Analysis

New methods needed to rein in consumer credit

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Consumer credit to households keeps increasing, and roughly one in four Finns held consumer credit in 2019 (Finance Finland). At the end of 2018, households' stock of consumer credit was estimated to amount to EUR 21.7 billion, and the stock has grown by EUR 3.5 billion in the past two years. Overall, consumer credit accounts for 14% of the total loan debt of Finnish households. Debt problems caused by consumer credit are increasing, while high-interest consumer credit is being aggressively advertised.



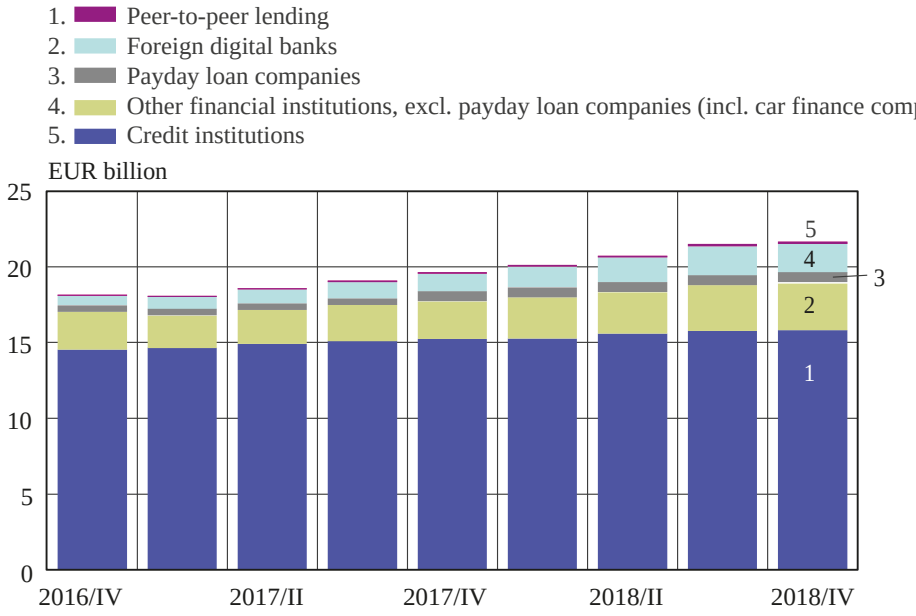
Record growth in unsecured consumer credit granted by credit institutions

The stock of consumer credit granted by credit institutions has increased rapidly in recent years. Especially unsecured consumer credit other than overdrafts and credit card credit has grown at a record rate. The Bank of Finland estimates that one of the key factors in the growth of unsecured consumer credit by credit institutions is the good performance of car sales in recent years.[1] A relevant benchmark could be vehicle financers outside the credit institution sector,[2] whose loan receivables increased by more than 20% in 2017.

Despite strong growth in unsecured consumer credit granted by credit institutions, the overall credit losses recorded on consumer credit have remained moderate. However, credit institutions' business models vary, and the differences are clearly reflected in the interest rates and credit losses on unsecured consumer credit. Some credit institutions provide mainly high-interest unsecured consumer credit. The annual growth rate of the stock of consumer credit[3] granted by such credit institutions was over 50% in March 2019, with an annual interest rate above 15%. In this category of credit institutions, credit losses relative to the size of the loan stock are also several times higher than those of commercial banks. According to the Bank of Finland's MFI statistics, it appears that these credit institutions attract more customers with lower solvency than, for example, commercial bank customers.

Chart 1.

Households' consumer credit stock estimated at almost EUR 22 billion



Sources: Bank of Finland, Statistics Finland, Sweden's Riksbank, Ministry of Finance, financial statements and consumer credit lenders' published data.

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Growing share of consumer credit granted outside credit institution sector or from abroad

A growing share of consumer credit in Finland is granted by other than Finnish credit institutions. These companies[4] have increased their share up to around 27% in just a few years. The change indicates the growing importance of new companies on the consumer credit market. Foreign digital banks[5] and payday loan companies actively using digital distribution channels have increased their market share particularly rapidly. Peer-to-peer lending has also grown strongly, even though it still constitutes only a very small share of the total credit stock.

In recent years, especially Norwegian and Swedish digital banks have begun offering consumer credit to Finnish households. In the last two years, their loan stock to Finnish households has increased by more than 200%, totalling at EUR 2 billion at the end of 2018. These digital banks mainly provide unsecured consumer credit with high interest rates. However, in the last quarter of 2018, the stock of said consumer credits increased only slightly, as the digital banks cleaned their

balance sheets by selling much of the non-performing loan stock to debt collection companies. Further inspection of the business model of some of these companies reveals an abundance of bad loans, which the companies sell to debt collection agencies, for example.

Payday loans are a profitable business

According to calculations by the Bank of Finland, at the end of 2017 households held EUR 660 million in consumer credits granted by payday loan companies. Loan receivables held by payday loan companies increased by more than 50% in 2017. Payday loan companies are also profitable, as the average profit of a payday loan company registered with the Southern Finland Regional State Administrative Agency in 2017 was EUR 3.5 million, with a profit margin of 35%. Peer-to-peer lending through crowdfunding platforms has also increased. In 2018, the volume of peer-to-peer lending was EUR 150 million, with an increase of 40 % on the previous year.

Consumer credit may push households into financial difficulties

The introduction of new companies and operating models in the consumer credit market has increased the supply of loans to a wider customer base. It is also possible to grant several loans to a single person. Some consumer credit providers employ aggressive marketing strategies to promote their loans. During 2013–2018, clients with consumer credit applying for guarantee for restructuring loans from the Guarantee Foundation[6] held an average of 17 loans. The majority of applicants for a loan guarantee from the Guarantee Foundation are in employment and live in rented accommodation. Debt problems among the retired are also reflected in the number of applications to the Guarantee Foundation.

In an interview survey conducted by Finance Finland,[7] above average use of payday loans was found among 18–24-year-olds and 45–64-year-olds. According to the survey, payday loan borrowers were also above average in their use of other consumer credit. According to Statistics Finland's wealth survey, more than 90% of debt among households with the least net wealth consists of other than housing debt. Other debt includes consumer credit.[8,9]

According to Suomen Asiakastieto (which provides information on customers' creditworthiness), 385,000 people had a payment default entry on their credit report at the end of March 2019, the highest number ever recorded. Payment default statistics show that consumer credit is a common cause for a payment default entry. According to a study on payment default among young adults,[10] unemployment contributes to payment default entries. Half of the unemployed young adults who

responded to the survey had a payment default entry. The study also analysed the causality between level of education and payment default entries. Among survey respondents, those with only basic level education had the most payment default entries. According to the study, persons with payment default entries had a low income consisting of income support, housing allowance or student financial aid. Academic studies also show a correlation between the negative impacts of poverty on rational decision-making and prolonged poverty.[11]

In 2018, 519,000 people were subjected to debt collection procedures, 3.5% more than in 2017.[12] According to a study on debt-related court rulings,[13] a court ruling is often rooted in consumer credit. The sums involved in consumer credit-related court rulings increased significantly during 2013–2016. In 2014–2016, banks were the original creditors in 3.4% of all debt-related court rulings, while other credit companies, such as payday loan companies, were the original creditors in 35.8% of all rulings.

More tools required for prevention of debt problems

Debtors with serious debt problems may be granted debt adjustment by a district court. The number of applicants for debt adjustment is relatively small compared to the number of payment default entries,[14] but increasing nonetheless. In 2018, debt adjustment applications by private persons increased by 7.6% on the previous year.

The Guarantee Foundation may guarantee debtors a restructuring loan, provided that the total debt does not exceed EUR 34,000. Due to the increasing size of debts, the Guarantee Foundation is able to assist a decreasing number of debtors.[15] Some municipalities also grant social loans. The purpose of social lending is to help prevent economic exclusion and over-indebtedness. According to 2016 statistics by the National Institute for Health and Welfare (THL), social loans were most commonly granted to cover consumer credit and debt enforcement debt.[16]

In 2013, Finland sought to curb payday lending by introducing an interest rate cap for loans under EUR 2,000. However, companies started circumventing the interest cap by offering larger loans and limits. In order to curb the growth of consumer credit lending, the Ministry of Justice began in April 2018 to prepare a reform of the legislation relating to consumer credit. The main goal of the reform is to reduce debt problems caused by high-interest consumer credit. The interest cap (20%) that will come into force in September 2019 will apply to most consumer credit. The reform will also limit the right to collect other loan-related costs from consumers.

The Ministry of Justice finished an assessment report on a positive credit register in autumn 2018. The report suggested that Finland should establish a centralised database for positive credit

information. Authorities should be able to more accurately assess the influence of consumer credit granted outside the credit institution sector on total indebtedness. A credit register that covers all household loans would provide a better picture of overall indebtedness, improve market pricing of risk, and allow better management of personal finances.

In the future, the Bank of Finland's collection of statistics will include data on intermediation of financing outside credit institutions. Credit institutions' finance companies and companies providing consumer credit will come within the scope of the expanded collection of statistical data.

Consideration should be given to how the monitoring and regulation of consumer credit can be developed. Development is also being assessed by a working group appointed by the Ministry of Finance in autumn 2018, with the task to propose new methods for containing household indebtedness.

Notes

1. In the Bank of Finland's MFI statistics, unsecured consumer credit also includes consumer credit where, for example, a vehicle is used as collateral. Only collateral accepted in the Regulation of the European Parliament and the Council on prudential requirements for credit institutions and investment firms are accepted as collateral. Such include, among other things, residential or commercial property. ↑
2. This includes companies mainly providing car finance registered with the Southern Finland Regional State Administrative Agency. ↑
3. Excluding overdrafts and credit card credit. ↑
4. In addition to credit institutions, consumer credit is also provided by companies specialising in car financing, payday loan providers, peer-to-peer lenders and foreign digital banks. ↑
5. In this connection, foreign digital banks refers to Norwegian and Swedish credit institutions providing consumer credit across the border, without maintaining branches in Finland. ↑
6. See https://www.takuusaatio.fi/en/guarantee-foundation/about-foundation/guarantee-operations. ↑
7. See http://www.finanssiala.fi/materiaalit/SLM%202019_Tutkimusraportti.pdf. ↑
8. Other debt also includes, for example, student loans. ↑
9. See https://www.stat.fi/til/vtutk/2016/vtutk_2016_2018-06-05_kat_005_fi.html. ↑
10. Minna Alhonen: Nuorten aikuisten maksuhäiriömerkintä: syyt ja seuraukset. ('Payment default among young adults: causes and consequences') Available at: https://www.theseus.fi/handle/10024/146192. ↑
11. See e.g. Haushofer – Fehr (2014): On the psychology of poverty, Science, 344, 6186, 862–867 and Adamkovic – Martoncik (2017): A review of Consequences of Poverty on Economic Decision-Making: A Hypothesized Model of a Cognitive Mechanism, Frontiers in ↑

Psychology, 8, 1784.

12. See https://findikaattori.fi/en/35. ↑
13. Karoliina Majamaa – Laura Sarasoja – Kati Rantala: Viime vuosien muutokset vakavissa velkaongelmissa. Analyysi velkomustuomioista ('Recent changes in serious debt problems. An analysis of debt-related court sentences'), available at: http://www.julkari.fi/bitstream/handle/10024/135270/YP1706_Majamaaym.pdf?sequence=3&isAllowed=y. ↑
14. Debt adjustment is not granted lightly, as the Act on the Adjustment of the Debts of Private Individuals lists several impediments to debt adjustment. Statistics by Statistics Finland show that during 2018, Finnish district courts received a total of 4,533 applications for debt adjustment by private individuals. ↑
15. See https://www.takuusaatio.fi/takuusaation-neuvonta-ennatysruuhkainen-velallisten-ahdinko-syvenee. ↑
16. Available at http://www.julkari.fi/bitstream/handle/10024/135278/Tr31_17.pdf?sequence=1&isAllowed=y. ↑

Keywords

consumer credit, credit institutions, households, indebtedness, payment defaults