CONSUMER PROTECTION LAW IN CAMBODIA AND INTEREST RATE HIKES

April 2023 INSIGHT

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1. Introduction

On 24 March 2023, the Ministry of Commerce (the "**MOC**") and the National Bank of Cambodia (the "**NBC**") issued a joint press release on the implementation of the Law on Consumer Protection and Prakas on Unfair Contract Clauses in the Banking and Financial Sector (the "**Press Release**"). Pursuant to the Press Release, the MOC and NBC, among other things:

- noted that they have observed a number of standard form contracts containing "unfair" clauses in standard form contracts;
- requested banks and financial institutions ("**BFIs**") to operate in accordance with the Law on Consumer Protection and Prakas on Unfair Contract Clauses; and
- encouraged members of the general public to report "excessive exploitation" in standard form contracts.

This all comes at a time when high levels of inflation have caused central banks around the world to make substantial increases to interest rates which has, of course, had a corresponding impact on the cost-of-funds for BFIs in Cambodia. BFIs have two primary sources of funds, customer deposits and borrowings. BFIs in Cambodia typically borrow from offshore lenders under loans that are usually denominated in USD and bear interest at floating rates.[1] The proceeds of such loans are then on-lent to Cambodian borrowers at fixed rates of interest giving rise to interest rate risk (as well as currency risk where on-lent in Khmer Riel). As the interest rate risk continues to grow, BFIs are starting to rely on clauses in standard from contracts that permit them to adjust the applicable interest rate. The question is whether such a clause would be "unfair" or "excessively exploitative".

Before discussing this issue further, it is important to note that this Insight considers only those loans pursuant to which interest rates may be adjusted and does not consider interest rates charged on new loans made by BFIs. Further, as standard form loan contracts do not refer to benchmark rates such as SOFR, adjustments to the interest rate under such loans is not considered in this Insight.

2. Law on Consumer Protection and Prakas[2] on Unfair Contract Clauses

On 2 November 2019, the Law on Consumer Protection (the "**Consumer Protection Law**") was enacted in Cambodia which notably:

- established the National Committee on Consumer Protection (the "**NCCP**") as Cambodia's competent authority for consumer protection (though the sub-decree on the organization and function of the NCCP was enacted 10 months later)[3]
- prohibits certain types of "dishonest" conduct; and

[1] For a description of floating rates of interest see "LIBOR – The Death of a Dear Friend" (https://www.hbslaw.asia/index.php/update/insights/327-libor-the-death-of-a-dear-friend)
[2] A "prakas" is a regulation passed by a ministry or a supervisory authority, being the NBC in the case of BFIs.
[3] See Sub-Decree No. 135 on the Organization and Functioning of the National Consumer Protection Committee issued on 27 August 2020.

- leaves the door open for the MOC to enact further regulations regarding the types of conduct to be prohibited.

The types of conduct specified in the Consumer Protection Law are what might fairly be regarded as dishonest (e.g., conduct that has an element of deceit underlying it). However, on 1 March 2022, the MOC issued Prakas No. 0067 on Unfair Contractual Clauses ("**Prakas No. 67**") which goes beyond dishonest conduct and covers what might more properly be considered as constituting "unfair" conduct.

Prakas No. 67 applies to standard form contracts[4], being contracts offered by the suppliers of goods or services that cannot be negotiated, modified or influenced by the consumer[5]. As such, the types of loan that may be impacted by Prakas No. 67 are likely to be limited to non-business loans for homes, cars etc. Commercial loans made to businesses would appear to not fall withing the ambit of Prakas No. 67 as the relevant borrowers will be able to amend or modify the terms of the loan to the extent that they have the bargaining power to do so.

3. The Prohibitions Under Prakas No. 67

There are two core prohibitions under Prakas No. 67 being prohibitions on:

- making "excessive benefits"; and
- including "unfair terms".

(a) Excessive Benefits

Article 6 of Prakas No. 67 provides that a business person shall not include clauses in a standard form contract "*in order to make excessive benefits from the consumer as defined in Article 351 of the Civil Code*".

It is not clear what Article 6 is referring to when it speaks of the definition of "excessive benefits". Article 351 of the Civil Code contains no such definition and simply states as follows:

> "*Should a party enter into a contract while taking advantage of the other party's economic difficulties, ignorance or inexperience, and receive excessive benefits from said contract, the counter-party may rescind the contract on the grounds of defect in the Declaration of Intent.*"

Despite this, Article 7(1) of Prakas No. 67 goes on to provide that in determining whether a benefit is "excessive", "*the actual situation of the contracting parties shall be carefully considered such as the economic dominance, social status, ignorance or inexperience and other circumstances*".

The problem with Article 7(1) is that it requires a case-by-case examination of each individual borrower's status, economic difficulties, knowledge and experience which appears inappropriate in the context of standard form contracts which, by definition, are supposed to be in the same form *regardless* of such considerations. Indeed, it would appear much more logical to consider the characteristics of, and market practice in, the relevant sector than the circumstances of the parties in determining whether a benefit is excessive.

It is useful to note that Article 7(2) of Prakas No. 67 goes on to provide that the criteria for determining whether a benefit is excessive may be determined by a relevant regulator (the NBC). As discussed below, the uncertainty created by Prakas No. 67 is arguably best addressed by the NBC issuing a clarificatory regulation.

It is unclear how a court might interpret and apply Articles 6 and 7 of Prakas No. 67 given the lack of a clear and appropriate definition of "excessive benefits". However, where a modification to the interest rate can be seen as reflecting a corresponding increase in the cost-of-funding of the loan (in the context of funds from floating rate loans but not fixed rate loans), a BFI would seem to be in a much stronger position to argue that the benefit is not excessive. In any event, it would be prudent to draft a clause permitting adjustments to the interest rate in a way that links the adjustment to changes in cost-of-funds as this may mitigate against the risk of an increase being considered excessive.

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[4] Article 2, Prakas No. 67.
[5] See the definition of Standard Form Contract in Article 3, Prakas No. 67.

For the sake of completeness, it is worth noting that on 13 March 2017, the NBC issued Prakas B7-017-109 on the Interest Rate Ceiling on Loans ("**Prakas No. 109**") which applies to microfinance institutions, deposit-taking microfinance institutions and rural credit operators. Article 2 of Prakas No. 109 provides that its object is to "protect consumers from excessive interest rates" and Article 3 sets the rate at 18% p.a. It is important to note that the concept of an excessive interest rate is not the same as an excessive benefit as the latter requires a comparison between the before and after interest rates.

(b) Unfair Terms

Somewhat ironically, Article 8 of Prakas No.67 provides that a business person may not include unfair clauses in standard form contracts that create an excessive benefit. The only difference between Article 8 and Article 6 is the use of the word "unfair" in relation to the relevant clause. As a preliminary matter, it would appear logical that any clause providing an excessive benefit should be considered as being "unfair". On this view, Article 8 covers the same ground as Article 6.

Notwithstanding the above, Article 9 goes on to provide that a standard form contract may not (subject to contrary regulations being passed by the relevant regulator) contain a clause that:

1. excludes or limits the liability of a business person with respect to statutory guarantees given under certain articles of the Civil Code;
2. permits the business person, without the prior consent of the consumers, to materially modify any clause relating to the price, quantity, and quality of goods or services or any other "substantial" clause; or
3. permits the business person to unilaterally and arbitrarily interpret and / or terminate the contract at the business person's sole discretion.

It should be noted that while Article 9 is entitled "Contractual Clauses that are considered as Unfair Contractual Clauses", it provides a simple prohibition on such clauses and does not provide that the abovementioned types of clause are unfair clauses for the purposes of Article 8. As such, it operates independently of Article 8 and, notably, does not require that there be an excessive benefit.

On a literal interpretation of Article 9, the interest payable by the borrower is clearly the price of the loan and a "material modification" to the interest rate would appear to fit squarely within the prohibition specified in Article 9(2). Prakas No. 67 is silent on what constitutes a "material modification". In this regard, the threshold test of a "material modification" would seem much more easily satisfied than the "excessive benefit" threshold as any increase in the interest rate would seem to be material as it costs the borrower more to service the interest payments.

As is the case with Article 7(2) of Prakas No. 67, Article 9 contains an exception where a relevant regulator issues a contrary regulation.

4. Clarificatory Regulations

In order to nullify the impact of the uncertainty created by Prakas No.67, it might (subject to the discussion in Section 5 below) be appropriate for the NBC (alone or together with the MOC) to issue a regulation regarding the adjustment of interest rates. It is fortunate that Prakas No.67 contains the exceptions referred to above but even in the absence of such exceptions, the NBC has, in any event, the power to issue regulations that override Prakas No.67 in relation to BFIs.

As to the contents of such a regulation, it would seem appropriate that it clarify the factors to be considered in determining unfairness and excessive benefit by:

- specifying that adjustments made to interest rates under floating rate loans that refer to benchmarks such as SOFR do not fall within the prohibitions discussed above;
- permitting BFIs to include interest rate adjustment clauses in standard form contracts that are based on quantifiable changes in its cost of funds; and
- reiterating the restriction on interest rates under Prakas No. 109 discussed above.

5. Who Should Take the Risk?

Despite the above, there is a relatively strong argument for *not* permitting BFIs to rely on clauses in standard form contracts that allow them to adjust interest rates; they are in a better position to mitigate interest rate risk (and consequent increases in its cost-of-funds) than their customers and can do so by ensuring that they either:

(a) hedge it through the use of OTC or exchange-traded interest rate derivatives; or
(b) by lending at floating rates so that the asset/liability mismatch is reduced.

6. Conclusion

The author is aware of several banks that are looking to adjust interest rates in pursuant to various clauses in their standard form loan agreements. Given that we are not likely to see interest rates drop in the near future, this trend is likely to continue and the ability of some BFIs to rely on wide-sweeping clauses that allow them to adjust interest rates may soon be restricted.

This Insight does not constitute legal advice and may not be relied upon as such. Please contact us should you require advice on the issues raised in this Insight.

AUTHOR'S PROFILE

Patrick SMITH
Partner/Head of Banking and Finance
Email: patrick@hbslaw.asia