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DO REGULATORY STRINGENCY AND HOUSEHOLD INDEBTEDNESS AFFECT FINANCIAL STABILITY? AN ANALYSIS OF THE MARKET FOR NON-BANK LENDING INSTITUTIONS IN SELECTED CENTRAL AND EASTERN EUROPEAN COUNTRIES[1]

Abstract: The aim of the paper, which provides a comparative analysis of the regulatory framework for non-bank lending institutions in 12 CEE countries, is to answer 2 questions: (a) is the level of household indebtedness a sufficient indication that consumer credit risk is considered important for financial stability?; and (b) is the level of stringency of supervisory regulation of non-bank lending institutions related to financial stability risk? The conducted analysis leads to a conclusion that the stringency of regulations on the operation of non-bank lending institutions does not affect risks arising from the economic and financial performance of lenders, and that the level of household indebtedness is not closely related to the quality of portfolios of non-bank lending institutions. Of key importance, from the point of view of financial stability and the fulfillment of the role of non-bank lenders as institutions supporting the credit inclusion process, is the quality of the credit assessment procedure and its transparency, as well as the reliability of the source data on which credit decisions are based. The research fills an existing gap in the economic literature for a comparative analysis of non-bank lending institutions in CEE countries from a supervisory and regulatory perspective and in terms of creating financial stability.

Keywords: consumer finance, Central Europe, Eastern Europe, financial stability, household, indebtedness

[1] The publication is the result of internships completed by Krzysztof Waliszewski at the Warsaw School of Economics and Paweł Niedziółka at the Poznań University of Economics and Business in 2024.

Introduction

Consumer finance is a form of loan that provides a consumer with financing for their immediate needs (FLA 2024). A consumer is an individual making a legal operation with a company that is not directly related to the consumer's commercial or professional activity. One of these actions is a consumer credit, which can be granted by banks or non-bank lending institutions. In the EU, its size stems directly from the 2008 Consumer Credit Directive (CCD, Consumer Credit Directive), which was modified in 2023 (EU 2008, EU 2023). It ranges from EUR 200 to EUR 75,000, with the maximum value set by law in the country's currency for non-eurozone countries or in euros for eurozone countries, and a relatively short financing period. In particular, a consumer credit agreement is considered to be a loan agreement, a credit agreement, a deferred payment contract (Buy Now Pay Later, BNPL) or a revolving credit agreement (UMW 2024). In the above context, consumer finance can be identified with short-term unsecured loans granted to individuals, although, as the analysis in this article shows, in some markets in non-EU Eastern European countries, consumer finance is understood more broadly, as long-term loans and mortgages or loans secured on other assets by non-bank financial entities are allowed.

Consumer finance is at the same time a component of a wider concept, which is personal finance, also referred to as household finance (Waliszewski 2022). As already mentioned, consumer finance products are offered by banks and non-bank lending institutions. It is quite common to argue that the customer groups of banks and non-bank institutions do not overlap. This would imply that banks and non-bank lenders are complementary institutions that do not compete with each other. Current research (Waliszewski et al. 2024) shows that there is a group of consumers who use both banks and non-banks. The activities of non-banking institutions are inclusive (Waliszewski et al. 2023) and through their activities an important part of consumers can obtain short-term financing. Otherwise, these customers would be pushed into the grey market or become dependent on the offer of pawnshops.

As there is an imbalance of parties in the consumer finance market – consumers and financial institutions, including banks and lending institutions – consumer legislation is being introduced to protect the interests of consumers and balance the parties in the form of protection by information at the pre-transaction, transaction and post-transaction stages, in consumer credit advertising, the right of withdrawal and early repayment of consumer credit, and by limiting the interest rate (rate cap) and commissions on a granted consumer credit.

The stability of the financial system is defined as a state in which the system performs its functions continuously and efficiently, even in the event of unexpected and adverse disturbances of significant magnitude and low probability of occurrence. The scale of possible debt servicing problems of households and the resulting

credit losses of banks can create a systemic risk (NBP 2024). Channels for the impact of changes in household capacity on financial stability have been identified by Santoso and Sukada (2009) and Niedziółka (2009), among others. Of key importance in this case is the relationship between disposable income and debt servicing (Monahov 2022).

The purpose of this article is to determine the degree of institutional and regulatory development of the consumer finance market in selected Central and Eastern European countries. Twelve countries were analysed, including six belonging to the European Union (EU). All jurisdictions studied are located to the east of Poland. A comparative analysis of supervisory regulations, which can be included in the spectrum of responsible lending principles and the applied instruments of macroprudential policy, is a tool for achieving the above objective. Indeed, consumer finance market security and financial stability result from two factors: the quality of regulations protecting consumers from over-indebtedness and the debt loop, as well as the management standards of lending institutions. In the context of the significant divergence in the characteristics of consumer finance markets in the studied countries, not only in terms of regulation, but also in terms of the participation of non-bank lenders that cannot finance their activities with deposits, a question about the factors that are important from the point of view of financial stability and social welfare arises. The analysed markets also differ in the scale of the burden of servicing credit commitments on households. Figure 1 illustrates the variation in the economies analysed by household debt.

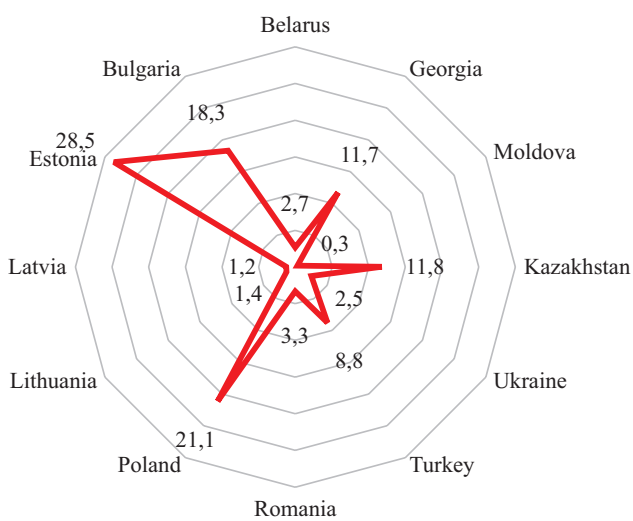


Fig 1. Consumer Debt Index

Source: the authors' own elaboration based on data available from: https://tradingeconomics.com/country-list/consumer-credit?continent=europe; https://www.ceicdata.com/en/countries, IMF databases, United Nations databases

The consumer debt index presented in Figure 1 is the authors' concept for parameterising household debt. The index takes into account the amount of consumer debt per capita and the level of economic development reflected by GDP per capita. The formula is presented in Equation 1:

$$IZK = \frac{CCpC}{GDPpC} \cdot 100 \quad (1)$$

where:

IZK – Consumer Debt Index,
CCpC – consumer credit per capita,
GDPpC – GDP per capita.

The data in Figure 1 show that three countries in the EU (Poland, Estonia and Bulgaria) have the highest household debt of all the surveyed countries. In view of the above, the authors pose the following research questions: 1) Is the level of household indebtedness a sufficient rationale for considering the risks associated with consumer credit as relevant for financial stability? 2) Is the level of stringency of supervisory regulation of non-bank lending institutions related to financial stability risk? The study, using an economic analysis of the law and literature review, focuses on non-bank lending institutions due to the dynamic development of this market, the wide variation in quantitative and quantitative regulations, as well as the observed difference in the timing of the implementation of macroprudential instruments and the use of a proactive or reactive approach across the countries. In particular, attention is paid to the capping of debt or the level of consumer credit by different indicators: DSTI[2], LTV[3], DTI[4].

2. Regulatory framework and selected quantitative and qualitative standards for consumer credit in Central and Eastern European countries

Moldova

In 2013 a law based on EU Directive 2008/48/EC (EU 2008) and referring to consumer credit agreements was introduced in Moldova. It obliged lending institutions to disclose all costs related to financing to borrowers, as well as to assess

[2] Debt Service-To-Income – a measure of the annual (monthly) amount of debt service payments relative to total annual (monthly) disposable income. The DSTI in some countries (e.g. Georgia) is called PTI (Payment-to-Income).

[3] Loan to Value – a measure of the amount of mortgage loan relative to value of real estate constituting security for repayment of the loan.

[4] Debt-To-Income – a measure of the total amount of the debt repayment relative to annual disposable income.

creditworthiness in advance. The law on non-bank lending institutions, in force since 2018, introduced standards for the framework of the lending process, including consumers' rights to complain. Lending institutions are subject to registration with an obligation to maintain capital at least equal to the required value. They are also required to disclose their ownership structure, including the beneficial owner. The state authorities have competences to supervise non-bank lending institutions (Lehmann 2019). In 2022, responsible lending regulations related to non-bank lending institutions and banks came into force. Their aim is to prevent consumers from becoming over-indebted. Responsible lending is identified here as a process based on a creditworthiness assessment, the effect of which will be to limit financing to a level that ensures that the debtor will be able to service it. Specifically, creditworthiness is to be based on a consumer's current (rather than projected) income, without taking into account possible proceeds from the sale of collateral (InfoMarket 2022). These regulations introduce limits for LTV (80%) and DSTI (40%) ratios and a maximum period for consumer loans (5 years). For loans intended for the purchase of real estate, the period is a maximum of 30 years (NBM 2023). These ratio limits apply to both banks and non-bank lenders (IMF 2022).

The 2022 law results in a change of supervisory competences over non-bank lending institutions. It moves them from the National Commission for Financial Markets (NCFM) to the National Bank of Moldova (NBM). Non-bank lending institutions are to be subject to mandatory external audits and their managers to meet certain standards of competence in the area of risk management. The above reform is the implementation of one of the demands of the International Monetary Fund (IMF) and is part of efforts to strengthen the stability of Moldova's financial system. At the same time, the IMF recommends the introduction of the Twin Peaks model, in which consumer protection competences would be placed in an institution independent from the central bank (IMF 2023). Although the regulations introduced in 2022 do not include a ceiling for the effective interest rate, there is a cap on the interest rate (50%) and the sum of daily commissions and fees, amounting to 0.04% (Schendra 2023).

Belarus

Consumer loans in Belarus are offered primarily by banks. Lending institutions that are not banks must be affiliated with banks. This obligation has been in place since 2015. As of mid-2018, 8 institutions in Belarus were affiliated to banks (4 cooperatives and 4 funds). The second channel of short-term consumer lending by non-banks is pawnshops, whose activities require registration in Belarus. Their share of the market for loans granted by non-banks accounted for approximately 95% at the end of June 2018, and, at that time, there were 107 institutions of this type. The official market for microlending by non-bank institutions is quite

underdeveloped, which is evidenced by its very low share of less than 0.1% in the assets of the Belarusian financial system. The National Bank of Belarus, which supervises the banking sector, has introduced short-, medium- and long-term liquidity requirements for bank-affiliated micro-lending institutions, which further limits their development (Gattini | Borysko 2018).

As of 2017, there is no obligation to submit documents proving income, while the mandatory creditworthiness assessment is based on a client's statements. In exceptional cases, the lender verifies the statement with the employer. In view of the risk of the financial system destabilisation as a result of the dynamic increase in the volume of consumer loans (the dynamics being a function of inflation and the lowering purchasing power of the population), the central bank has introduced a limitation in the form of a DSTI of a maximum of 40%. Vetting of potential borrowers is based on a register of suspected terrorists. Loans are only granted in the local currency (Amby Legal 2024; Labanava 2018). In 2023, analyses began in Belarus to increase the scope of protection for consumer credit customers.

Georgia

Still at the beginning of the 21st century, the Georgian market for loans to individuals and small businesses was unrecognised in terms of the applied scale and standards. Its clean-up was two-pronged, involving the initiation of educational activities among the public, as reflected in the educational strategy announced in 2016 (NBG 2016), and an institutional reform. Currently, the non-banking sector in Georgia is made up of Micro Financial Institutions (MFIs) and Loan Issuing Entities (LIEs), mainly against pledges of gold or jewelry. All loans granted to consumers by MFIs and LEIs must be denominated in the local currency. Georgian law includes a cap on the interest rate and all the fees and commissions on loans to consumers. A maximum level of the loan granted to a consumer is also set. For banks, the terms and conditions of consumer loans are more liberal than for MFIs. Secured financing is granted for up to 10 years, and also in currencies other than the local currency. MFIs are subject to registration, capital and liquidity requirements (NBG 2018). They are also supervised by the National Bank of Georgia and must regularly report to the central bank. In Georgia, regulations have been implemented to guarantee the protection of the consumers using financial services, the principles of responsible lending and requirements for the management standards of consumer credit providers. Restricting over-indebtedness of the citizens is aimed at PTI (Payment-To-Income) and LTV ratios, which both MFIs and LIEs are obliged to comply with. MFIs do not have access to central bank financing. The source of their lending is their own capital and deposits, which, however, are not covered by the protection of the deposit guarantee scheme. This implies a relatively high cost of funding, which translates into the interest rates on loans. The National Bank of Georgia creates incentives for MFIs

to become micro-banks dedicated to lending to individuals, subject (like all banks in Georgia) to supervision by the central bank, whose deposits would be covered by the protection of the deposit guarantee scheme. Becoming a microbank also entails strengthening corporate governance, the capital base and the risk management system. The institution of a microbank is relatively new in the Georgian law. It was introduced in line with the recommendations of the IMF in 2023.

Features that distinguish microbanks from banks include: a lower required capital, a lower maximum amount of a single loan, and the ability to accept deposits only up to the limit set by the deposit guarantee scheme (MG Law 2023). LIEs have relatively the lowest requirements (there are about 200 such entities in Georgia). They are not allowed to accept deposits either, but activities require registration and regular reporting to the central bank. Georgia has a credit information bureau supervised by the National Bank of Georgia. Its resources are fed with data provided by lending institutions and banks, and information on any transaction whose amount exceeds a certain threshold should be registered with the said institution. At the same time, it should be mentioned that a certain part of the loan market in Georgia is not regulated. These are entities with 20 or fewer customers (IMF 2020). The implementation of consumer protection reforms (NBG 2021), the structuring of the market in the form of the categorisation of institutions and the definition of requirements for different types of entities have resulted in an improvement in the quality of loans to consumers (NBG 2023).

Turkey

Consumer credit in Turkey is provided by both banks and non-bank lenders. Both types of institutions are supervised by the Banking Regulation and Supervision Agency (BRSA). At the same time, it should be added that non-bank lending institutions are capitally controlled by banks and the main source of funding comes from their owners (Fitch Ratings 2023). Consumer loans in Turkey can only be granted in the local currency and for a period that does not exceed 60 months. Their interest rate is fixed. While there is no cap on the interest rate on loans, the central bank puts pressure on consumer lending institutions to reduce the interest rate (Kandemir | Ozsoy 2023). These loans are subject to a tax, which was restored after the COVID-19 pandemic to 15% (previously 10%). This is unsecured financing dedicated to individuals or partnerships where the source of repayment has been documented. Individuals must also demonstrate steady employment and income stability, such as pensions (BRSA 2013).

The size of permissible lending provided by non-bank lending institutions is determined, among other things, by the net result of the previous operating period (Erbilen et al. 2024) and the amount of own funds, which must be at least 3 per cent of the total assets (BRSA 2013). Turkey's central bank uses another tool to control the

unsecured consumer credit segment. This is the requirement to maintain collateral at the central bank for these exposures. Its amount depends on the interest rate of the loans. The higher it is, the higher the provisioning, with three interest rate thresholds applied and collateral coverage for the different bands being respectively: 0%, 20% and 90% (ING 2023). The inclusion of non-bank lenders in the macroprudential policy circle and the tightening of capital and liquidity requirements observed in recent years limits the ability of these entities to raise stable, long-term financing, including foreign funding (Fitch Ratings 2023). The central bank of Turkey's policy towards lending institutions and banks with regard to short-term, unsecured consumer credit is based on a belief that lending in this area drives inflation. This hypothesis is not clearly supported by research findings (Yuksel | Ozsari 2016).

In the area of protecting the rights of consumers using financial services, in recent years, the Turkish law has moved significantly closer to EU standards. This includes the rules on withdrawal, costs and other conditions for breaking a contract, rules on advertising financial products, regulations of online financial services, requirements for precise and fair information on financial offers, and involuntary cross-selling (Şenocak 2022). Some evidence that the Turkish government pays a significant attention to the consumer protection was a drastic increase in penalties for unfair market practices in this area in 2022 (Sozer 2021).

Kazakhstan

The development of consumer lending in Kazakhstan took place in the second decade of the 21st century and was driven by the relatively attractive relationship between the profitability of this type of financing and the associated risks compared to other customer segments. The consumer finance market in Kazakhstan is dominated by banks and all lenders are supervised by the State Agency for Financial Market Regulation and Development. An important factor supporting the development of consumer finance was the 2004 enactment of a law regulating the activities of credit bureaus that produce credit track record reports. The leading institution in this area is First Credit Bureau, founded by the international business intelligence agency Creditinfo and three Kazakh banks. However, the World Bank points out that not all lenders, and not to the full extent, have access to their clients' credit track record (World Bank 2024). In 2014, fearing the emergence of a financial crisis triggered by consumer loan defaults, the National Bank of Kazakhstan introduced prudential norms to limit the scale of consumer finance. Two prudential norms were implemented: one limiting the demand, and one reducing the supply of loans. The former is a DSTI ratio of 50%. At the same time, the annual dynamics of a given lender's consumer loan portfolio cannot exceed 30% (Nurbayev 2016).

The aforementioned solutions have not yielded satisfactory results, which is manifested by the doubling of the size of the consumer loan portfolio between 2019

and 2023, the lengthening of financing periods, the increasing share of refinancing loans, the growth of DSTIs and the significant share of non-performing loans (NPLs) in consumer loan portfolios granted by banks and non-bank lending institutions (World Bank 2024). The reasons for this state of affairs are attributed to the inadequacies of the consumer bankruptcy law (only at the end of 2023 did the process of tidying up procedures in this area begin), the lack of adequate regulations in the area of consumer protection (including the principles of offering financial products, full disclosure of financing conditions and risks), the lack of adequate economic education, and the low quality of lenders' risk management systems (Dancausa | Melecky 2024; Gusmanova | Kurmanalina 2023). The creditworthiness framework for banks was only established in 2017, and for non-bank lenders in the late 2019.

Still, these rules do not apply to secured loans and the analysis does not take into account the stability of income sources (World Bank 2024). In response to the growing indebtedness of citizens and debt servicing difficulties, an interest rate cap of 50% on loans to individuals was introduced at the beginning of 2024, but, according to market analysts, this restriction does not solve the problem of over-indebtedness. At the same time, the credit assessment process has been formalised to improve its effects and lowering NPLs. Borrowers who are more than 90 days in arrears will not be allowed to take out additional unsecured debt. However, the above restriction applies to customers characterised by low income (Kumenov 2023). In addition, capital requirements for banks (from 150% to 350% of risk-weighted assets) and non-bank lending institutions (from 100% to 500% of risk-weighted assets) were increased. A maximum share of NPLs in the portfolio was also set at 20%. The spectrum of income sources that can be taken into account in the credit assessment process was reduced. The maximum interest rate was reduced from 25% to 15% per annum (not the effective rate, however, but the nominal rate) and a maximum daily interest rate of 1% was introduced (Prime Minister of the Republic of Kazakhstan 2023).

Ukraine

In Ukraine, the rules for consumer lending are contained in the Law of 11 November 2016 No. 1734-VIII "On Consumer Lending". This law came into force on 10 June 2017. The high historical and projected market dynamics triggered calls for a tighter regulation (Csajbok et al. 2020), and therefore the said law was amended in December 2021. The Ukrainian law allows for loans based on variable interest rates, but they must be denominated in the national (local) currency. Originally, there was no limit to the amount of interest rates. Only at the end of 2023 was the law amended, setting the maximum cost of borrowing at 1% per day, whereas a ceiling of 0.8% was originally planned against the market practice of using a rate of 2.5% per day

(Hudima et al. 2024). The introduction of the maximum interest rate, combined with the tightening of portfolio monitoring rules, according to the National Bank of Ukraine, is expected to protect individuals from the debt loop and reduce the risk appetite of lending institutions. In this context, Ivashchenko et al. (2021) notes that the introduction of modern scoring systems and consumer loan insurance are necessary initiatives to improve the profitability of this market segment. An interest rate ceiling occurs for late payments.

The Ukrainian law, largely modelled on EU solutions, contains a number of provisions protecting borrowers. These concern, among other things, an obligation imposed on lenders to reliably inform consumers about the terms of financing. Other provisions regulate the possibility of withdrawal and early repayment of the debt (Molodyko 2018; NBU 2024a). The supervision of non-bank lending institutions is exercised by the National Bank of Ukraine. Its competences include: (a) registration of lending institutions, (b) verification and approval of interest rate calculations quoted in promotional materials and contracts, (c) supervision of the forms of advertising consumer loans, (d) verification of creditworthiness assessment rules and ordering changes in this respect. Creditworthiness assessment is mandatory. Despite the declared introduction of maximum values for LTV and DSTI indicators in the Macroprudential Policy Strategy, this initiative has not materialised so far (NBU 2024b).

The consumer lending market in Ukraine is divided into the banking segment (highly concentrated) and non-banking institutions (highly competitive), and the customers of each segment do not intermingle. In 2024, the scale of lending to individuals did not reach the pre-Russian aggression levels in Ukraine, although a recovery was observed. At the same time, an increase in the value of the remote lending portfolio was recorded. Simultaneously, the share of loan-financed purchases was increasing (NBU 2024a; UBN 2024).

Romania

The non-bank consumer lending market in Romania has been operating since 2005. Previously, household financing was handled exclusively by banks (EMN 2019a). In Romania, the area of consumer rights protection, including those using financial services, is regulated in quite a detailed and comprehensive manner, and the institution responsible for monitoring the observance of consumer rights is the National Authority for Consumer Protection (ANPC). This institution, responsible for creating and giving its opinion on draft legislative changes, also maintains the register of non-bank lenders (a lending institution is subject to registration after meeting certain requirements and their verification) and adjudicates whether lenders comply with the applicable law and best market practices (EC 2020). Credit intermediaries in Romania should have insurance to cover potential liabilities

(including for imposed penalties), as well as provide guarantees on the processing of personal data in accordance with the applicable law. Nevertheless, ANPC's activities have been criticised. Stănescu (2023) accuses it of low transparency, lacking the necessary resources and succumbing to political influence and the lobby of financial institutions. The ANPC's main task is to protect consumer rights, while micro-prudential supervision is carried out by the Romanian central bank. This entity formulates quantitative requirements and also verifies the performance of market participants and the quality of their risk management (ICLG 2024).

The National Bank of Romania has the competence to issue separate regulations applicable to non-bank financial intermediaries. The central bank includes consumer loans in its financial stability assessment. Market dynamics, trends and the condition of households are taken into account in the annual financial stability reports.

Lending institutions in Romania must hold capital, the minimum level of which is set by the central bank. A significantly higher requirement applies to lending institutions with mortgage loans on offer (EMN 2019a). In addition, restrictions on the sale of consumer credit receivables are in place. The sale of receivables is only possible to professional and supervised financial institutions. Romania has a fairly long history of using macroprudential policy tools, such as DSTI and LTV ratios. It dates back to 2003 and aims to limit household debt. The DSTI cannot exceed 40%. For liabilities denominated in other currencies, the limit is 20%. The DSTI ceilings are increased by 5 percentage points for households with mortgages (ESRB 2019). The DSTI limits, under certain conditions and within certain limits, may be exceeded by lenders (KPMG 2019).

In Romania, there is no maximum interest rate for loans to consumers. At the same time, an indirect way of regulating the maximum interest rate should be mentioned. Lending institutions placed in the Special Register may not exceed the following limits of the effective annual interest rate (FRRF 2022):

- 200% for loans in RON and 133% for loans in foreign currencies if the financing period does not exceed 15 days;
- 100% for loans in RON and 67% for loans in foreign currencies if the financing period is between 16 and 90 days;
- 50% for loans in RON and 33.33% for loans in foreign currencies if the financing period exceeds 90 days.

However, the interest rate on NPLs cannot be more than 3% above the interest rate on the loan before reclassification. There is no restriction on the charging of interest on interest (FRRF 2022). At the same time, a maximum level of early repayment commission is set. Only after 90 days of default can the creditor terminate the contract and take a collection action (Iacob 2016). At the same time, a maximum repayment period of five years has been introduced for consumer loans (ESRB 2019; ESRB 2024). Consumer credit in Romania does not have an amount limit and

restrictions on the disbursement of funds. Both fixed and variable interest rates are allowed. The rules for advertising loans to households are set out in detail, including the information that must be included in the offer. These include the interest rate, the financing period, the amount of the loan, the duration of the offer of at least 15 days, the rules for termination and early repayment of the loan (ECCR 2024).

Romania has a system for exchanging information on household non-performing debt, but it does not include small lenders. They are not obliged to feed it, but they do not have access to the data collected there either (EMN 2019a). Moreover, there is no obligation to take into account data from the Lender Information Exchange System in the creditworthiness assessment process (FRRF 2022).

The consumer lending market in Romania is dominated by banks. Non-bank lenders, despite their very dynamic growth, represent less than 6% of the market. As of mid-2023, approximately 180 companies engaged in financial intermediation, including consumer lending, were registered in Romania (NBR 2023).

Bulgaria

Non-bank lending institutions in Bulgaria are supervised by the Bulgarian National Bank. What distinguishes their offer from the spectrum of consumer credit products in other countries is:

- lending to farmers;
- a significant share of the secured lending market – collateral can be a salary pledge, a surety, a cash deposit and a pledge on a movable property.

Bulgarian law, in line with EU regulations, contains a number of clauses protecting consumer rights. These concern, among other things, the transparency and completeness of the offer, as well as the need to state the annual percentage of the interest rate so that the consumer can compare various offers. This interest rate reflects the total cost of financing (Vasileva 2019). Lenders are obliged to share information about customers and their repayment within the information exchange system, but there is no obligation to take these data into account in the creditworthiness assessment process. In Bulgaria, there is a cap on the amount of loans granted by non-banks and a cap on the interest rate, which is 50%, i.e. five times the rate describing the interest rate on arrears. This ceiling is determined by a government decision (EMN 2019b; EMN 2023). A maximum interest rate for overdue receivables is also set.

Within the framework of macroprudential policy, it is possible for the Bulgarian National Bank to introduce limits not only for DSTI and LTV ratios, but also for LTI (Loan-to-Income). The central bank may also limit the term of financing in the form of consumer credit and introduce a requirement relating to debt amortisation (ECB 2020). So far, these instruments have not been implemented, although they are being monitored (ESRB 2024). Quite restrictive regulations apply to the transfer

of receivables by lending institutions. Such sales require a written consent of the debtor (FRRF 2022). Institutions offering loans to households must comply with capital requirements (EMN 2016) and regularly report on their own economic and financial condition to the central bank (FRRF 2022).

Lithuania

Among all the European countries, Lithuania is characterised by a very high share of consumer loans held by non-bank lenders, amounting to almost 30%. Activities of lending institutions are licensed and their register is maintained by the Central Bank of Lithuania. These lenders are supervised by the Bank of Lithuania (formerly the State Consumer Protection Authority) and are required to report periodically. Although there are no capital requirements for non-bank lenders in Lithuania, the intensity of supervision can be assessed as high. In addition to controlling the business and verifying its compliance with the law and the supervisor's recommendations, the central bank is the arbiter in disputes between lenders and borrowers. The Bank of Lithuania is also responsible for the design of consumer credit regulations, formulates recommendations and guidelines on responsible lending, and analyses data describing the payment condition of households and market trends (BoL 2024). Lithuania has a limit on the maximum cost for consumer credit. However, it is relatively high (79%), and only a decade earlier it was as high as 250%. A maximum rate of daily interest on overdue payments is also set.

As in the vast majority of the European countries, lenders are obliged to carry out a creditworthiness assessment (irrespective of the amount requested), taking into account data from borrower information exchange systems and a spectrum of income sources defined by the central bank and a DSTI cap of 40%. Stress tests for a DSTI of 50% and an interest rate of 5% are also mandatory. If the customer uses a mortgage, the allowable DSTI cannot exceed 60%. In Lithuania, the requirements for advertising consumer loans (in particular, these products may not be offered to persons under 18 years of age), the presentation of information about these products and the standard of the loan agreement have been defined in quite a detailed and conservative manner. At the same time, the maximum period for which households may be granted financing, except for mortgage loans, is not specified (Bublienė 2014; ESRB 2024). In Lithuania, special attention is paid to the credibility of the owners of institutions offering loans to households. In particular, they must not have been convicted by a final court judgment (FRRF 2022).

Latvia

Non-bank lenders play an important role in the consumer credit market in Latvia. In addition to typical short-term unsecured loans, they can offer long-term mortgage financing. The market is developing very dynamically and is characterised by a high level of competition (Mazure 2017). Non-bank lending institutions in Latvia should have the capital of at least EUR 425,000. Their activities require registration, and this is preceded by verification of compliance with a number of requirements, including the internal control system, credit procedures, creditworthiness assessment, and those aimed at protecting against money laundering. The activities of lending institutions are supervised by the Consumer Rights Protection Centre. Non-bank lenders are obliged to report periodically on their financial performance, the quality and structure of their portfolio, their sales practices and their compliance with applicable laws. As is the case in other countries, regulations stipulate a maximum level for the cost of consumer credit, and the decision to grant financing is preceded by a creditworthiness assessment (regardless of the amount applied for by the client) in each case. An original solution, not found in other jurisdictions, is the prohibition of concluding credit agreements between 11 pm and 7 am. If the lending institution does not have up-to-date or complete information on the credit track record as well as on the sources of income, it is obliged to base on the figures provided by the system of the intercreditor data exchange. The daily cost for the consumer cannot be higher than 0.07%. Another restriction referring to the loans granted for up to 30 days is setting the maximum amount of the credit for 50% of the minimal monthly salary (announced and updated by the government). In case of such products, it is forbidden to prolong their term more than twice, however it is not relevant for amortised (repaid in installments) products. In the case of loans granted for up to 3 months, the total costs cannot exceed the amount of financing. Also, the maximum rate for overdue commitments is defined, however it is forbidden to take interest on interest. Special attention is paid to the rules of responsible lending, with whose regulations concerning acceptable forms for advertising consumer finance products is associated (FRRF 2022). In addition, quantitative limitations referring to the scale of consumer finance exist in Latvia. One of them is the maximum term of financing, which in the case of mortgage loans lasts 30 years, while for unsecured consumer loans it is 7 years. Limits are set for DTI and DSTI ratios. The DTI, i.e. the ratio of the borrower's total liabilities and 12 times their income, must not exceed 6.0 and the DSTI ratio must not exceed 40% respectively. If the DSTI is higher than 40% and, at the same time, the creditworthiness is defined as insufficient, the result is the inability to grant a loan. The Latvian law allows for derogations from the application of the DSTI and DTI ratios, as well as with regard to the maximum duration of financing. However, the total value of exposures characterised by exceeding the above-mentioned standards may not exceed 10%

of the portfolio value. In 2023, there was some liberalisation of the DSTI and DTI ratios. A DSTI threshold of 45% and a DTI of 8.0 were allowed when a customer uses financing to purchase a property characterised by an A+, A, B or C energy efficiency certificate. Exposures with increased DSTI and DTI are included in the 10% portfolio pool described above (ESRB 2024).

Estonia

In Estonia, the tightening of requirements for non-bank lending institutions took place in 2016. The activities of these entities are licensed and relevant permits are issued by the Financial Supervision Authority (FSA). Capital requirements, quarterly reporting requirements to the FSA, as well as certain standards for responsible lending and governance (including the need to have an internal audit unit) are imposed on lending institutions. The assessment of creditworthiness is mandatory (irrespective of the loan amount) and should take into account data from information exchange systems. Creditworthiness in Estonia is mainly verified using the Payment Default Register. There is a maximum cost of borrowing and a maximum ceiling on interest rates on overdue payments. There are also restrictions on advertising consumer loans. They must not be publicised through television and radio, and suggest that taking out a debt is risk-free or a simple solution to financial problems (FRRF 2022). The DSTI standard has been in place since 2014, but the rules for its calculation were changed in 2024. While the cap for the total cost of consumer loan is still 50%, the larger of the rates used in the calculation is the loan interest rate or 6% p.a. Previously, it was the larger of the loan rates plus 2 p.p. or 6% p.a. (ESRB 2024). Mortgage-backed consumer loans are possible in Estonia, and each lender is obliged to define maximum LTV and DSTI ratios, as well as the maximum loan term and stress tests in its policy. Financing provided to households can be based on a fixed or variable interest rate (Riigikogu 2016). An audit of the non-bank consumer lending market conducted by the National Audit Office in 2023 revealed a number of irregularities in lenders' operation. These relate in particular to the mode of creditworthiness assessment, the forms of advertising loan products, and the extent and form of risk communication to customers. The above observations lead to a conclusion of the need to intensify the supervision of the market and to update the existing regulations, including the limits and the methodology for calculating indicators describing debt sustainability. It is also necessary to expand economic education (Cole 2023).

Poland

Loan institutions in Poland have been supervised by the Polish Financial Supervision Authority since 1 January 2024, which has been obliged to report information on their economic and financial condition and portfolio structure. This entity has maintained a publicly accessible register of lending institutions since 2017. The form in which loans are advertised as well as the content and form of contracts are subject to review by the Office of Competition and Consumer Protection. This office controls whether the consumer has been comprehensively and fairly informed about the financial product and the risks involved in using it. As in other countries, there is a prohibition on persons convicted by final judgements of an offence against document reliability, property, economic circulation, money and securities trading or a fiscal offence from carrying out this activity. Moreover, a minimum capital for lending activities has been established. The form of the business is not insignificant either. In order to grant consumer loans, a limited company or a joint-stock company must be established. Taking out a debt with a lending institution is preceded by a mandatory creditworthiness assessment, based on information obtained from the potential customer and from the credit bureau managing the information exchange system. There is a statutory definition of the upper limit for consumer credit at PLN 255,550.

Although there is a category defined as a maximum interest rate (twice the reference rate of the National Bank of Poland plus 3.5 p.p.), a fixed (10% of the loan amount) and a time-dependent component (10% maximum), for short-term products up to 30 days, it is a maximum of 5% of the loan amount. The non-interest costs of the loan must not exceed 45% of the total loan amount. A ceiling on non-interest costs was defined during the COVID-19 pandemic at 5% for loans up to 30 days, and 10% plus 10% for each year for products with longer repayment periods. There is also an interest rate cap for overdue liabilities, which is twice the NBP reference rate plus 5.5 p.p. (Consumer Credit Act 2024; FRRF 2022; Gębski 2022). In Poland, there are no DSTI limits in place that, if exceeded, would mean an automatic rejection of a customer's application, but lending institutions are obliged to exercise due diligence in assessing the risk of customers whose DSTI exceeds 40% for borrowers with incomes below the regional average or 50% for other customers (ESRB 2024). Non-bank lending institutions in Poland only provide unsecured, usually short-term loans. They do not offer mortgage products.

3. Final conclusions

A synthetic comparison of the regulatory framework for non-bank lending institutions in 12 CEE countries is provided in Table 1.

Table 1. Regulatory considerations for the operation of non-bank lending institutions in the studied countries

	Moldova	Georgia	Ukraine	Kazakhstan	Poland	Lithuania	Latvia	Estonia	Belarus	Romania	Bulgaria	Turkey
Is a creditworthiness assessment compulsory?	Yes	Yes****	Yes	Yes***	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Does the state supervise non-bank lending institutions?	Yes	Yes*	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Has a maximum cost of borrowing been set?	**No**	**Yes**	**Yes**	**Yes**	**Yes**	**Yes**	**Yes**	**Yes**	**No**	**No**	**Yes**	**No**
DSTI/PTI	**No**	**Yes**	**No**	**Yes**	**No**	**Yes**	**Yes**	**Yes**	**Yes**	**Yes**	**No**	**No**
DTI	No	No	No	No	No	No	Yes	No	No	No	No	No
Maximum term of a loan	Yes	Yes	No	No	No	No	Yes	No	No	No	No	Yes
Maximum amount of a loan	No	No	No	Yes	Yes	No	Yes	Yes	No	No	No	No
Is the share of secured lending in the consumer finance market significant?	Yes	Yes	No	Yes	No	No	No	No	N/A	No	No	Yes
Is there a market for non-bank lenders that are not pawnshops?	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	N/A	Yes	Yes	Yes**
Capital requirements for non-bank lenders	**Yes**	**Yes**	**No**	**Yes**	**Yes**	**No**	**Yes**	**Yes**	**N/A**	**Yes**	**Yes**	**Yes**
Liquidity requirements for non-bank lenders	No	Yes	No	No	No	No	No	No	N/A	No	No	Yes

* – excluding lenders serving up to 20 customers
** – de facto controlled by banks
*** – not applicable to secured loans
**** – up to 25% of the portfolio may be receivables for which no credit assessment has been carried out Legend:
Mild regulatory regime
Moderate regulatory regime
Tightened regulatory regime
Prohibition of non-bank lending institutions

Source: The authors' own elaboration

The key determinants of the restrictiveness of the regulations shaping the activities of non-bank lending institutions are: the credibility and financial standing requirements of the lender (supply criterion), restrictions preventing household over-indebtedness in the form of DSTI limits (demand criterion) and the maximum interest rate level (mixed criterion). Based on these, the financial systems were classified in terms of restrictiveness, with a division into four categories. The absence of at least two quantitative norms among the aforementioned implies a lenient regulatory regime, one implies a moderate one, and the presence of all three restrictions is identified with a tighter regulatory regime.

The consumer credit market in the CEE countries is growing faster than in the euro area, although credit volumes are still significantly bigger there. The euro area is characterised by significantly higher DTIs, which should be linked to the greater stability and predictability of the labour market in these countries (Waliszewski | Gębski 2024). However, one cannot conclude from this finding that consumer loans are a low-risk segment of the financial market. Indeed, consumer lending can pose a threat to financial stability. Among the surveyed countries, the examples of Kazakhstan, Moldova and Turkey bear witness to this. In the first case, the source of the problem, according to the IMF, is the inadequacy of the credit risk assessment systems, the low quality of the management of lending institutions, and insufficient market transparency (IMF 2024). In Moldova, concerns about financial stability and the negative social impact of over-indebtedness were found to be caused by non-transparent and lax credit appraisal rules, low reliability of the data on which decisions were based, and unfair lender practices (USAID 2018). In Turkey, on the other hand, stability is threatened by the macroeconomic environment in the form of high inflation and dynamically changing and largely unpredictable supervisory regulations (Fitch Ratings 2023).

Referring to the data in Table 1, Figure 1, as well as press releases and those contained in official documents of governments and central banks, the following conclusions can be drawn:

- the restrictiveness of the regulation of the operation of non-bank lending institutions is not related to the risks arising from the economic and financial condition of the lenders (high share of NPLs, liquidity problems);
- the level of household indebtedness is not closely related to the quality of non-bank lending portfolios (no such relationship was observed, except for Kazakhstan, with Kazakhstan being primarily influenced by other factors described earlier);
- a significant tightening of quantitative norms usually follows the identification of problems related to the quality of lending institutions' portfolios or the build-up of social problems resulting from over-indebtedness;
- the quality of the credit appraisal process and its transparency, as well as the reliability of the source data on which credit decisions are based, are

of key importance from the point of view of financial stability and the role of non-bank lenders in supporting the credit inclusion process. The credit assessment systems, the quality of the risk management systems and the competence and credibility of the managers of lending institutions should be subject to evaluation by supervisory institutions;

- the implementation of quantitative standards should be proactive and gradual in order to make the development of the non-bank lending market sustainable.

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