The overall picture of debt accumulation gets blurred as provision of consumer credit becomes diversified

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Kimmo Koskinen
Adviser


Olli Tuomikoski
Economist

Finnish household debt accumulation is also rapidly increasing via consumer credit. The majority of these loans are still from credit institutions, but there is a growing number of channels for credit provision. Lending has grown both via foreign providers of credit operating online and through peer-to-peer lending services, and household debt accumulation from these sources is difficult to monitor.

Consumer credit refers to a loan that is granted mainly for the private consumption of goods and services. There are various forms and purposes of consumer credit. In addition to a traditional one-off loan, consumer credit can also be in the form of an overdraft, in which case the maximum amount of credit that can be drawn corresponds to the value of the account.

Large consumer credits are usually secured, but consumers can obtain small loans from various sources fairly rapidly and flexibly without collateral. Consumer credit is also taken out by credit card holders.[1] Moreover, many retailers offer consumers the opportunity to sign a consumer credit agreement in connection with the purchase of, for example, a car or household appliance. Credit is also marketed in connection with the purchase of services, for example a holiday trip.

In contrast to credit from financial institutions, peer-to-peer lending services direct households into borrowing directly from each other. The forms and channels of lending are thus developing rapidly in an increasingly digitalised world.

As with borrowing in general, household consumer credit plays a key role in financial stability. In the worst case, excessive volumes of consumer credit may – together with other household credit, such as home loans – create a systemic risk from the perspective of financial stability.

Consumer credit accounts for a significant share of household debt

Even though consumer credit is typically small in volume and short in maturity compared with, for example, home loans, it accounts for a significant share (some 12%) of aggregate household debt. Relative to its significance, there is fairly little data available on the purpose of consumer credit.

A survey[2] by the Federation of Finnish Financial Services indicates that the use of consumer credit is fairly widespread in Finland, as nearly 40% of respondents reported that they have consumer credit. This means that some 1.6 million Finns have consumer credit. The same survey shows that consumer credit is distributed more evenly between age groups than, for example, home loans.

Consumer credit is considered one of the key reasons for payment default entries. Payment default statistics by Suomen Asiakastieto show that in 2016 some 12% of payment default entries were due to consumer credit.

The majority of Finnish households' consumer credit is granted by credit institutions operating in Finland. Statistics compiled by the Bank of Finland show that in February 2017 Finnish households' consumer credit granted by credit institutions totalled EUR 14.6 billion. Of the consumer credit granted by credit institutions, 31% are overdrafts or credit card credit, and the rest is other forms of credit taken for the purpose of consumption. In most cases, consumer credit granted by credit institutions is covered by real-estate collateral, but over half of the credit is nevertheless unsecured.

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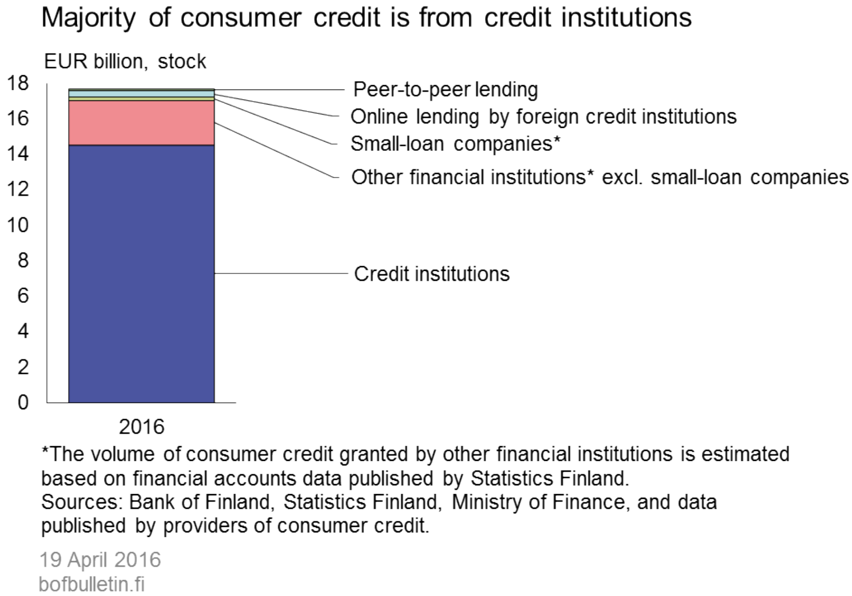
1. A zero-interest loan until the due date of the invoice and extended credit card credit if the credit card balance is not fully repaid.
2. Säästäminen, luotonkäyttö ja maksutavat 2015 ('Savings, credit and payments', in Finnish only).

Chart 1



Even though in Finland a significant share of consumer credit is granted by credit institutions, the share of non-performing loans and loan losses on their credit has thus far remained moderate. The share of non-performing assets, i.e. unlikely to pay assets, in the stock of consumer credit was 2.8% in February 2017, and the amount of loan losses recognised in the past 12 months amounted to 0.7% of the credit stock.

The amount of loan losses recorded on consumer credit has also decreased in the past 12 months.[3] In other household loans, the share of problem loans is even smaller: in February 2017, non-performing loans amounted to 1.4% and loan losses to 0.07% of the loan stock in the past 12 months. The interest rates on consumer credit are, however, considerably higher than those on other household loans, and the average interest rate on consumer credit has not declined significantly in recent years, in contrast to the rates on loans taken out for other purposes.

New players in the consumer credit market

In recent years, the provision of consumer credit has spread significantly to non-banks. In addition to banks, consumer credit has traditionally been granted by, for example, banks' finance companies lacking authorisation to pursue the business of a credit institution or companies providing car finance. In recent years, the consumer credit market has seen the arrival of various companies providing small loans[4] and, most recently, peer-to-peer lenders.

There is, however, little data available on the consumer credit market of institutions not authorised to pursue the business of a credit institution. According to data by Statistics

3. The share of non-performing loans in the loan stock has increased slowly in recent years, but this is partly explained by the more specified definition of 'non-performing loan'.

4. Instant loan companies.

Finland, Finnish households' consumer credit from other financial institutions totalled some EUR 2.7 billion at the end of 2016.[5] These financial institutions do not have authorisation to pursue the business of a credit institution and are not supervised by the Financial Supervisory Authority. Authorities have however started to register their activities otherwise. For example, since the beginning of 2017, companies providing credit and peer-to-peer lenders have been obligated to enter a register maintained by the Regional State Administrative Agency (AVI) Southern Finland.[6], [7] Even though there is currently no complete data available on the amount of small loans, Statistic Finland's data collection on small loans nevertheless shows that the stock of credit granted by small loan companies totalled EUR 119 million at the end of 2015.[8]

The Ministry of Finance, in turn, has been monitoring peer-to-peer lending[9] in Finland as part of preparations for the Crowdfunding Act. According to a survey by the Ministry, peer-to-peer loans by consumers totalled EUR 71.6 million in 2016, and the volume of borrowing is growing significantly. Online credit provided by foreign credit institutions is also increasingly popular. There is very little data available on this cross-border lending activity, but based on data disclosed by the entities, the stock of credit can be estimated at some hundreds of millions of euro.

In recent years, concerns have frequently been raised about the drawbacks of expensive consumer credit. According to Suomen Asiakastieto, consumer credit often triggers a spiral of payment default entries. The numbers of payment default entries and persons with payment default entries have risen in recent years, despite efforts to curb lending on the market for small loans by setting an interest rate cap on the loans. The interest rate cap has been circumvented by offering larger loans and limits to which the current loan cap does not apply.

Developments in small loan activity can be assessed partly on the basis of Bank of Finland statistics, as some of the finance companies engaged in small loan activity have authorisation to pursue the business of a credit institution and are thus included in credit institution statistics. The exclusion of these finance companies from other credit institutions gives a striking picture of the nature of the activities by small-loan companies.

The multiple annual interest rates and volumes of loan losses of credit institutions specialised in unsecured consumer credit compared with commercial banks provide an indication of differences in customers and operating models. It seems that the customers of these credit institutions have a lower creditworthiness than the customers of commercial banks. Some of the entities beyond the credit institution sector are also likely

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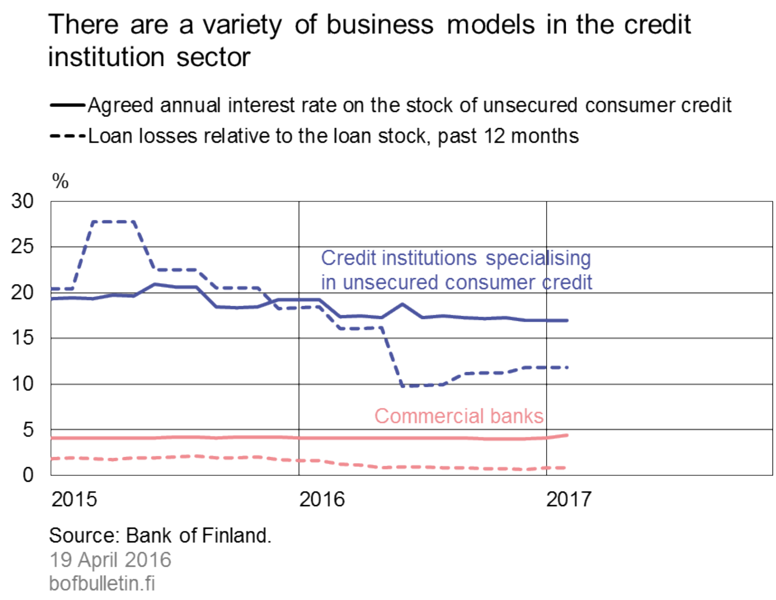
5. The estimate on the size of the loan stock is based on data compiled by Statistics Finland on loans granted to households by other financial institutions, and the sample may not be comprehensive in all respects.
6. On 4 April 2017 the register included 55 entities.
7. The Regional State Administrative Agencies (AVIs), together with the Finnish Competition and Consumer Authority, monitor the legality of the marketing of consumer credit as well as credit agreements.
8. According to data by Statistics Finland, the annual growth rate of the loan stock was as high as 56%. Data collection has been discontinued.
9. Peer-to-peer loans fall within the scope of the Consumer Protection Act together with other consumer credit provided by other financial institutions.

to have similar levels of interest rates and loan losses. This view is also supported by statistics produced by some small-loan companies and peer-to-peer lenders.[10]

Chart 2



Risk resilience of new operating models not properly tested

The development of new operating models, digitalisation, lack of well-established definitions and reliable data, as well as fragmented legislation hamper the monitoring of consumer credit. The differences and risks of the various operating models may remain unclear to consumers.

There is a risk that the consumer credit stock of those entities will grow whose operating models and risk resilience have not been tested under different economic scenarios. The rapid growth in lending enabled by the new operating models as well as aggressive advertising may extend credit provision to persons with a weak ability to repay high-interest loans.

In the United States, some of the new players have been faced with problems generated by rapid growth. The stronger-than-expected growth in loan losses has already raised doubts over the resilience of the recently introduced operating models, and, for example, the amount of new consumer credit granted by peer-to-peer lenders has decreased strongly. In peer-to-peer lending, there is also a cause for concern in the credit risks to the investors. A survey conducted in the United Kingdom shows that some investors do not seem to be aware of the risks related to peer-to-peer lending.[11]

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10. The volume and content of the data available do, however, vary significantly between entities. Some entities do not publish any data.
11. Deloitte (2016) Marketplace lending: A temporary phenomenon? An analysis of the UK market.

Currently, it does not yet look as if consumer credit will cause a systemic risk, but there is nevertheless a social risk. Households have to be vigilant in the management of their debt accumulation.[12]

On the other hand, the consumer credit stock and credit channels are developing at a rapid pace, and therefore it is advisable to consider how long the current volume of data on the consumer credit market will be sufficient.

Despite the importance of new operating models and innovations, they should not increase the drawbacks of debt accumulation. The larger role and risks of the new players have thus triggered a debate on the need for tighter regulation. Monitoring the situation would require more extensive reporting and data collection.

Tags

peer-to-peer lending, digitalisation, consumer credit, small-loan activity

12. At the same time, payment is becoming increasingly invisible. See article by Kari Kemppainen Payments becoming increasingly real time and less visible Bank of Finland Bulletin 2/2017.