise in one of our high streets, or a walk round our welcoming shopping arcades, would demonstrate that as far as brand, functionality, after sales service and price are concerned, there is little difference from one shop to another. Very often, the selling crux lies in credit terms, the interest-free credit on offer, and the once in a life-time buy ‘now’ and pay later offers, promoted prominently on the outlets’ windows.

This scenario is also found in other countries. A report issued by the Directorate-General for Enterprise of the European Commission on late payment, suggests that late payment is hindering growth amongst smaller firms and is causing financial distress to small firms, because smaller firms are in a low bargaining position to enforce credit terms on their customers.

But does credit come for free? Can we do without it?

Credit has become an important element in today's trade. In both business-to-business and business-to-consumer transactions, credit comes in naturally. Part of the selling agreement relates to credit terms and limits. But credit is not only expensive to grant and manage it, it is also risky.

Creditors know that if payments are not made on time, they have to finance that credit from their own reserves or by making use of their bank overdraft. Therefore, the risk involved in credit should be well calculated, as it may have a negative effect on the cash flow and the profit of the business.

The local business community should know how to assess credit risk and assign an interest rate according to the level of the risk in case of late payment. However, this risk can only be calculated if the supplier has access to market information pertaining to credit. Being a member of a credit circle, such as MACM, the supplier will be able to calculate the risk based on the information shared between the members of the credit circle themselves. Other information can be obtained from one's own account experience, press reports, customer visits, bank references, credit reports, trade references and other public sources.

Businesses should also be aware of the difference that exist between trade and consumer interest charging. Consumer Credit is regulated to ensure that consumers are protected and credit is granted to individuals in a responsible manner. The EU Regulations oblige the creditors to inform the individual with the total interest rate, including any related charges. This interest rate is called APR. Prospective debtors are to be made aware of the APR before the credit transaction is signed by both parties.

Trade credit is different. The EU Directive to combat late payment on commercial transactions states that in case of late payment, an interest rate of 7% above the set European Central Bank rate can be charged automatically to the customer without the need to specify it in the contract of sale.

The same Directive allows the seller to retain title of goods until payment is completed, however this should be explicitly agreed between parties before delivery.

Moreover, the law addresses the compensation for all the costs associated with the recovery of the debt. Article 26C (5) states that *"unless the debtor is not responsible for the delay, the creditor shall be entitled to claim reasonable compensation from the debtor for all relevant recovery costs incurred through the latter's late payment."*

This Directive applies to all commercial transactions including all the transactions carried out between undertakings or between undertakings and the public authorities. The Government, the Local Councils and other public bodies are therefore included whenever a public procurement contract is signed with the private sector.

Nevertheless, the honest trade debtors should not be effected by this Directive, and should neither effect the business relationship between the trade creditors and their debtors, provided that the debtors honour their commitments on time and as agreed in the contract between the parties concerned.

More details on the Conference addressing ‘Effective Interest Charging’ are available from the Malta Association of Credit Management or the Chamber of Advocates.