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# **DEVELOPMENT OF CONSUMER LENDING BY NON-BANK CREDIT COMPANIES IN BULGARIA**

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**Abstract:** The study focuses on consumer loans extended by corporations specializing in lending in Bulgaria during the period March 2008 – September 2018. A brief presentation of the essential features of consumer loans is made and attention is paid to key aspects of statutory regulations of this type of lending in Bulgaria. The main trends in the dynamics of the volume of consumer loans extended by corporations specializing in lending are outlined and their main determinants in the country are worked out. The analysis of non-bank consumer lending is supplemented in a comparative perspective by trends in the dynamics of bank consumer lending. On this basis, the main prospects for growth in the segment of non-bank consumer loans in Bulgaria are presented.

**Keywords:** consumer loans, quick loans, corporations specializing in lending.

**JEL:** E51, G21, G23.

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## **Introduction**

Consumer loans extended by non-bank corporations specializing in lending in Bulgaria are an important external source of funding for household consumption used to meet a wide range of consumer needs. These loans help borrowers to improve their standard of living by enabling them to immediately consume goods and services. Thus, the growth of consumer loans (consumer credits) can stimulate individual household consumption.

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During the period of and after the last global financial and economic crisis, non-bank consumer lending in Bulgaria underwent significant changes with regard to quantity and quality caused by the impact of a number of factors.

The **research problem** of the study is consumer loans extended by corporations specializing in lending in Bulgaria during the period March 2008 – September 2018.

The **research area** of the study is the dynamics of consumer loans extended by corporations specializing in lending in Bulgaria.

The **main objective** of the article is to analyze the development of consumer loans extended by corporations specializing in lending in the country during the studied period.

In order to implement the main objective, the following **research tasks** have to be accomplished:

- To outline the more important trends in the development of consumer loans extended by corporations specializing in lending in Bulgaria.
- To highlight the main factors determining the dynamics of non-bank consumer loans in the country.
- To supplement the analysis of non-bank consumer lending in a comparative perspective by trends in the dynamics of bank consumer lending in Bulgaria.

The analysis is based on the use of statistical data provided by the Bulgarian National Bank (Monetary Statistics and Other Financial Institutions).

## **1. Regulatory basis of consumer lending in Bulgaria**

Under *Directive 2008/48/EC of the European Parliament and of the Council of 23 April 2008 on credit agreements for consumers and repealing Council Directive 87/102/EEC (2008)*, a consumer credit is a credit which a particular creditor (a natural or legal person) in the course of his trade, business or profession grants or promises to grant to a consumer credit in the form of a deferred payment, loan or other similar financial accommodation.

According to a guide providing information on financial products and services, prepared by the Bulgarian National Bank (BNB, 2017), a consumer credit is intended to fund current consumer needs of natural persons. Examples of the use of consumer loans given in the guide are as follows: redecoration, purchase of black or white goods, training, treatment, holidays, current utility payments, purchase of a vehicle, etc. It can be added that this type of loans is also used to refinance existing credit obligations. It is pointed

out that consumer loans are offered by banks and financial institutions registered with the BNB. They can therefore be either bank or non-bank consumer loans.

Depending on the availability of collateral, consumer loans are unsecured and secured. To secure a loan the following can be used: a salary pledge, a guarantee, a pledge of a financial asset (deposit), a pledge of movable property, etc.

The current Consumer Credit Act (CCA) in Bulgaria came into force on 12 May 2010 repealing the 2006 Act. The new Act aims to introduce the requirements of the European Directive on Consumer Credit Agreements (2008) into our national legislation.

The CCA, taking into account the specifics of consumer loans, supplements and strengthens consumer protection provided by the Consumer Protection Act.

An important point in the effective CCA is the measures aiming to responsible behaviour both on behalf of creditors in the provision of credits and towards responsible behaviour on behalf of consumers when applying for and obtaining a loan.

Art. 9, para. (1) of the effective CCA (2010) states that a consumer credit agreement is “an agreement whereby the creditor grants or promises to grant to a consumer credit in the form of a loan, deferred payment or any other similar form of financial accommodation, except for agreements for the provision on a continuing basis of services or for the supply of goods of the same kind, where the consumer pays for such services or goods for the duration of their provision by means of instalments”.

The amendments to the CCA, effective as of 23.07.2014, forbid creditors to require payment of charges and commissions for activities related to the absorption and management of a credit. A significant point in the Act is the changes made to achieve greater transparency in the formation of interest rates on loans.

An important element in the 2010 CCA as well as in the 2006 CCA repealed is the annual percentage rate of charge (APRC)<sup>2</sup>, which makes it possible to compare different consumer credit proposals. Banks calculate APRC for consumer loans which includes all interest payments, charges, commissions and other expenses on behalf of a client, the payment of which is a condition for extending a loan. The APRC reflects the actual cost of a credit and represents the total cost of a credit, expressed as an annual percentage of the total amount of the extended loan.

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<sup>2</sup> APR is calculated by a formula provided in the CCA.

According to the amendments to the CCA made in 2014, the APRC for consumer loans cannot be higher than five times the legal interest rate on outstanding liabilities, determined by a government decree. Practically, the change affects non-bank financial institutions extending credits to consumers as APRC on bank consumer loans are far below the established limit.

With the changes made in 2014, credits lower than BGN 400 fall within the scope of the CCA. This change is an important step towards strengthening consumer protection in the field of consumer loans extended by corporations specializing in lending, or the so called 'quick loan companies'. However, this change was to be done earlier in time.

With regard to the regulatory framework in the field of consumer lending in Bulgaria, it can be concluded that changes made in the legal provisions on this type of loans during the analyzed period contribute to raising the level of consumer protection. In relation to making responsible decisions by consumers on the assumption of debts, it is particularly important to promote and implement more financial educational initiatives supported by state institutions, professional associations, non-governmental organizations, etc.

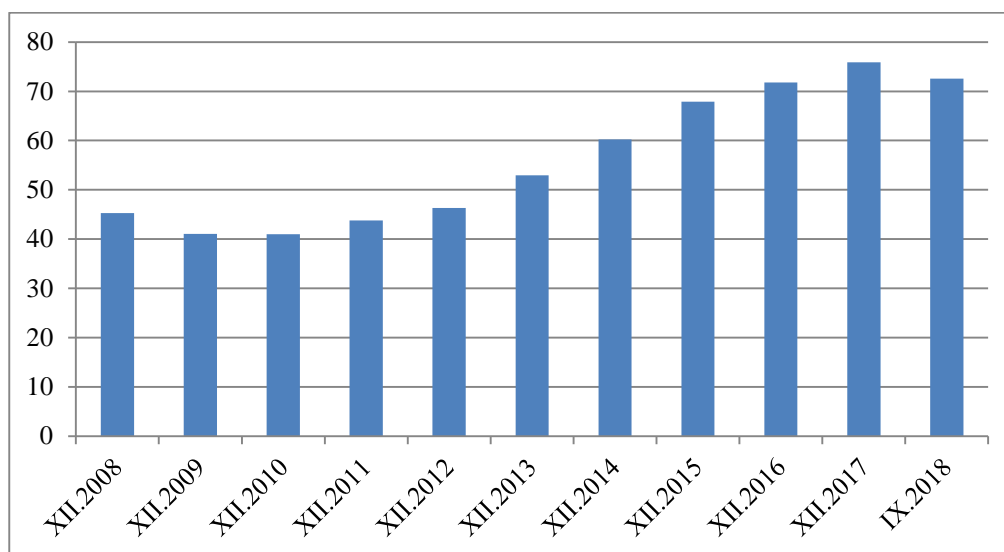
Good financial literacy is essential for the development of consumer self-defence in relation to unforeseen circumstances and excessive risk-taking.

## **2. Trends in the development of consumer loans extended by corporations specializing in lending during the period March 2008 – September 2018**

Between March 2008 and September 2018, consumer loans dominated in the structure of credit claims of corporations specializing in lending<sup>3</sup>. The relative share of this type of loans in the total amount of credit claims by residents of corporations specializing in lending increased to 75.9% at the end of December 2017 against 45.3% at the end of the same month in 2008 (see Figure 1). As of September 2018, the percentage decreased to 72.6%, but remained highly dominant.

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<sup>3</sup> Corporations specializing in lending are non-bank financial institutions providing loans.



**Source:** BNB (other financial institutions: corporations specializing in lending); own calculations.

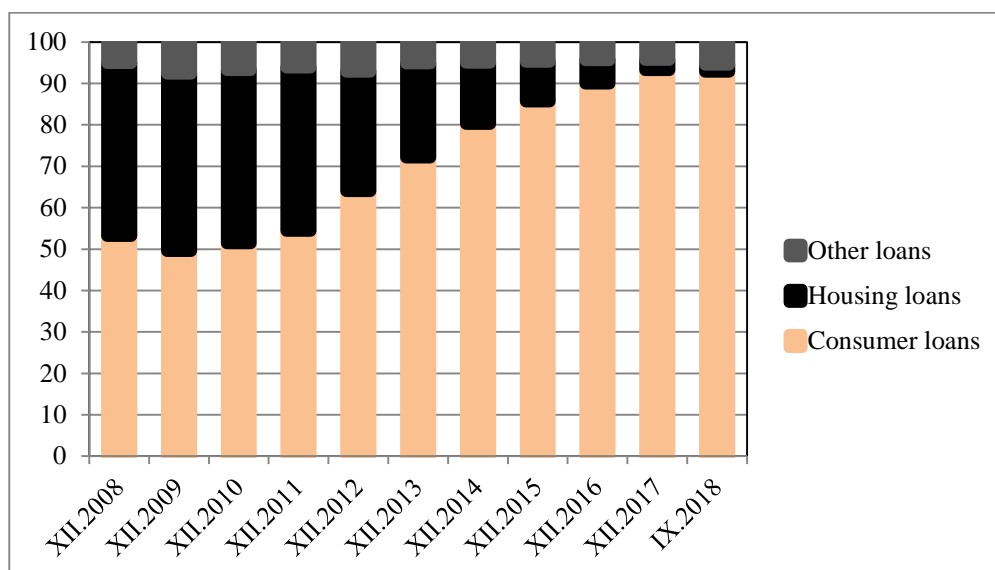
*Figure 1. Share of consumer loans in the total volume of credit claims by residents of corporations specializing in lending during the period December 2008 – September 2018 (%)*

In the structure of credit claims by households and non-profit institutions serving households (NPISHs), consumer loans were around 92.9% at the end of the third quarter of 2018 compared to 53.3% at the end of 2008 (see Figure 2). In other words, lending companies focus mainly on extending loans used to meet current needs.

Generally, consumer loans pose the highest risk to creditors in comparison to housing loans and loans to non-financial corporations, which implies higher returns. Higher profitability makes consumer loans attractive to creditors.

In this regard, Trifonova (2015) points out that for such products as unsecured personal loans, creditors charge a higher price for the higher risk.

Under conditions of macroeconomic stability in the period prior to Bulgarian economy being affected by the last global financial and economic crisis, there was a high credit activity in consumer lending carried out by non-bank lending companies in Bulgaria. The high growth of non-bank consumer loans was due to increased supply and demand for this type of credits. With increased employment and income, households felt more confident that they would be able to meet financial obligations.



**Source:** BNB (other financial institutions: corporations specializing in lending); own calculations.

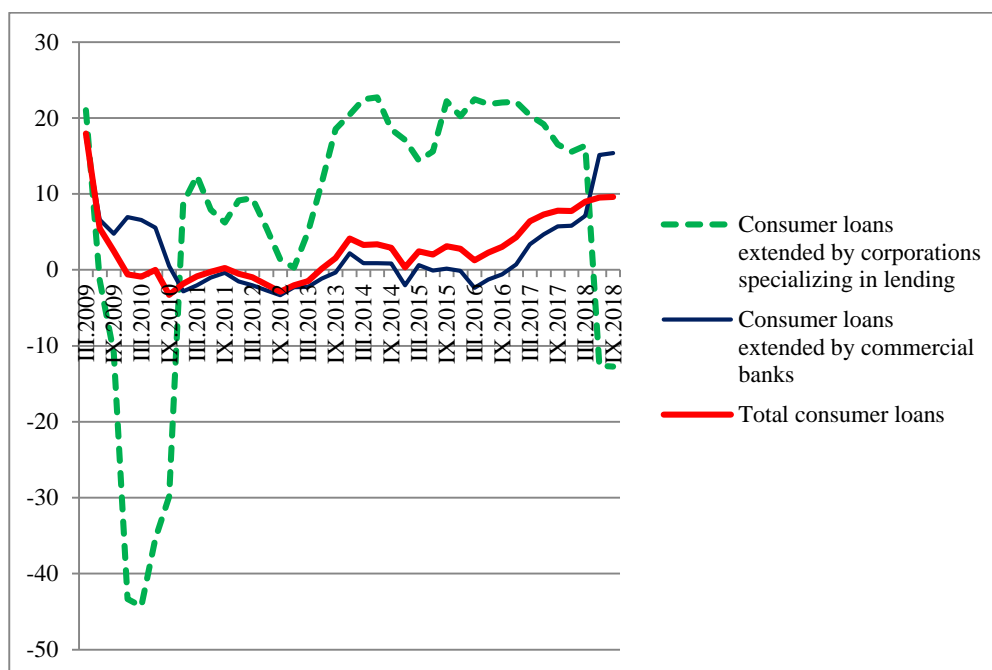
*Figure 2. Structure of household loans and loans of non-profit institutions serving households (NPISHs) extended by corporations specializing in lending during the period December 2008 – September 2018 (%)*

Consumer loans extended by corporations specializing in lending grew strongly by the end of 2008, with annual growth rate on the volume of these loans reaching the impressive 53.6%.

The global financial and economic crisis affected corporations specializing in lending as well. Since the beginning of 2009 the volume of consumer loans in this sector has started to decrease. In the period the second quarter of 2009 – the third quarter of 2010, their annual growth rate was negative as at the end of the first quarter of 2010, it reached the record -44.3% (see Figure 3).

Under conditions of job insecurity and uncertainty about future income, households are seeking to reduce their indebtedness and are more cautious about incurring extra debts.

From the end of 2010 to mid-2012, the annual growth rate of consumer loans extended by corporations specializing in lending ranged from 5.5% to 12.4%. However, in the second half of 2012 it was very low.



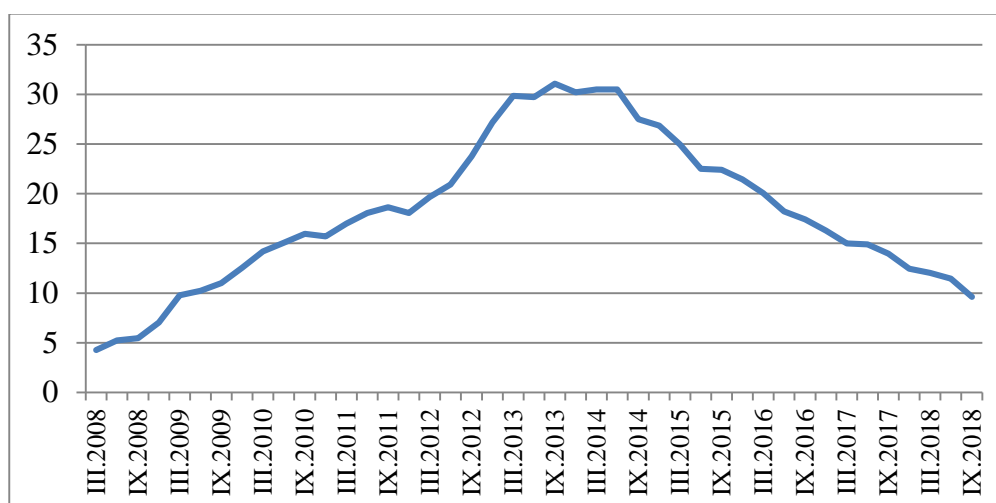
**Source:** BNB (monetary statistics: loans to non-financial corporations, households and NPISHs; other financial institutions: corporations specializing in lending); own calculations.

*Figure 3. Growth rates on an annual basis of the volume of consumer loans during the period March 2009 – September 2018 (%)*

As a result of the negative effects of the global crisis processes, credit activity in consumer lending in the country weakened to the point that a negative annual growth rate of the total volume of consumer loans extended by commercial banks and corporations specializing in lending was observed as a whole in the fourth quarter of 2009 and the first quarter of 2013.

For most part of this period, the negative values were the result of a decline in bank consumer loans. (see Figure 3).

Due to the emergence of economic problems as a result of the recent global crisis, many households are experiencing serious difficulties with paying off their debts, which leads to an increase in non-performing loans. In the period since the beginning of the last global crisis, the quality of loans extended by non-bank lending companies in Bulgaria has deteriorated drastically (see Figure 4).



**Source:** BNB (other financial institutions: corporations specializing in lending); own calculations.

**Note:** The BNB does not publish data on non-performing loans by type of loans.

**Figure 4. Share of non-performing loans in the total volume of credit claims by corporations specializing in lending in the period March 2008 – September 2018 (%)**

Rising unemployment and expected lower income may lead to postponing consumption and investment thus reducing demand for credit. On the other hand, unavailability of alternative sources of funding or self insurance against potential future lack of liquidity by agents, may expand demand for banking loans in the short run. (Calani, Garcia & Oda, 2010).

Since the beginning of 2013 there has been a recovery of consumer lending in the field of quick loans. Over the last years, non-bank lending companies in Bulgaria have become more and more popular. From mid-2015 to the end of 2016 there was a high and relatively steady annual growth rate of these loans between – 20.2% and 22.5%.

By mid-2016, consumer loans extended by banking and non-banking institutions in Bulgaria accounted for 12.7% of the country's gross domestic product, while in most of the other Eastern European countries this percentage varied between 7% and 10%, which means the consumer credit market in Bulgaria is well developed. (UniCredit Bulbank Consumer Financing, 2016).

Under conditions of gradual economic recovery in the country in the period from the second quarter of 2013 to the third quarter of 2018, there was a positive annual growth rate of the total volume of bank consumer loans and consumer loans extended by corporations specializing in lending.

Over the prevailing part of the period from the second quarter of 2013 to the fourth quarter of 2016, the positive rate of growth was achieved due to



the high growth of non-bank consumer loans, which counterbalanced the decline in bank consumer loans.

This development is the result of the stricter regulations under which banks operate thus ‘overloading’ them with changes in the regulatory order, as well as of a number of advantages that quick credit companies provide their customers with as compared to banks.

The relatively simplified procedure for applying for and approving of non-bank consumer loans is worth noting here. Users of consumer loans extended by corporations specializing in lending typically receive the corresponding amount within a very short time after the application – usually within a few hours.

Compared to bank loans, access to non-bank loans is generally easier. Among the many factors associated with the positive dynamics of non-bank consumer loans are the flexibility of non-bank creditors and the convenience they offer in lending – they offer their loan products at homes, online, and over the phone.

Many potential borrowers have no or difficult access to bank loans because they are unemployed or do not have a formal job, i.e. they are employed in the grey sector and are unable to prove their income.

Until the introduction of the regulatory changes in APRC during 2014, it often reached, and sometimes exceeded three-digit values with loan products offered by non-bank lending companies due to the high risk they take in extending mostly unsecured loans (Ivanova, 2014). According to the regulatory framework in the field of consumer lending, the APRC cannot exceed 50% in our country over the last years<sup>4</sup>.

Despite the APRC restrictions, non-bank lenders have actually managed to find ways to circumvent them. Practice shows that after legal amendments, non-bank credit companies start charging certain fees that are not included in the APRC calculation, such as a fee for providing a guarantor (when clients cannot provide two persons to warrant for them) and a fee for express processing of credit applications (Neychev, 2018).

Regardless of the extremely strong competition in the non-bank lending sector, the cost of these loans remains high, which is mainly related to the risk they take and the facilities they offer to their clients. Despite the significantly higher price (higher APRC) of non-bank consumer loans compared to bank loans and the strong reduction in the price of bank consumer loans in recent years, non-bank loans continue to be preferred by a number of borrowers. Most of these users have a high risk profile, cannot meet the stricter requirements of banks, and for them it is the only practical alternative.

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<sup>4</sup> The BNB does not publish data on the average APRC for consumer loans extended by corporations specializing in lending.

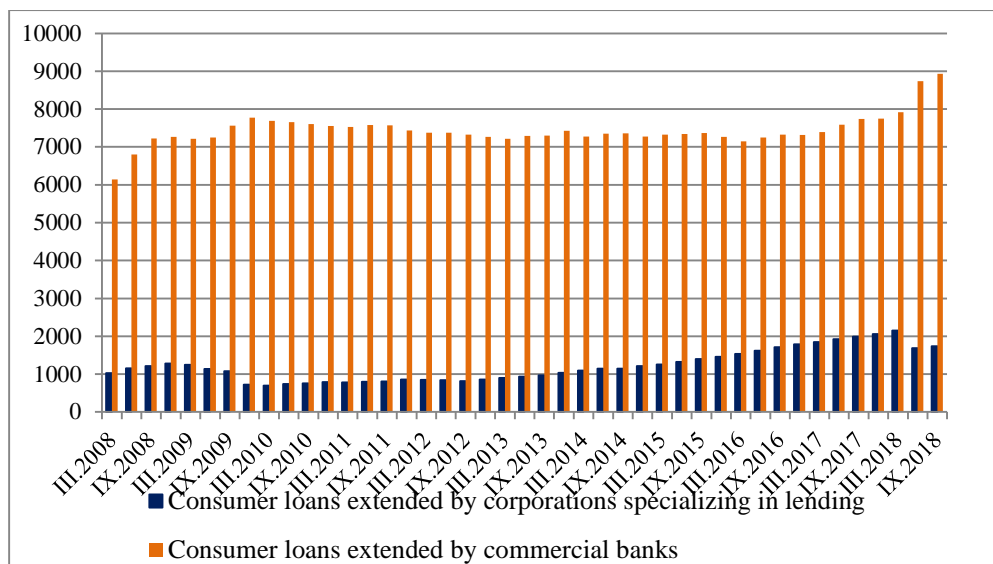
Very often, clients of non-bank lending companies take small amounts for a short period of time.

A problem that has to be posed is that many users of consumer loans extended by non-bank credit institutions lack or have very low financial literacy. In many cases, clients of non-bank creditors do not read carefully the clauses in the respective agreement before signing it, do not make efforts to compare offers, or they do not even read the agreements they sign.

According to data presented by the BNB (2019), the volume of loans extended by corporations specializing in lending reached the record of BGN 2.15 billion at the end of March 2018. (see Figure 5).

Despite the high growth rates of the volume of consumer loans extended by corporations specializing in lending, the realized volume remained far from that of bank consumer loans.

According to data presented by the BNB (2018; 2019) at the end of September 2018 the volume of consumer loans extended by corporations specializing in lending decreased to BGN 1.74 billion while the volume of consumer loans extended by banks increased to BGN 8.93 billion.



**Source:** BNB (monetary statistics: loans to non-financial corporations, households and NPISHs; other financial institutions: corporations specializing in lending); own calculations.

*Figure 5. Volumes of consumer loans extended by corporations specializing in lending and commercial banks in the period March 2008 – September 2018 (million BGN)*

At the beginning of 2017, the annual growth rate of consumer loans extended by quick loans companies began to slow down, and in the second and third quarters of 2018 it was already negative. At the end of the third quarter of 2018 it amounted to -12.7%. At the same time, strong credit activity was observed in the segment of bank consumer loans (see Chart 3). At the end of September 2018, the annual growth rate of consumer loans extended by banks in Bulgaria accelerated to 15.4%.

These directions of development are related to several key factors. Under conditions of growing employment and wages, on the one hand, households can finance a larger part of their own expenses by own funds and, on the other hand, the access of natural persons to bank loans becomes easier. In recent years, banks have significantly improved price conditions of consumer loans offered by them. It should be noted that a tendency for banks to enter the segment of quick loans has been observed over the last two years (Ilieva, 2018).

On the basis of all mentioned so far, it can be concluded that some users of non-bank loans sector reorient themselves to banks. A factor having a negative impact on the dynamics of consumer loans is the sales and write-offs of loans. These actions taken by creditors contribute to the strong decline in non-performing non-bank consumer loans. At the same time, the positive trends in the labour market observed over the past few years have a positive impact on the ability of households to service their debts on a regular basis.

## **Conclusion**

Despite the changes made in the regulations regarding consumer loans over the analysed period in the country contributing to increased consumer protection, there is still more to be done in this direction. It would be appropriate that the so-called quick loans should be settled with a separate act in our country. It is also not enough for consumers to rely only on existing regulations on the protection of their rights. The protection of consumer interests is also related to the efforts of various institutions and organizations to increase the financial culture of population.

In recent years, consumer lending by non-bank lending companies in the country has developed dynamically. Over the studied period, consumers are better acquainted with the 'quick loan' product.

Enhancing competition in the consumer credit market in recent years has led to an increase in the range of consumer loan products and requires an individual approach to clients. Strong competition is an incentive for lenders to become more innovative, more flexible and more accessible to their clients.

While maintaining employment and wage growth trends, households may continue to create optimistic expectations for their future financial

position, hence increasing their willingness to borrow funds to finance their consumption and investment.

There is potential for growth in both bank and non-bank consumer loans in the country

In the event of ongoing favourable labour market trends, lending activity in non-bank lending could be expected to be weaker in the short run compared to bank lending. The fact that banks are actively entering the quick loan market and the lower cost of loans offered by banks compared to non-bank loans give grounds for these expectations.

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