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*The background of regulating non-bank loan institutions in Poland*

**Key words:** non-bank loan institutions, regulations, payday loans

**JEL:** G23, G28, N20.

**Abstract**

*Non-bank loan institutions in Poland often face a bad reputation or lack of trust, are compared to ‘parabanks’ and they are often recognized as companies operating at the borders of the law. Despite their membership in the financial sector, until recently the public supervision had little control over loan companies and had little knowledge about the scale of their operations. The greater restrictiveness of the new regulations caused a slowdown in the development of loan companies. Changes such as the introduction of bank levy and the amendment to the Consumer Credit Act of 2016 had a significant impact on the financial results and the structure of products offered by loan companies. Along with the new regulations, there is doubt, however, whether these changes, which are intended to organize the market for non-bank loans, will actually lead to an exodus of loan institutions from the market and to significant limitation and financial exclusion of the part of polish consumers.*

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1. **Introduction**

The subject of non-bank loan institutions raises controversy and provokes discussions among both borrowers and market observers. Loan companies in Poland often have a bad reputation or lack of trust, are compared to ‘parabanks’ and are considered to operate at the borders of the law. Although they belong to the financial sector, until recently, public supervision exercised little control over them and had little knowledge of the scale of their activities[[1]](#footnote-1). In the light of recent law changes, the issues of non-bank loan institutions (also known as loan companies or loan companies) have become more and more important.

The increased stringency of the new regulations has slowed down the development of loan companies. The amendment of the Consumer Credit Act of 2016 in Poland (pol. *Ustawa o kredycie konsumenckim*) had a significant impact on the financial results and the structure of loan companies' products. Doubts have arisen as to whether the new regulations, which are (according to their originators) supposed to organize (‘civilize’) the market of non-bank loans, will not lead to its limitation and financial exclusion of a part of the society which, due to its low creditworthiness, does not use banking services. The aim of this article is to present the most important changes in the legal regulation of loan institutions in Poland, to show the reasons for these changes and to assess their impact on the industry. The research method in the article is the analysis of literature.

1. **The definition of non-bank loan institution.**

In Polish law, the term ‘loan institution’ was defined in August 2015 with the amendment of the Consumer Credit Act (pol. *ustawa o kredycie konsumenckim*). According to this Act, ‘a loan institution is any legal entity that is a lender and does not fall into any of the following categories: (1) bank or credit institution; (2) cooperative savings and loans credit union (pol. *Spółdzielcza Kasa Oszczędnościowo-Kredytowa*, SKOK); (3) entity whose activity consists in granting consumer credits in the form of deferred payment of price or remuneration for the purchase of goods and services offered by it’ [Dz.U. 2019 poz. 1083, art. 5, pkt 2a]. From 22 July 2017 The Polish Financial Supervision Authority (pol. *Komisja Nadzoru Finansowego*, KNF) keeps the Register of Loan Institutions**[[2]](#footnote-2)**. Without a registration in the aforementioned register, a loan institution may not conduct business activity - otherwise it may be fined up to PLN 500.000. Before 22 July 2017, the unofficial ‘Register of Loan Companies’ was kept (without registration obligation) by the Polish Union of Loan Institutions (pol. *Polski Związek Instytucji Pożyczkowych*, PZIP, formerly the Union of Loan Companies, pol. *Związek Firm Pożyczkowych*, ZFP).

The codification of the notion of ‘loan institution’ had a positive impact on the image of these entities by making consumers aware that the services of loan companies are properly regulated and supervised. Deficiencies in nomenclature caused that loan companies were often mistakenly called parabanks. By definition parabanks are ‘institutions other than banks which perform deposit activities as their core business’ [https://www.nbportal.pl/]. Loan institutions cannot accept deposits from their customers and put them at risk but the funds for lending come from their own resources - they are therefore not parabanks. Loan companies are also called 'shadow banking' institutions. Although this term may be negatively perceived by consumers [Domańska-Szaruga, 2015] loan companies meet this definition as they, when granting consumer credits, process liquidity transformation and maturity transformation [Markowski, Tymoczko, 2018].

1. **Unfair practices of non-bank loan institutions.**

The sector of non-bank loan institutions has been facing negative public opinion for years, which was also reflected in the literature: ‘Parabanks feed on the naivety of consumers, taking advantage of their helplessness’ [Koćwin, 2016]. Negative opinions were the result of many unfair practices of loan companies in Poland, which determined the tightening of legal regulations for this sector in 2015.

The reports of the Office of Competition and Consumer Protection (pol. *Urząd Ochrony Konkurencji i Konsumentów*, UOKiK) are an objective source of information about improper practices on the non-bank loan market. In 2013 The UOKiK examined the fees charged to the clients of loan companies. At that time high non-interest charges were allowed and this was a common practice. UOKiK focused on the truthfulness of information on the total cost of a loan and whether it complies with the Acts on counteracting unfair market practices and on counteracting unfair competition.

The first unfair practice was not to provide the customer with information specified in the Consumer Credit Act (5 out of 30 companies did not do it). Most of them explained that this information was provided to the consumer only after the loan is paid out. Other infringements included: lack of information about the interest rate of the loan, about the total cost of the loan, about the total amount to be repaid, about the order in which the instalments were counted towards the repayment, etc. Some companies did not provide information about the duration of the contract, the date of payment of the loan, the APR[[3]](#footnote-3), the costs of debt collection activities, etc. Some credit agreements also contained provisions significantly limiting the customer's rights, e.g. the right to change the content of the agreement without the consumer's consent, charging fees for contacting the customer, additional costs of termination of the agreement etc. In 30 surveyed companies, UOKiK detected over 207 violations of law related to loan agreements and information forms provided to clients [UOKiK, 06/2013].

UOKiK also analyzed advertisements broadcast by loan companies (e.g. on TV, radio and on the Internet, on leaflets, posters and in the press)[[4]](#footnote-4) in terms of the occurrence of unfair practices, i.e. in the active form - presenting false information or passive form - concealing true, desired information [UOKiK, 05/2013]. The main irregularity was the suggestion in advertisements (by means of the slogan ‘without BIK’) that no analysis of the borrower's credit risk is made upon granting a loan. The President of UOKiK stated that if companies do not check their clients in the Credit Information Bureau (BIK)[[5]](#footnote-5) and assess credit risk in a different way, they deliberately mislead the recipient by suggesting that they grant a loan to anyone who requests it. Frequent practice has been to misrepresent the loan company as 'cheapest' or 'the only one available' on the market and to conceal key information about the cost of borrowing (e.g. by short displaying the information in TV commercial or printing it in small print). In total, 23 of the 25 companies surveyed had breached fair advertisements practices.

1. **The impact of law changes on the non-bank loan institutions in Poland**

The idea of introducing stricter regulations concerning the market of non-bank loans is part of the global trend to increase supervision of the financial market, which was ignited by the subprime crisis. The main reasons for regulating consumer loans [Waliszewski, 2017] are:

a) asymmetry of information between the lender and the borrower, leading to adverse selection (before the conclusion of the contract) or to the temptation of fraud (after the transaction);

b) high transaction costs;

c) an unequal legal position between a loan company and an individual consumer;

d) the relevance of the loans for economy from a macro- and microeconomic point of view;

e) occurrence of breaches of client interests by loan firms.

The ‘closing’ of legal loopholes in the Polish financial sector was addressed, among others, by the Financial Stability Committee [ZPP, 2015]. The Consumer Credit Act, amended in 2015, defines the notion of a loan institution, defines its legal form (a capital company), the minimum amount of share capital (PLN 200.000) and limits on the punishability of management board or supervisory bodies members.

Chart 1. Maximum level of the total cost of a loan as a % of the loan amount

Source: Own elaboration on the basis of the Act amending the Act on supervision over financial market and some other acts and the report ‘Rynek firm pożyczkowych’ (P. Miliński, M. Żmudzin, NWAI Dom Maklerski, Warsaw, 2016).

 Since March 2016, amendments to the Civil Code and the Act of 12 May 2011 on Consumer Credit have been in force, introducing the maximum value of interest on granted loans and credits. If the interest is not specified, statutory interest amounts to the National Bank of Poland (NBP) reference rate + 3.5 percentage points (p.p.). Maximum interest may not exceed twice the amount of statutory interest [Dz.U. 2015, poz. 1830, art. 2, pkt 1][[6]](#footnote-6). If the debtor does not repay the loan on time, the creditor may demand interest for the duration of the delay. If interest for delay is not given in the contract, statutory interest for delay shall be due at the NBP reference rate increased by 5.5 p.p. Maximum interest for delay may not be higher than twice the above mentioned statutory interest for delay [Dz.U. 2015, item 1830, art. 2, pkt 2]. Non-interest-bearing costs (so far constituting a significant part of the cost of loans) were limited to 25% of the total loan amount and 30% of the loan amount per year [Dz.U. 2019, poz. 1083, art. 36a]. Therefore, non-interest bearing credit costs over the entire loan term cannot exceed the total loan amount, as shown in Chart 1.

To sum up, loan companies may now charge consumers 10% of the annual percentage points and an additional amount of up to 55% of the loan value per year, while the maximum amount of non-interest charges may not exceed the loan value. The changes in the law are summarized in Table 1.

Table 1: Changes in the law in the period 2015-2017 affecting non-bank loan institutions

|  |  |  |
| --- | --- | --- |
| **Date of entry into force** | **Legal basis** | **Fundamental legal changes** |
| 11.03.2016 r. | Act of 5 August 2015 amending the Act on supervision of the financial market and certain other acts (“anti-usury act, pol. *‘ustawa antylichwiarska’*) | * the definition of 'credit institution'.
* requirements as to the amount of share capital and the form of business activity
* prohibition of punishability of persons exercising control over the company
* maximum amount of non-interest-bearing credit costs
* maximum amount of total credit costs
 |
| 1.02.2016 r. | Act of 15 January 2016 on the tax on certain financial institutions | * “Bank Levy’ refers to loan institutions with assets over PLN 200m.
 |
|  | The Act of 23 March 2017 on Mortgage Credit and Supervision of Mortgage Credit Intermediates and Agents | * Public Register of Loan Institutions at the Polish Financial Supervision Authority
 |

Source: Own elaboration

The above changes enforced changes in the offer of loan institutions. According to the ZFP survey, more than half of the surveyed companies had to change their loan offer within 3 months after the change of law [ZFP, 2016]. In 2016, the share of short-term loans offered decreased by 12 percentage points[[7]](#footnote-7) and the share of long-term loans increased by 10 p.p. y/y [Kozioł, 2017]. Previously, the main revenues of loan companies came from very high non-interest bearing costs (e.g. costs of outcalls / home credit services). The reduction of loan costs resulted in lower profitability of outcalls, whose share in the offer of loan companies decreased[[8]](#footnote-8), giving way to internet loans with much lower service costs but higher loss ratio [Markowski, Tymoczko, 2018]. It is worth noting that the loss ratio of the loan portfolio (share of unpaid receivables) in the loan sector is much higher than in banks[[9]](#footnote-9), which justifies higher total loan costs in relation to the banking sector. Loan companies try to cover their losses, due to write-offs of non-performing assets[[10]](#footnote-10), mainly with non-interest bearing costs. Further statutory reductions of these costs may make the lending business unprofitable[[11]](#footnote-11) or may lead to a significant reduction of its scale.

 The reduction of maximum loan costs and the extension of the average repayment period led to a decrease in the revenues of loan companies. As many as 42.5% of the surveyed companies confirmed that their financial situation deteriorated [ZFP, 2016]. The CEO of Provident's owner announced that the direct reason for the decrease in the company's revenues in 2016 by 6% y/y were legislative changes, which forced, among others, reduction in employment and cost optimization [http://media-provident.pl/, 2017].

 The law changes also affected the strategy of managing overdue loan portfolios. Prior to the introduction of the loan cost limit, due to late repayment, it was worthwhile for lenders to process debt collection and additionally charge customers for this action. After the law has changed a new trend was born among non-bank loan companies – it is called securitization[[12]](#footnote-12).

 The legislator expected that the changes in the law would result in lower loan costs, greater confidence in the lending sector and fewer abuses and complaints from consumers [Waliszewski, 2017]. However, according to some experts, the same results could have been achieved by other actions, e.g. [Szpringer, 2015]:

a) increasing the information requirements of financial institutions vis-à-vis consumers;

b) reducing social exclusion;

c) implementing measures to prevent over-indebtedness of society;

d) promoting the free market while protecting consumers' rights.

 In December 2016 The Ministry of Justice published a draft amendment to the Polish Penal Code (pol. *Kodeks Karny*), which provided for a limit of non-interest-bearing loan costs of 20% per year (instead of 55%). In the explanatory memorandum to the draft law amending certain laws to counter usury, it was written that usurious loans, which prey on poverty and human drama, and often also on the credulity of the elderly people, remain a shocking social problem [https://www.ms.gov.pl/]. By the time of publication of this article, these changes, considered by the industry to be very controversial, had not entered into force yet[[13]](#footnote-13). The Polish government had for a long time been proposing to reduce the non-interest-bearing costs of loans to 45% (from 55%), but on 18 June 2019 it adopted a surprising bill restoring the previously planned limit of non-interest-bearing costs of 20%. The Polish Union of Loan Institutions declared that the proposed regulations would eliminate the legal and supervised lending market in Poland and would also cause [businessinsider.com.pl/, 2019]:

1. development of non-contractual loans in the grey market and pawnshops for the most desperate consumers,
2. attempts to circumvent the limit by complicated legal constructions or foreign structures,
3. increasing financial exclusion by cutting consumers off from the possibility of taking out a legal, small, short-term loan that banks do not offer due to insufficient creditworthiness.

Discussions on the regulation of the market in credit institutions often raise the issues of numerous limitations of credit costs and stricter penalties for credit companies, but almost completely ignore the need for universal consumer education and raising consumers’ (legal) risk awareness. Low level of financial and legal knowledge of the society causes that consumers more often fall into the so-called ‘debt spiral’, when the costs of borrowings exceed consumers’ income. The most common reason for this is the inappropriate, often ill-considered consumption of the loan institutions’ offer. This phenomenon is often exacerbated by a pushy marketing message from loan institutions, emphasizing easier access to loans than in banks, but not showing the risk associated with potentially higher costs of these loans.

1. **Legal regulations for loan institutions in selected European countries**

 In 2014, maximum credit cost regulations existed in most European countries. According to the World Bank, interest rate caps on loans were introduced to protect consumers from unfair practices of lending companies, to prevent them from falling into debt and to reduce the problem of financial exclusion [Maimbo, Henriquez Gallegos, 2014]. It seems that changes in Polish law, such as limiting the maximum credit costs, do not result from the specificity of the local market, but are part of a common trend, examples of which are presented in this chapter.

 In 2015, Slovakia banned cash loans by eliminating the possibility of home servicing [www.bankier.pl, 2015] and introducing the obligation for loan companies to hold licenses granted by the National Bank of Slovakia and restrictions on the legal form and minimum capital[[14]](#footnote-14). Employees of loan companies may maintain direct contact with customers only on working days until 6 pm [Szołuch, 2015]. Provident Financial board member Aleš Janek stressed that the withdrawal of cash loans would have a negative impact on the situation of the lending sector, as many customers did not have or did not want to use a bank account or wait any longer for a loan [https://www.investujeme.sk, 2015]. A year after this statement, International Personal Financial, the owner of Provident Financial, decided to completely withdraw from the Slovak market [https://spectator.sme.sk, 2016]. The regulatory changes caused the withdrawal of about 80% of loan companies from Slovakia [Instytut Staszica, 2019].

 In the United Kingdom, the law on loan companies has also been tightened. British institutions must have a license obtained from the Office of Fair Trading - British Office of Competition and Consumer Protection [Szołuch, 2016]. In 2015, the British Financial Conduct Authority (FCA) introduced limits on the maximum cost of loans to 12 months - max. 100% of the loan amount, and the daily cost - max. 0.8% of the loan amount. Collection fees for late repayment may amount to a maximum of £15 [Szelągowska, 2015].

 In Latvia, there is no limit to the maximum cost of a loan, but since 2011, loan companies have to hold a license from the Latvian Consumer Protection Centre, at a cost of approximately EUR 70.000. The minimum share capital of a loan company is EUR 426.000. As a result of the new regulations, the number of companies operating on the Latvian loan market has decreased [Szołucha, 2016].

 According to the German banking law (ger. *Kreditwesengesetz*), loans can only be granted by banks. However, there are many credit intermediaries in Germany that provide financial advice and mediate loans [Szołucha, 2016]. The maximum loan costs are not legally sanctioned there, but the emphasis is on transparency and comprehensibility of credit agreements. However, it is assumed that the maximum cost of a loan is up to twice the average consumer loan rate calculated by the ECB [Szelągowska, 2015].

1. **Summary**

The specificity of the loan company market is that the regulatory environment, rules of conducting and financing operations and the method of sale are completely different for loan companies than for banks (despite the fact that their loans resemble bank loans). Until recently, this market was not supervised, which, combined with unethical actions taken by some entities, cast a shadow over the reputation of the entire market. Legislative control became a challenge for those loan institutions that had based their activities on the vision of quickly obtaining the highest possible margin from loans.

The trend of tightening the regulation of loan institutions, mainly in terms of maximum costs and interest rates, is global. The reasons for the tightening of the law were unfair practices of some loan institutions, very high loan costs, lack of clear information on the structure of loans and violation of consumer rights. Although the new regulations were supposed to benefit consumers (e.g. by lowering the maximum cost of loans and protecting them from usury and falling into a ‘debt spiral’), they may result in a significant drop in the profitability of the lending industry and a decrease in the supply of loans, which paradoxically may further exacerbate the financial exclusion of those parts of the population who will not be financed by banks due to their low creditworthiness. An example of overregulation is the ban on cash loans introduced in Slovakia in 2015, which caused the exit of Provident, the largest local loan company, from this country. Unfortunately, the discussion about non-bank loans often forgets that the origins of social problems related to over-indebtedness are not usually caused by insufficient regulation of the loan company market, but above all by the lack of sufficient financial and legal education of consumers.

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1. According to the data from Polish Central Statistical Office (pol. *Główny Urząd Statystyczny*, GUS), the total value of loans and credits granted in 2017 by the loan companies loans in cooperation with credit intermediaries amounted to PLN 45.9 bn. For comparison, receivables from the non-financial sector in Poland in 2017 totalled PLN 976 bn. [Markowski, Tymoczko, 2018]. [↑](#footnote-ref-1)
2. On 30.01.2019, there were 430 entities in the register. [↑](#footnote-ref-2)
3. Annual percentage rate; pol. *roczna rzeczywista stopa procentowa*, RRSO. [↑](#footnote-ref-3)
4. The specificity of the loan institutions industry at that time was that few companies used TV spots. Most lenders preferred marketing channels such as the Internet and the press. Interestingly, many of them advertised anonymously - not giving the name of the company, but using slogans such as ‘momentary loans’, ‘no BIK’ (no creditworthiness check in any credit agency), ‘quick money transfer’ etc. [↑](#footnote-ref-4)
5. Pol. *Biuro Informacji Kredytowej*, BIK, which acts as credit reporting service. [↑](#footnote-ref-5)
6. Pol. *Dz. U.* means Journal of Laws. [↑](#footnote-ref-6)
7. The '500+' programme, introduced by the Polish Government in April 2016, could also have contributed to the decline in demand for short-term loans. [↑](#footnote-ref-7)
8. In 2010, 73.5% of loans granted by non-bank loan companies were home serviced loans, and in 2017 this share decreased to 26.4% [Markowski, Tymoczko, 2018]. [↑](#footnote-ref-8)
9. Loans with late repayment of instalments (exceeding 90 days) constituted 12.1% of the number of loans granted in 2016-2017 by Polish non-bank loan companies; in the case of Polish banks the ratio for cash loans amounted to 4.3% [Markowski, Tymoczko, 2018]. [↑](#footnote-ref-9)
10. Non-performing loans and credits are called NPLs. [↑](#footnote-ref-10)
11. The average return on assets (ROA) of the sector of non-bank loan companies in 2017 amounted to 3.20% and was still higher than in the case of banks (0.8%) [Markowski, Tymoczko, 2018], [PZIP, FRRF, 2019]. [↑](#footnote-ref-11)
12. In the Polish reality, securitisation of non-performing loans (NPLs) consists in their sale (for a fraction of the nominal value) to non-standared closed-end securitisation funds (pol. *NS FIZ*) serviced by debt-collecting companies. The main sellers of non-performing loans in Poland are banks, which may recognise tax deductible costs in such a sale only if the buyer is a securitisation fund. [↑](#footnote-ref-12)
13. The project was considered very restrictive and its implementation could lead to a paralysis of the loan market. The potential effects of these changes were evidenced by the reactions of stock market investors - shortly after the publication of the draft bond the price of IPF Investments Polska bonds (a company related to Provident Polska) of the IPP0620 series (with a total nominal value of PLN 200m) decreased from 97% to 73% of the nominal value. [↑](#footnote-ref-13)
14. Legal regulations introduced in July 2017 on the Polish market are similar to some restrictions operating in Slovakia - e.g. establishment of a register of loan institutions, introduction of a minimum limit on the amount of share capital and limitation of legal forms of conducting business activity by loan institutions to joint-stock companies and limited liability companies. [↑](#footnote-ref-14)