

MicroFinance Transparency
Truth-in-Lending Legislation Summary: Ecuador

Scope of Legislation

The Central Bank of Ecuador, through its Board of Directors (*Directorio*, in the Spanish original), is responsible for implementing, executing and applying the monetary, financial and credit policies in Ecuador, and adopting corresponding regulations for such purposes. The two most important regulations regarding truth-in-lending in Ecuador were adopted by the Board of Directors in 2007¹ (the “2007 Regulation”) and in 2014² (the “2014 Regulation,” and, together with the 2007 Regulation, the “Regulations”).³ The Regulations were both included in the consolidated Regulations Code of the Central Bank of Ecuador (*Codificación de Regulaciones del Banco Central del Ecuador*, in the Spanish original, or the “Code”).

The Central Bank of Ecuador has jurisdiction over all entities which are part of the National Financial System, and the Regulations apply to all such entities. In addition, certain provisions of the Regulations apply to extensions of credit entered into outside the financial system, as noted below where relevant.

The Regulations and the Code do not apply exclusively to microfinance and do not create a separate body to regulate microfinance. However, solely for purposes of calculating the TEA (as defined below), the Regulations established different credit segments as summarized in the chart below. Separate maximum TEAs apply for each particular credit segment, and there are three separate segments within the “microcredit” area.

Area	Description	Specific Segment	Definition
Commercial	Financing directed to productive activities	Commercial Corporate	Credit to companies with annual sales above a level to be defined for each economic industry, in a separate ordinance to be adopted by the General Manager (<i>Gerente General</i> , in the Spanish original) of the Central Bank of Ecuador.
		Small and mid-size companies (<i>PYMES</i> , in the	Credit to (i) small and mid-size companies with annual sales equal or greater than \$100,000 ⁴ and lower than the thresholds defined in the abovementioned ordinance; or (ii) self-employed

¹ Regulación No. 153-2007, emitida por el Directorio del Banco Central, dated December 28, 2007.

² Regulación No. 058-2014, emitida por el Directorio del Banco Central, dated June 12, 2014.

³ The 2007 Regulation focused on establishing a price cap on the cost of credit, and as a result introduced the concept of TEA, as defined below, and the provisions regarding credit segments, pricing, provision of information from credit providers to the Central Bank of Ecuador, and publicity related to credit, as described below. The 2014 Regulation was mostly aimed at enhancing the disclosure requirements applicable to credit providers, and introduced the more comprehensive and inclusive concept of TEACF, as defined below, and the corresponding provisions regarding disclosure of information by credit providers to borrowers. The disclosure provisions of the 2014 Regulation are to be implemented by the entities of the National Financial System by December 9, 2014.

⁴ The official currency of Ecuador is the United States dollar.

Area	Description	Specific Segment	Definition
		Spanish original)	individuals with annual sales equal or greater than \$40,000.
Consumer	Financing to individuals earning a salary or income, for the purchase of goods or payment of services	Consumer	Direct credit transactions (i) for an amount greater than \$600; or (ii) when the aggregate balance of indebtedness of the individual with that financial institution is greater than \$600; or (iii) with credit cards with a credit limit greater than \$1,200.
		Retail consumer	Direct credit transactions (i) where both the amount of the transaction and the aggregate indebtedness of that individual with that financial institution is not greater than \$600; or (ii) with credit cards with a credit limit not greater than \$1,200
Microcredit	Credit extensions not greater than \$20,000 and directed at financing small-scale production, sales or services activities, where the principal source of payment is the sales revenue, to either (i) a company with sales below \$100,000, ⁵ or (ii) a self-employed individual, or (iii) a jointly liable group of borrowers (<i>un grupo de prestatarios con garantía solidaria</i> , in the Spanish original). In the case of item (ii), credit may also be directed to finance the purchase of goods or services	Subsistence microcredit	Credit transactions where both the amount of the transaction and the aggregate indebtedness of that borrower with that financial institution is not greater than \$600.
		Simple accumulation microcredit	Credit transactions where either the amount of the transaction or the aggregate indebtedness of that borrower with that financial institution is greater than \$600 but not greater than \$8,500.
		Extended accumulation microcredit	Credit transactions where either the amount of the transaction or the aggregate indebtedness of that borrower with that financial institution is greater than \$8,500.
Housing	A credit segment in itself, defined as credit extended to individuals for the purchase, construction, repair, renovation or improvement of dwellings owned by such individuals, provided that such extension is secured by a mortgage and that such extensions are made to the end-user of the real property.		

Borrowers Protected

The Regulations do not specifically provide for the protection of any particular category of borrowers. Their provisions apply to all transactions carried out within the financial system and, for purposes of the maximum TEAs (as defined below), to transactions outside the financial system. However, as noted above, each credit segment is assigned a distinct TEA.

Disclosure

For purposes of their disclosure and pricing provisions, the Regulations introduce the concept, and provide the corresponding formulas for calculation, of (i) an “effective annual interest rate” (*tasa de interés efectiva anual*, in the Spanish original, or “TEA”), based on the internal rate of return associated with the cash flows under a credit extension, and (ii) an “effective annual financing cost rate” (*tasa efectiva anual del costo de financiamiento*, in the Spanish original, or “TEACF”), resulting from all disbursements and payments made under a credit extension, including all costs (defined as any amounts directly related to the credit, which are paid by the customer to the financial system entity) and expenses (defined as any amounts indirectly related to the credit, which the customer must pay to third

⁵ In this particular definition, the Regulations do not expressly mention whether this reference is to the *annual* sales of the borrower.

parties as a result of the credit, such as life insurance and taxes).⁶ The creditor must calculate the TEA and TEACF taking into consideration the number of days between the extension of credit and its maturity.

Under the Regulations, whenever a client requests information for a potential extension of credit or upon the actual extension of new credit, an entity that is part of the National Financial System must give the customer all information required for a full understanding of the proposed amortization schedule. Such entity must give the customer the option to choose among different amortization schedules, including, at a minimum, a straight-line amortization schedule (referred to as “French amortization”) and an equal principal payments amortization schedule (referred to as “German amortization”). Such entity may also include additional alternative amortization schedule choices.

The Regulations mandate that interest payable by a borrower always be calculated on the balance of principal due, regardless of the amortization schedule selected.

On such occasion, such entity must also provide the customer with an information sheet regarding the proposed credit extension, in a prescribed form and containing at least the following information: (i) the total amount, term, and TEA; (ii) the reference TEA calculated by the Central Bank of Ecuador for that specific credit segment; (iii) the amount of principal amortization, interest and total payment, in each period and for each proposed amortization system; (iv) a description of all costs and expenses, whether direct or indirect, related to the credit; (v) the total amount to be paid by the customer for the credit under each amortization system, including all costs and expenses related to the credit; and (vi) the TEACF, expressed to two decimals. Each of the items above must include brief explanations. In the case of credit provided under variable interest rates, the TEACF must be calculated under the then current conditions and the information sheet must disclose the assumptions and reference rate used for such calculation. In addition, the Regulations require the creditor to inform the debtor, upon any adjustment to the variable component of a variable interest rate, of any variation to the final TEA resulting from such change. The Regulations also require each credit instrument to expressly disclose the credit segment to which the relevant credit transaction pertains, and to specify the amounts, term, frequency of payment of principal and interest, conditions for early repayment, nominal interest rate and corresponding TEA.

Each entity that is part of the National Financial System must also include an automatic credit simulator on its website, running at least the two basic amortization schedule options described above, allowing customers to simulate different amounts, terms and TEAs and providing the corresponding TEACF for each case.

All institutions of the financial system must, under the Regulations, provide the Central Bank of Ecuador, among other disclosure and reporting requirements, with consolidated weekly information on its transactions, specifying amounts, terms, nominal interest rates and TEAs, so that the Central Bank of Ecuador may calculate reference TEAs for each credit segment (an average of the TEAs for all reported transactions, weighted by their respective amounts).

⁶ The definition of the TEA in the 2007 Regulation contained an express carve-out excluding any cost of insurance from its calculation. The introduction of the TEACF by the 2014 Regulation addressed this exclusion by requiring that the TEACF include all costs and expenses associated with the extension of credit, this time expressly including, as an example, the costs of life insurance.

Further, the Regulations require that any form of publicity by an institution of the financial system be truthful and specify nominal interest rates and TEAs for each term, and the frequency of interest payments.

Pricing

The Regulations provide for a maximum TEA in each credit segment (as described above), which must correspond to the weighted-average TEA determined for each such segment in relation to the four weeks preceding the last full week of the month in which they become effective, multiplied by a factor to be prescribed by the Board of Directors of the Central Bank of Ecuador. A nominal interest rate resulting in a TEA greater than the maximum for the relevant segment may not be charged. The maximum TEAs are established on a rolling basis for each month, based on the calculation period described above for that month.

Variable interest rates are permitted under the Regulations. In such case, the parties may freely agree on (i) a variable component, which must be any of the PRIME rate, the LIBOR rate, the basic rate associated with the nominal weighted-average return of 1-year or less bonds issued by the Central Bank of Ecuador, or the reference TEA for that specific credit segment, and (ii) a fixed component, expressed in percentage points, and which may not be changed during the term of the transaction. The variable interest rate cannot in any circumstance be higher than the maximum TEA for the corresponding credit segment, and the variable component may not be readjusted for periods of fewer than 90 days.

Interest rates for transactions outside the financial system may be freely agreed, but may not be greater than the maximum TEA for the corresponding credit segment.

The Regulations allow creditors (including in transactions outside the financial system) to apply a surcharge in the case of late payments, no greater than 0.1 times the TEA applicable for that transaction, except for financial leasing transactions, where such surcharge may be no greater than 0.2 times the relevant TEA. In the case of variable interest rates, the 0.1 surcharge will be applied to the variable component of the interest rate (giving effect to the applicable readjustment periods).

Remedies and Enforcement

The Regulations do not create any specific remedies for borrowers against lenders.

The Regulations provide that any failure by an institution of the financial system to provide the Central Bank of Ecuador with the periodic information required shall be reported to the Banking and Insurance Superintendence (*Superintendencia de Bancos y Seguros*, in the Spanish original), so that it may impose the relevant sanctions under applicable law. In addition, the institutions that fail to comply with a reporting obligation may not take part in any open market transaction carried out by the Central Bank of Ecuador during the week immediately after the week in which the failure took place. Finally, an institution of the financial system that charges an interest rate resulting in a TEA above the maximum permitted will be subject to the relevant sanctions under applicable law.

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