EFFECTS OF INTEREST RATE CAP ON INSTANT LOAN MARKET IN FINLAND
Bachelor’s Thesis

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I declare I have written the bachelor’s thesis independently. All works and major viewpoints of the other authors, data from other sources of literature and elsewhere used for writing this paper have been referenced.

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ABSTRACT

Short-term, unguaranteed loans have quickly integrated into Finnish credit markets. Legislation on quick loans have been amended several times since they first appeared. The aim of this bachelor’s thesis is to examine, how the implemented interest rate cap has affected instant loan companies and the products they offer. This study was conducted with quantitative approach. Data consist of lending register held by Regional State Administrative Agency, Statistics from Statistics Finland, essential government proposals and legal initiatives and product information gathered from the loan companies’ website.

Results of the research indicate that the interest rate cap has significantly decreased the amount of instant loan companies. The most common product in the market after the regulatory change is flexible credit with adjustable loan amount and payback period, but the companies also offer short- and long-term instant loans. After the interest rate cap became effective, the average loan amount has increased and payback period extended significantly. At the same time, the expenses to credit ratio has decreased and the euro amount and number of new loans have decreased compared to the time before the regulation.

According to the results can be stated, that the legislative changes have had clear effects on instant loan market. Since the granting of credits has decreased, only part of the borrowers can take advantage of cheaper credits. With the changed features of products, instant loans have moved closer to the regular consumer credit.

Keywords: consumer credit, instant loan, short-term loan, interest rate cap, interest rate regulation
INTRODUCTION

Despite the short history, payday loans have attracted a lot of discussion and criticism among the providers, users, media and legal authorities in Finland. There is no precise information about when the instant-loan market was established, but multiple sources indicate that first companies appeared in 2005 and after that there has been rapid growth within the industry. According to Statistics Finland, in 2012, over 1,5 million short-term loans were granted and the number of companies operating was around 80. The greatest concern related to the industry is the number of low-income customers accounted as borrowers and the following problems linked to the loans. Moreover, the high price of the loans and responsibility of the actors in the field is questioned.

Due to the rapid growth and the consequent pressure from the public, the Finnish parliament has renewed the laws related to instant lending repeatedly in the last two decades. For example, the Act on Registration of Creditors (RA) forced the companies to have a registration in the creditor register to conduct lending business, Criminal Law has been updated and Consumer protection act has been revised several times. Most recent and crucial amendment made regulations for a maximum annual percentage rate of charge (APRC), allowing the maximum annual rate for loans below EUR 2000 to be 50 percentage points added to the reference rate according to the law (CPA 38/1987 7:17a). The aim of the procedures has been to better monitor the actions of the lenders and the market, and to improve the situation of the borrowers. Four years after the amendment to the law, the lenders and borrowers have readjusted themselves to the current situation.

The research is conducted using quantitative methods, to point out the effects of regulation in the instant loan market. The research contains chosen cases, through which the author tries to identify and explain the current situation in instant loan market. The aim of this thesis is to gain an understanding of the industry and the effects of the aggressive changes in legislation with the intention to reduce the number of lenders and amount of loans granted.
Quantitative method is justified, since the outcome of the research is based on statistics and significance test, to present reliable results.

The aim of the research is to become familiar with the actions of the instant loan providers and the general legislation affecting the industry. Further, to find out how the recent changes in legislation has affected the number of companies operating in the field and the product range the companies offer after the change. Eight relevant hypotheses are constructed to research the changes from statistical point of view. If the interest rate cap is effective:

- The euro amount of new granted credits decreases
- Number of new granted credits decreases
- Average loan amount increases
- Payback period extends
- Expenses related to new credits decreases
- Expenses to credit ratio of loans decreases
- Euro amount of credit portfolio decreases
- Number of companies decreases significantly

However, limitations of the study are the effects of change in legislation to the consumer behaviour, as well as the profitability of instant loan companies and further analysis of the legislation regarding the industry.

The literature of the research is divided to four sections. The size of the industry and number of lenders in Finland is studied with the help of the creditor register provided by Regional State Administrative Agencies (AVI). The literature contains information about 31 companies operating in instant lending business. The types of products the companies offer after the change in regulation, as well as the current interest rate, loan amount, payback period and specific terms of such credits are gathered from the web sites of the companies. The aim is to find out, how these reflect the change in regulation.

Second part of the literature is statistics provided by Statistics Finland (SVT) related to instant loan companies. Statistics contain information gathered from the companies, including average loan amount, number of new credits granted, average repayment period, credit portfolio and expenses related to the credit. Statistics Finland has gathered information quarterly since the beginning of 2008, which is used to review the product range. Further, the current situation is reflected to regulation of the industry and how it can possible shape the industry in the future.
Short-term loan industry is relatively young and research made of the field is limited. Nevertheless, a few individuals have researched the topic, mainly from legal perspective. Pönkä and Parkkali (2010) have made comprehensive research on legal problems of short-term credit, whereas Länsineva (2010) has viewed the regulation of instant loan lenders in relation to the basic rights of an individual. Tapani (2010) has reflected the amendment of criminal law to the operations of instant lenders. Määttä (2010) has made a review of the regulation of instant loans from a legal perspective. Juurikkala (2012) has presented divergent opinion about the functionality of the interest rate cap and proposed different solution to the problem.

On the other hand, interest rate restrictions have been studied on international level from different aspects. The effect of interest rate restrictions and its implications has been researched in EU-level extensively (iff/ZEW, 2010). In United States several studies are conducted, for example Villegas (1982), Peterson (1979) and Teminin and Voth (2008) have studied the impact of interest rate restrictions to credit market. DeYoung and Phillips (2013) and Zinman (2008) have studied the interest rate restrictions related to short term consumer credit. Most of the research is related to the equivalent of instant loans in America, to payday loans, but gives an insight into the interest rate restrictions made Finland, and the possible consequences it might have. In addition, related legislation, government proposals, documents and reports are used when conducting the research.

In addition to an introduction, the thesis has four chapters. Second chapter is about short-term loans as a product, essential legislation related to the industry and the amendment made to the regulation. Further, a closer look to the interest rate cap as a regulatory factor and the effects it has towards the short-term loan market. In third chapter, methodology and research material is explained. First, the impact of regulation towards the number of companies and then the change in products and features of the product the companies offer. Also, a t-test is conducted to show the significance of changes after the regulation. Last chapter collects together the main points of the research, reviews the results of the research, and provides a conclusion of the research.
1. THE REGULATION OF SHORT-TERM LOANS AND THE INTEREST RATE CAP

1.1. Short-term loan as a product

The consumer loan portfolio of Finnish households was about 14 billion in August 2015, of which the share of short-term loans was around 100 million (Suomen Pankki 2015, SVT 2015). Short-term financial need is usually fulfilled by using credit card or instalments, since getting a small loan from a bank might be time consuming and not available for everyone. Short-term loans were invented to fill that gap, to provide the small financial aid which was troublesome to obtain. There is no official legal term for short-term loan in Finland, but among legal scholars and legislators the definition of Määttä (2010, 265) is used where the short-term loan is quickly achievable, unsecured, less than three months, minor consumer credit, and which is attainable via internet or text message. The amount of short-term loan is typically from around 20 euros to couple hundred euros, and the price is based on fixed costs rather than variable interest rate. Obtaining the credit through computer or mobile devices is easy and fast, and the loans are not bound on buying commodities. Depending on the amount of loan and payback time, the annual percentage rate varies from around 200 to over 1000 percent (Valkama, Muttilainen, 2008, 14). In terms of annual percentage rate, short-term loans are very expensive compared to conventional consumer credit. Before the interest rate cap, the average APRC of short-term loans averaged 920 percent (HE 78/2012).

Credit card is considered as a form of consumer credit granted by the bank or financial company. The amount is unsecured and starts from one thousand euros, which the consumer can use to pay the bills. Depending on the lender, the cost of credit varies. The cost consists of the credit interest including the reference rate and the marginal, annual fee, and billing fee. Payment of the loan is possible in instalments or in full by the due date of the credit. The interest rates of credit cards vary from less than ten percent to a few tens of percent (Suomen rahatieto,
To obtain a credit card, the consumer should be adult, have fixed income and no payment default entries. (Danske Bank, 2017)

Another way to finance short-term needs is through hire purchase. Hire-purchase refers to a system by which one pays for a commodity in regular instalments from which one or more of the instalments is paid after the commodity is handed over to the customer. Further, the seller has reserved the right to take back the commodity or hold the ownership until the commodity is paid (CPA, 38/1978, 7:7). Pricing in Hire-purchase is similar to the one in credit cards and the requirement for fixed income is common.

Municipalities in Finland have voluntary option to give social credit to inhabitants. The purpose of social credit is to prevent economic exclusion, over-indebtedness, and encourage independent living. Target group for this service is low income, underprivileged individuals, who are otherwise excluded for getting a reasonable loan, but who can pay back the social credit (Ministry of Social Affairs and Health, 2017, Makkonen, 2010, 118). Considering the financial situation of municipalities, cost of credit and the amount of work required to provide such services, the target group of social credits is narrow. Social credit should be considered as a part of social security rather than free financial markets.

Closely related product to short-term loans is called a payday loan which is popular in United States. In traditional payday loan, the borrower will write a future dated check to the lender. For example, a check for 235 dollars in exchange for 200 dollars, which the borrower gets in advance. Usually the period for the check is two weeks or until the borrower’s next payday, when the lender gets the borrowed amount back and a reward of 35 dollars. In many cases, the borrowers pay only the financial charge, renewing the loan for another two weeks. Similarities to the Finnish short-term loans are that the loan is granted fast, it is unsecured and for a short period, and high annual percentage rate of charge. Unlike the short-term loans in Finland, payday loans are usually acquired from offices, or in other words, pawnshops. Payday lending is a relatively new business: At the beginning of 1990s, there were less than two hundred payday loan offices but in 2001 the number was already about 10000 (Caskey, 2002).

Similarities among the products of consumer credit are short time period, pricing strategy and the use of the product. Social credit is very limited form of credit and available only for few people. Credit cards and hire purchases require fixed income, and in many cases an assurance before it is granted. That is why they cannot be considered as a direct alternative.
for instant loan. Compared to more traditional form of consumer credit, instant loans take advantage of technology, which makes the granting and taking a loan simple and fast.

1.2. Essential regulation of the industry

Arrival of the instant loans to the consumer credit market created a need to evaluate and amend the current regulation. Jakobsson (2007) has studied consumer credit from the perspective of marketing regulations and consumer law. Määttä (2010) has discussed the main points of the reform: announcing the annual percentage rate of charge, whether the business is usurious and the identifying of borrowers. Tapani (2010) has studied the reforms made in Criminal law, for improved suitability to consumer credit. Pönkä and Parkkali (2010) as well as Määttä (2010) present the current state of legislation regarding consumer credit. Thus, deeper examination of the legislation is not necessary, although review of the essential regulation is justified for better understanding of the topic.

Instant lending is all about the short-term credit offered to consumer by the lender. Therefore, the substantive regulation is CPA 38/1978. Because the providers of instant loans do not accept deposits, the Credit institutions act 610/2014 does not apply to instant loan companies. Since the marketing rules of chapter seven of CPA does not apply to instant loans, Chapter two and three of CPA is used to set the general boundaries to the marketing of instant loans (Makkonen, 2014, 98). The provision prohibits the objectionable and misleading marketing (Jakobsson, 2007, 159). Loans acquired by mobile devices are regulated by the chapter six of CPA 38/1978. Further, the chapter seven of the CPA 38/1978 specifies the regulations of loan acquired through mobile devices. This is because the short time period of the loan. The borrower has the possibility of revoking the credit within 14 days from the conclusion of the agreement (CPA 38/1978, 7, 20).

The interest act (633/1982) determines the amount of interest on arrears. The lender can charge interest for late payment corresponding to the credit interest rate after the expiration for 180 days. This is so that the failure to pay would not be profitable for the borrower (Interest act 633/1982). Contribution of Criminal law 39/1889 regarding instant lending is to prohibit and prevent extortion. National Bureau of Investigation investigated instant loan creditors during 2008. Investigation released instant loan creditors from suspicion of extortion (Jarva, 2010, 4). The need for penal regulation has been criticised regarding instant lending business. For
example, Pönkä and Parkkali (2010, 598) highlight that Criminal law should not be the primary means of dealing with problems on instant loan market. Distortions should be corrected through consumer law and only as a last resort, to rely on Criminal law.

1.3. Amendments of the regulation related to short-term lending

Legislation concerning instant lending has been amended several times: February and December 2010 and 2013. The first amendment created new restrictions and liabilities to instant lenders, such as prohibiting the night-time lending and broadening the identification of the consumer. Further, notification of annual percentage rate of charge was extended to reach instant lenders and Criminal law was updated, so that unreasonable costs would be assessed in relation to creditor’s performance. Amendments were presented in government bill to Parliament HE 64/2009.

The objective of the second amendment was to implement the EU Consumer Credit Directive (2008/48/EC). Chapter seven of CPA was comprehensively reformed, including creditor’s obligation for assessment of consumer’s creditworthiness and regulation on good lending practice. Further, an obligation of registration for all consumer creditors (747/2010) was implemented and supervision system was established. In addition to the EU directive, reform to the regulation on national level was carried out, because of the problems detected with the instant loans. (HE 24/2010, Makkonen, 2014, 98)

Third amendment regarding instant lending was introduced in 2012, where obligation of assessment of creditworthiness and regulation on good lending practice was tightened. The most essential amendment, also included in the CPA’s chapter seven was the price regulation. In other words, interest-rate cap: “In cases wherein the consumer credit amounts to less than EUR 200, the actual annual percentage rate of interest must not exceed the reference rate under section 12 of the interest act plus 50 percentage points” (CPA 38/1978 7:17a).

The interest-rate cap entered force in June 2013. According to the government proposal HE 78/2012, aim of the amendment is to provide consumer credit on more reasonable terms and to decrease debt problems. It is expected that the amendment reduces the supply of instant loans significantly. Länsineva (2010, 1055) has criticised that the amendments made before interest-rate cap have been technical fine-tuning of the regulator and the cap can be considered as a powerful regulatory way.
1.4. Interest rate cap as a regulatory factor

Interest rate restrictions as a term refers to all rules that limit the price of credit contracts in consumer credit markets (iff/ZEW, 2010, 29). Opinions on regulation remains controversial. Opponents argue that the regulation has damaging consequences and the caps exclude higher risk borrowers from being able to obtain credit or develop a credit history. On the other hand, defenders argue that caps prevent naive borrowers from agreeing to loan terms on which they will eventually be forced to default, and that the cap reduces the interest rates a given borrower pays because lenders have market power. Further, it is argued that usury restrictions can be Pareto-improving if income shocks are mainly temporary and idiosyncratic. (Rigbi, 2013, 3, Termin and Voth, 2008, 743).

Institute for Financial Services and Centre of European Economic Research (iff/ZEW, 2010) have made an extensive study on interest regulatory methods and their effects on Member States of European Union. In 2010, 14 out of 27 states had either relative or absolute interest rate cap. Countries which use relative interest rate ceilings based on an average market rate, multiplied by quota or based on a money market rate multiplied by four, have developed highly effective systems. On the other hand, Countries with absolute ceiling, Malta, Ireland and Greece, does not seem to have achieved much impact through the ceiling. Too many exemptions have been made to the regulation, which has lowered the effectiveness (iff/ZEW, 2010, 44).

Interest rate ceilings have been implemented in many ways and the variance between the allowable interest rates is relatively high. For example, in Spain the ceiling is applied only to overdraft credit and protected housing loans. Some countries have constrained the ceiling to certain institutions, like in Ireland to credit unions and moneylenders, and in Greece to non-banks. In France, the cap varies from 5,72 percent to 21,63 percent, whereas in Slovenia the cap ranges from 453 percent for small loans to 13,2 percent for a long-term loan (iff/ZEW, 2010, 5). There is no specific regulation reportedly in any state in European Union. Among Nordic countries, Finland is the first one to regulate instant lending so aggressively. In Denmark, the interest rate cap has been discussed due to the increase of instant lending, but the proposal has not been officially introduced and no legislative measures taken. In Sweden and Norway, there is no restrictions regarding interest rates on small loans. All though in Sweden, there are some legal measurements regarding small loans in Consumer protection law (iff/ZEW, 2010, 416, HE 78/2010).
In 2009, the incumbent Minister of Justice answered to a written question that the interest rate cap is not necessary and the regulation of instant lending is executed by another means (KK 873/2009). Already in December 2011 a work group was assigned by Ministry of Justice to changing laws of instant credit, which issued the report in April 2012. The work group suggested two options for the implementation of expense regulation, both for credits below 1000 euros. First option was interest cap combined with expense regulation where in addition to APRC of 31 percent the creditor would be entitled to charge additional expenses related to granting the credit. Second option was a model, where APRC would be reference rate plus 35-49 percent. The work group ended up proposing the alternative two, because of greater support (Ministry of Justice Publication 17/2012, 30/2012). In the follow-up preparations, the applicable limit was raised to 2000 euros. This was to avoid transition to larger supply of credit, which could increase the debt problems of consumers. Further, it was assumed that the credit risk would decrease due to the higher threshold. In addition to the threshold, interest rate cap was raised to 50 percent, to not unreasonably restrict high credit risk customer’s access to credit (HE 78/2012).

Numerous parties presented their opinions on the interest rate cap. Ministry of Social Affairs and Health, Ministry of Economic Affairs and Employment, District Court of Helsinki and Financial Supervisory Authority considers the proposal essential. Ministry of Finance proposed that the economic impact should be accurately estimated. Finnish Competition and Consumer Authority is worried that the decrease of the activity, part of the operations might go towards black economy. According to Finnish Small Loan Association the proposal should be prepared again and pay attention to the problems prohibition might cause (Ministry of Justice Publication 30/2012). Juurikkala (2012) has presented an interesting opinion, where he proposes a reflection period of 2-3 days before applying the loan instead of strict interest rate cap. He argues that interest rate cap causes distortions and is cumbersome regulatory instrument. Reflection period would reduce the psychological problems related to instant loans arising from the ease and speed of acquiring them. According Pönkä and Parkkali (2010), interest rate ceiling should be viewed with caution. They highlight that powerful restrictions might transfer the supply of credit to black market and suffocate the existing market. It is also conceivable, that adjusting the interest rate ceiling would limit too sharply the credit markets, in which the primary assessment of interest rates is demand (Pönkä and Parkkali, 2010, 600).
Functionality of interest rate cap depends on details and circumstances, but according to the study made by iff/ZEW (2010), revealed preferences do suggest that the APR is the most appropriate rate that is used and unified in all EU Member States. This is because fees and charges are part of the cost for the borrower. Further, majority of respondents favoured different ceilings calculated for different credit types as opposed to a single ceiling applicable to all consumer credit (iff/ZEW, 2010, 132). It can be stated that in Finland, the legislature has succeeded implementing the interest rate cap. Obligating the companies to announce the annual percentage rate of charge, was already a step to right direction. It helps the consumers to realise the credit risk for the constant use of instant loans (Pönkä and Parkkali, 2010, 595). The group working on the renewal of instant loan regulation justified the model based on annual percentage rate by its simplicity, reduction of problems of interpretation and requirement of fewer government resources compared to the interest rate and cost ceiling model (Ministry of Justice Publication 17/2012). On the other hand, the model of annual percentage rate has faced criticism being misleading, especially if the compared products differ. Määttä (2010, 266-267) argues that instant loans and other consumer credit are not comparable, due to the differences in loan period. Also, instead of comparing the products, the nature of delivery and handling costs of the loans should be considered. (Määttä, 2010, 279) Even though instant loans and other consumer credits cannot be compared with the help of APR, it improves the comparison between the first mentioned loans (Pönkä and Parkkali, 2010, 569).

Despite the extensive study made regarding the interest rate regulation, absolute ceiling was chosen. The limit of 1000 euros in the preparation phase was raised to 2000 euros and loans above the limit were exempted from the regulation. Lower interest rate ceiling was not considered necessary, as is assumed, that in the highly competitive credit market, the annual percentage rate of charge will remain lower in bigger and longer credits (HE 78/2012).

1.5. Impact of interest regulation to the credit market

Interest rate restrictions are among the oldest and most prevalent forms of economic regulation (Glaeser and Scheinkman, 1998, 1). Studies about the effects of the regulation to payday loans have been mainly studied in United States, where states can independently regulate the payday markets. Pew Charitable Trusts (2012) have identified three categories of state payday loan regulation. Permissive states are least regulated and allow initial fees of 15
percent of the borrowed principal or higher. Hybrid states are a little more tightly regulated, having rate cap, restrictions on the number of loans or allowing multiple pay periods for borrowers to repay the loan. Restrictive states prohibit or have price caps low enough to eliminate payday lending in the state. Restrictions in United States are not directly comparable to the restrictions made in Finland, but similarities between the regulations of instant and payday loan markets can be found.

Various studies with different viewpoints have been conducted related to interest rate regulation. DeYoung and Phillips (2013) have made an extensive study on interest rate restrictions on payday loan market in Colorado for a seven-year period. Results from the study indicate that the prices of the loans moved towards the price ceiling over time. The strategies in payday loan market changed during the period, from competitive low prices, towards more strategic pricing depending on location and target group. Rigbi (2013) found out in his research that interest rate restrictions do not deliver the outcomes that have been their main premise. Although higher interest rate limits have only slightly increased the interest which borrower must pay compared to cases with more stringent regulation of interest rates (Rigbi, 2013, 23). On the other hand, some of the researchers have discovered that interest rate restrictions have effectively decreased the price of consumer credit (Peterson, 1979, 39-40, Termin and Voth, 2008, 755). Can be said, that the effects of restrictions on interest rate vary, and depend on the severity and the way of implementing the restrictions.

Price regulation has been found to affect the supply of credit. DeYoung and Phillips (2013, 144) stated that the reduction of competition is part of the reason of rising prices in certain payday loan markets. In Australia, the interest rate cap based on maximum annual percentage rate of 48 percent, has been found to decrease the number of instant loan providers in states where the cap is in force (Government of Australia, 2011, 59). In addition, The Oregon policy change, entering force July 2007, constrained consumer loans under $50,000, capping the fees and charges of $100 loan to approximately $10, with minimum loan term of 31 days. Six months prior to the policy change, there were 346 licensed loan providers. The number dropped to 105 providers seven months after the change and further to 82, approximately a year after the policy change (Zinman, 2008, 6).

Overall, interest rate restriction has not been found to substantially reduce consumer lending (iff/ZEW, 2010, 238). Termin and Voth (2008, 744) observed in their study, that the stricter interest rate limit creates discrimination among borrowers, favouring high income
individuals and cutting off smaller borrowers bearing higher risk. Also, Study made by Villegas (1982, 953) concludes with an argument that by imposing rate ceilings, high-risk borrowers are prevented from obtaining a loan and going into debt. Further, in Zinman’s (2008) study, the before and after activity of lending was compared between Oregon and Washington, where only the first mentioned state implemented the cap. Results of the study show that payday borrowing decreased by 26 to 29 percentage points compared to Washington. Borrowers compensated the payday loans with other, more expensive credits (Zinman, 2008, 10). On the other hand, increasing the rate cap has increased the probability of granting the loan (Rigbi, 2013, 1).

Interest rate regulation do not only affect the availability, but also the product range in the market. Countries with strict interest rate regulation tend to have fewer different credit products in the market compared to countries with looser or non-existent regulation (iff/ZEW, 2010, 231-232). Termin and Voth (2008, 744, 750) discovered that average loan size and minimum loan size increased strongly. Also, preferences towards indirect, such as commodity-related credit increased if restrictions were strict. This is because such credit can be discounted and retailers absorb part of the risk (Peterson, 1979, 40).

Interest and price regulation causes various effects in the credit market. In many cases, effects are dependent on the regulatory approach. Low and moderate regulations may end up non-existent, whereas highly regulated market can cause significant changes. Especially in instant loan market, the pressure for regulation is enormous. Borrowers in the instant loan market have been found to be vulnerable and the products very expensive. Nevertheless, interest rate restrictions regulate the amount lenders can charge from the borrowers, considering the credit risk the borrowers may have. Regulations define if the market is profitable and in worst case scenario, small loans cease to exist.
2. EFFECTS OF INTEREST-RATE REGULATION ON INSTANT LOAN COMPANIES AND PRODUCTS

2.1. Methodology and material of the research

According to Aliaga and Gunderson (2002) quantitative research means explaining phenomena through numerical data which is analysed using mathematically based methods (Muijs, 2004). Quantitative method deals with numbers and logic, focusing on numeric data with detailed, convergent reasoning rather than divergent reasoning.

In the relevant study, Quantitative methods are used to analyse the effects the interest rate cap. The research is made from three perspectives. The effects of change are analysed through the number of companies operating in the industry. Second, the products the companies offer are researched. When appearing in the market, instant loan was a short-term, small amount, unguaranteed credit with very high annual percentage rate. Change in regulation forces the lenders to be creative and change the product in a way it fits to the new regulation. Third, the statistics are collected and researched to see how the regulation has affected the market. In perspective of companies and statistics, numerical data is provided to support the outcome. In case of products, according to the research made by author, the changes in products are explained clearly, to see the cause and effect.

To present the effect of regulation on number of companies, data has been gathered from the lending register made by Regional State Administrative Agencies (AVI) since it became effective in December 2010. Companies which offer consumer credit are required to register to the lending register, unless they belong to supervision of Financial Supervision Authority, offer credits only for buying commodities, or operate temporarily in Finland (747/2010). Reportedly there are no companies under supervision of Financial Supervision Authority and companies outside the lending register are not relevant due to increased regulation. Therefore, only the companies in lending register are regarded. The latest lending register was taken from the
website of AVI and the historical numbers of companies registered or removed from the register was obtained from an inspector by email, who is currently working in AVI. Total of 124 companies have been registered to the lending register from which the companies relevant for the research were separated.

Material about the products the instant loan companies offer were gathered one by one from the websites of the 30 currently operating companies registered in the latest lending register to ensure the reliability of the research. The information about the product range and the features of the products has been systematically gathered. The focus was in the type of credit, amount of credit, interest rate of the credit and payback period of the credit.

In addition to the lending register and product information, the statistics related to instant loan companies, provided by Statistics Finland, have been used. The statistics have been collected since the beginning of 2008 until the end of 2015. The whole period is used in the research. The statistics include the following categories: new granted credits, expenses related to new credits, the ratio of costs to credit, average payback period of new credits, credit portfolio, number of new credits and the average loan amount. Statistic Finland gathers the statistics independently, so the material can be considered reliable and used as part of the research. The categories have remained unchanged for the whole period, which makes them comparable. The data have been used in research to point out the significant changes in the light of statistics. To clarify the changes, charts are used to describe the effects and based on statistics, the t-test is made to compare eight quarters before and after the regulatory change to show the significance.

### 2.2. Companies

The companies involved in the study are gathered from the lending register. Since 2010, a total of 124 companies have been registered and 69 have been removed from the register. In 2017, 55 companies were registered. The register has been collected with the emphasis of instant loan companies, so majority of the companies provide consumer credit. In the latest register, 30 out of 56 are instant loan companies and the rest carry out other activities.

In December 2010, the Registration Act 747/2010 entered force with a transition period of six months to give time for the companies wishing to continue their operations to register. From Figure 1 can be observed that most of the companies were registered in the following
year, having almost 90 companies in the end of 2011. In 2013, the amount of removed companies is significant and is a result of the interest rate cap, which was implemented in June. After the end of 2013, the number of companies in the register has remained relatively stable. In 2016, the Registration Act 853/2016 was amended to include peer to peer lenders, but so far there is only one.

![Diagram showing the development of the lending register]

Figure 1. Companies in the lending register
Source: (Regional State Administrative Agencies).

The laws that came into force in 2013, especially the interest rate cap, have been most significant changes related to instant loan industry in recent years. The number of companies has reduced, even though there have not been any other strong factors affecting the industry. That is why the interest rate cap can be considered as the reason behind the decrease in numbers. The interest rate regulation has concentrated the market from 100 to around 30 companies, and made it easier to control.
2.3. Scope

Effects of interest rate regulation is observed from two perspectives. First, subject to research are the statistics provided by Statistics Finland. Statistics are reviewed and sorted, to find out if there are noticeable changes in statistics in the given time frame. The significance of eight variables from the provided statistics are tested through Student’s T-test. Second, companies and products which they offer are gathered to see if the changes in statistics and products support each other. Review of the companies was initiated by gathering information from lending register of Regional State Administrative Agencies. Total 31 companies were found to be currently active and operating. This was done to chart the size of the industry. To find out the largest players in the field, information about turnover was gathered from Suomen Asiakastieto (2017). The turnover for 2015 was available for 25 companies, which averaged approximately to 6,8 million. The main players in Finnish instant loan markets are Ferratum Finland, 4Finance, Tact Finance, OPR Vakuus and Euroloen Consumer Finance, each with a turnover of over ten million in 2015.

2.3.1. Statistical development

Statistics has been collected quarterly from 01/2008 to 12/2015 by Statistics Finland. The aim is to find out with the help of the statistics provided, how the situation has changed in the market. For significant figures, averages and change rates have been calculated to better point out the changes.

Before the interest rate cap (2008-2012) the average amount of loan was 217 euros and the loan was repaid in 32 days. Since 2008, the average loan amount has been growing from 159 euros and in 2012, the amount was already 276 euros. After the interest cap (2013-2015), the average loan amount was 419 euros and was paid back approximately in 100 days. The growth in loan amount is noticeable, when considering that in third quarter of 2015, the average amount was 765 euros. Also, the payback period for the loans has increased to about 100 days after the regulation became effective. The average loan amount has been raising over time, but after the change in regulation, a big leap is noticeable. Further, significant changes of increase and decrease can be observed between the quarters from Figure 2.
Figure 2. Average loan amount, euros

Source: (Statistics Finland)

From Figure 3 can be seen, that before relatively flat payback period has tripled. An upswing can be notices between the second and third quarter of 2013, which exactly is the timing of the implementation of the interest rate cap. Since the beginning of 2015, the trend of payback period has been upward, so the loan times are continuously growing.
The implementation of interest rate regulation caused a nearly ten percent decrease in the ratio of costs to new loans, which is shown in Figure 4. Although the ratio has been decreasing steadily since 2009, it is noticeable that the interest rate regulation has been effective. Instant loan companies were forced to reduce the annual percentage rate of loans below 2000 euros to a maximum of 50.5%, which decreases the amount of interest the companies can request.

Figure 3. Average payback period of instant loan in days

Source: (Statistics Finland)
On the other hand, longer loan period and higher amount of loan make higher income possible, even though the interest rate is lower. Therefore, the cost of lending, including checking the credit information and sources of income of borrowers, is more cost-effective to lenders. It reduces lending to already indebted consumers, but is not good indicator for the real price of the loan.

Overall, the total euro amount of new loans has decreased due to the regulatory change. Before the change, the amount of new loans was increasing steadily, hitting over 100 million euros at its highest peak in 2012. Compared to time before the interest rate regulation, can be said that the amount has decreased by half. The reduction is shown in Figure 5.
From the figure above, it is noticeable that the reduction of new credits is rather steep. The downward trend continued until first quarter of 2015 which was the lowest point, until the direction turned upwards.

Number of new credits has decreased by four times since the regulation came force, as can be seen from Figure 6. It is highly unlikely, that the need for small credits would have suddenly halved. Since the regulation restricts the implementing of costs to the loan prices, highly risky lending has also decreased. The changes refer more to the effects of tightened regulation rather than change in consumer behaviour.
From the Figure above, can be seen that there has been a decreasing trend before the interest rate cap become effective. Still, the decrease after the regulation is noticeably much steeper.

Before the regulation, the credit portfolio of loan companies grew rapidly due to the increase in the amount of loans admitted and in the average euro amount of loans. After the regulation became effective, there can be seen a huge decrease in the credit portfolio in the following year. This can be explained due to the massive decrease in number of new credits following the change of regulation and can be observed from Figure 7.
Still, after the decrease of the first year, the credit portfolio has been steadily increasing. It reflects the change in the structure of the loans and new situation in the market. In Table 1, the averages of relevant values are compiled and summarised.

Table 1. Average values before and after the interest rate regulation

<table>
<thead>
<tr>
<th></th>
<th>Before interest cap</th>
<th>After interest cap</th>
<th>Difference</th>
</tr>
</thead>
<tbody>
<tr>
<td>Average loan amount, euros</td>
<td>217</td>
<td>419</td>
<td>93.03%</td>
</tr>
<tr>
<td>Average payback period</td>
<td>32</td>
<td>105</td>
<td>228.13%</td>
</tr>
<tr>
<td>Expenses to new credits ratio, %</td>
<td>24.40%</td>
<td>14.30%</td>
<td>- 41.39%</td>
</tr>
<tr>
<td>Number of new credits</td>
<td>279 629</td>
<td>186 530</td>
<td>- 33.29%</td>
</tr>
<tr>
<td>New credits, euros</td>
<td>56513</td>
<td>51909</td>
<td>- 8.15%</td>
</tr>
</tbody>
</table>

Source: Compiled by author based on data provided by Statistics Finland
2.3.2. Statistical significance

The changes in statistics demonstrate that the direction of the industry has changed. To find out if the results are significant enough, two-tailed t-test was used for the statistics provided by Statistic Finland, to find out if there was a significant difference when comparing the statistics before and after the regulation. Sample of eight quarters before (2011/Q2-2013/Q1) and after (2013-Q2-2015/Q1) were taken for eight variables to ensure the reliability of the findings. Also, smaller t-test was made for the number of companies, taking samples before (2011-2012) and after (2014-2015) the regulation.

The hypotheses for the test are following:

$H_0$: regulation has no effect on the instant loan market

$H_1$: regulation has effect on the instant loan market

Where $H_0$ is the null hypothesis and $H_1$ is an alternative hypothesis

Results of the test for the chosen variables are presented in table 1, where means, the difference of means, t-value and p-value are presented.
Table 1. Mean, t-value and p-value.

<table>
<thead>
<tr>
<th>Category</th>
<th>Pre-reg</th>
<th>Post-reg</th>
<th>Difference</th>
<th>t-value</th>
<th>p-value</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Mean</td>
<td>Mean</td>
<td>Mean</td>
<td>t-value</td>
<td>p-value</td>
</tr>
<tr>
<td>New credits granted, 1000 eur</td>
<td>92 882</td>
<td>52 370</td>
<td>40 512</td>
<td>4.40</td>
<td>0.0006***</td>
</tr>
<tr>
<td>Exp. Related to new credits</td>
<td>21 595</td>
<td>8554</td>
<td>13 041</td>
<td>6.80</td>
<td>0.0000***</td>
</tr>
<tr>
<td>Expenses / New Credits, %</td>
<td>23.36</td>
<td>15.71</td>
<td>7.65</td>
<td>7.18</td>
<td>0.0000***</td>
</tr>
<tr>
<td>Average payback period of new credits</td>
<td>35.01</td>
<td>79.75</td>
<td>-44.74</td>
<td>-6.70</td>
<td>0.0000***</td>
</tr>
<tr>
<td>Credit portfolio, 1000 eur</td>
<td>111 411</td>
<td>90 863</td>
<td>20 605</td>
<td>1.77</td>
<td>0.0978*</td>
</tr>
<tr>
<td>Number of new credits</td>
<td>373 967</td>
<td>151 220</td>
<td>222 747</td>
<td>8.89</td>
<td>0.0000***</td>
</tr>
<tr>
<td>Average loan amount, eur</td>
<td>248.13</td>
<td>366</td>
<td>-117.90</td>
<td>-2.57</td>
<td>0.0219**</td>
</tr>
<tr>
<td>Number of companies</td>
<td>86.50</td>
<td>51</td>
<td>35.50</td>
<td>17.22</td>
<td>0.0369**</td>
</tr>
</tbody>
</table>

Source: Compiled by the author based on data provided by Statistics Finland.

***: Significant at the 1% level
**: Significant at the 5% level
*: Significant at the 10% level

From the table above can be observed, that there have been significant changes. Euro amount of new credits decreased 44 percent after the regulation (p < 0.01) and the hypothesis was correct. It indicates that the regulation has been effective and the results is significant. Number of new credits has decreased by 60 percent (p < 0.01) having also a significant result. In the hypothesis, it was claimed that number of new credits is going to decrease, so the hypothesis is proven to be correct. Expenses related to new credits decreased by 60 percent (p < 0.01). This result is also significant and is the result of the decrease in the number of credits. Prediction in hypothesis was to the same direction, so this is correct. The ratio of expenses to new credits has decreased by 33 percent (p < 0.01). In the hypothesis, it was estimated to
decrease, so this is also correct. Average payback period has extended by 128 percent (p < 0.01) and the average loan amount has increased by 48 percent (p < 0.05). Significance for average loan amount was slightly weaker, but it was notably under the five percent level. These two variables are the only ones, which have increased within the period. Hypotheses for these variables estimated growth in both cases, so these are both correct. The reason for the opposite change compared to other variables was explained in chapter 2.3.1. Credit portfolio decreased by 18 percent (p < 0.10), being very close to 10 percent level. Hypothesis was correct. Credit portfolio is the only variable which has managed to increase close to the same level before the regulation became effective. This indicates that the instant loan companies have been innovative, since the regulation has not been so strong in case of credit portfolio. Number of companies has decreased by 59 percent (p < 0.05). Hypothesis predicted a strong reduction in number of companies, so this is correct.

The results of the test show, that the changes are significant and every variable except two, have decreased due to regulation and the alternative hypothesis is true. This indicates, that at the statistical level, the interest rate cap has been an effective way to regulate the instant loan industry. Decrease in number of companies and credits shows that the industry has shrunken.

2.3.3. Product range

Material about the products in the market were collected from the websites of the companies currently active. Some of the companies have several products under different names. Data was collected by combining the products from various sources and by separating the types of products to short one-time credit, long one-time credit and continuous credit. One-time credit is a product where borrower is granted agreed sum of money, whereas continuous credit gives the borrower a credit limit within which credit can be raised at once or in batches, depending on the need. In addition, euro amount of loans, interest rates, payback periods and repayment methods were collected. Euro amount of loans vary from couple hundred euros to thousands. Payback period for loans were divided to short, long and instalments. The repayment period varies from a month to few years. Repayment of the loan is payable on a one-time basis hundred percent. Usually the annual percentage rate is presented only for the example loan, while the companies offer different amounts of credit. That is why instead of exact rates, interest
rates presented by the companies were compared to the regulatory limit (CPA 18/1978, 7:17) set in 2013. After reviewing the companies, similarities were found and three regularly occurring loan types were found: short one-time credit, long one-time credit and flexible credit.

From the identified product types, flexible credit is the most popular. In this form of credit, the borrower is offered a credit limit, which can be used whenever needed. Usually the amount is at least 2000 euros and the contract for indefinite period. Repayment is in most of the cases 1-12 months, where the borrower can shorten the loan for example once in a month. The interest rate in flexible credits varies from around 80 to over 300 percent but otherwise the credit is very like instant loan. In practice, availability does not depend on income or collateral, although many of the lenders announce in their terms that they check the employment situation and credit information of the borrower. Also, Finnish bank account, mobile phone and email is required.

Second loan type is short, one-time credit. The amount of credit is typically from 100 to one or two thousand euros. This type of credit is under the interest rate regulation, and the annual percentage rate of these credits is close to 50.5 percent. Before the loan time was very short, from one week to one month, but now the term of the credit is usually longer, starting from one month. Like in flexible credit, also in case of short one-time credit the borrower must prove the identity and have a proof of income before the loan is granted. Usually the short-term credit acts as a bait to get new customers, since many companies offer the first short credit without interest.

Third regular type of loan is long-term credit. About half of the companies offer these credits. The sum of money is usually slightly larger than in short-term credit, from one hundred to few thousand euros. The repayment period is longer, usually from one to few years, but some companies offer loans with repayment period of 12 years. The annual percentage rate of long-term loans is below the cap, but there are individual providers, which give a loan greater than 2000 and use slightly higher interest rate. The terms of the long-term loan are similar to the other two and usually the credits are denied if there are payment defaults or no fixed income. Combining factors of all products are easy and fast access. In addition, some of the companies provide loans which could be categorized to long or short term loans, depending on the amount of loan granted. Also, few of the companies offer a credit option very similar to credit cards, where the loan has to be repaid before the borrower can get a new one.
According to the collected material can be assumed, that the products in instant loan market have changed due to the interest rate regulation. Small credits are still available, but they are bound to a larger amount. This way the credits are outside of the regulation, and rates charged are still above the laid ceiling. Before popular one-time credits are available, but the terms of credit have tightened. The purpose of the terms is to decrease the credit risk and ensure, that the credit is paid back. By setting a longer loan period, the cash collection can be increased compared to shorter loans, which increase the annual percentage rate strongly but are regulated and becomes too expensive for the lenders. With change, the instant loans have moved towards other credit products. Current credits closely resemble credit cards and consumer credits offered by regular banks. Further, repayment is possible to do in instalments and many companies open a credit account to the borrower. Due to longer repayment periods and sums, some of the credits cannot be considered as instant loans anymore. The three most common loan products are summarised in the Table 2.

Table 2. The loan products offered by instant loan companies

<table>
<thead>
<tr>
<th>Product type</th>
<th>Loan amount</th>
<th>Payback period</th>
<th>APRC</th>
</tr>
</thead>
<tbody>
<tr>
<td>Short one-time loan</td>
<td>100-2000 euros</td>
<td>1-6 months</td>
<td>Below 50.5%</td>
</tr>
<tr>
<td>Long one-time loan</td>
<td>From 100 euros,</td>
<td>Over 12 months</td>
<td>Below 50.5%</td>
</tr>
<tr>
<td></td>
<td>upwards</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Flexible credit</td>
<td>2000 euros</td>
<td>1-12 months</td>
<td>Typical 100-200%</td>
</tr>
</tbody>
</table>

Source: Compiled by the author

The results found from the changes in products, statistics and t-test all indicate, that there have been major modifications in the instant loan market after the interest rate regulation. The average amount of loans has increased and payback period extended. Also, the tightened regulation motivates the companies to be more careful when granting a loan. Therefore, the number of new credits and the total amount of new credits has decreased considerably according to the statistics. After the change in regulation, the most common product in the current instant loan market is found out to be a flexible credit around 2000 euros with different payback repayment possibilities. Even though the regulation has been effective, the credit portfolio has
climbed up to the previous level. Using the Flexible credit, the interest rate cap is bypassed. Like the table above summarises, the typical percentages are between 100-200%, which are still threefold compared to the allowed rate. Instant loan providers have been innovative, which has resulted for instant loans to become closer to the regular consumer credit. To tighten the regulation, the regulators must consider how it affect products other than instant loans, since the similarity has become so obvious.
CONCLUSIONS

Instant lending has become part of the Finnish credit market. Earlier, instant loans could be distinguished from consumer credit due to small loan amounts, short payback period, speed and possibility to acquire without a guarantee. Quickly emerging activity needed fast reaction, which led to change of legislation. Three reforms were made to make the activity more responsible and to facilitate the position of borrowers.

The aim of this Bachelor’s Thesis was to research the interest rate cap as a regulatory instrument and how it has affected the instant loan industry in Finland. Quantitative method was used to build reliable data to show the relevant changes within the industry in a clear manner. The material of the research consists of four parts: The data from lending register, collected material from products, statistics regarding the industry and government proposals and legal acts. The research question of the thesis was: How the interest rate cap has affected the instant loan market in Finland? To support the main question, smaller questions were made to specify the topic: How the regulation has affected the number of companies in instant loan market and how the regulation has affected the products in the market.

According to the research, the number of instant loan companies has decreased significantly due to the regulation. From the beginning of enforcing the regulation, the before steady number of about 65 companies has decreased to about 30 companies. The results of the effects of interest rate cap are in the same direction as the results of the observations of Australian Government (2011), and research made by Peterson (1979) and Zinman (2008). The decrease of companies can be argued as being consolidation of the industry after the growth phase, but the timing of the strong decline increases the significance of the amendment to the law behind the decline in the number of the companies. In the light of the results, the typical way of granting loans is ineffective within the limitations of the interest rate cap and the business has been discontinued. On the other hand, the concentration of the industry can at the same time support the operating conditions of companies that continue to operate and grow through enhanced efficiency despite the stricter restrictions.
In the light of statistics, changes have taken place in the instant loan market. The average amount of credit granted has doubled depending on the period. Average payback period has increased almost three times. Also, the number and euro amount of new credits has decreased as well as the expenses related to credits has decreased. Also, based on the t-test, the results were significant. For euro amount of new credits granted, \( p < 0.0006 \), expenses related to credits, \( p < 0.0000 \), Expenses to new credits ratio, \( p < 0.0000 \), average payback period, \( p < 0.0000 \), euro amount of credit portfolio, \( p < 0.0987 \), number of new credits, \( p < 0.0000 \), average loan amount, \( p < 0.0219 \) and number of companies, \( p < 0.0369 \). Alternative hypothesis was chosen to be true. The results are similar with the research made before about the increase of average loan amount by Termin and Voth (2008), and decreasing interest rates, in other words, the decrease of the expenses of the credit by Peterson (1979) and Termin and Voth (2008). Also, the results of decreased number of loans support the previous research, where the interest rate regulation has been found to reduce the highly risky lending (Villegas, 1982, Termin and Voth, 2008, Zinman, 2008).

In the research, changes in the range and features of products the instant loan companies offer after the regulation, support the results found from statistics. Typical instant loan has been short-term, up to few months, small amount, unguaranteed one-time credit. After the regulation entered force, the most common product is flexible credit, which grants the borrower, regardless of the loan amount, a continuous credit with a cap of 2000 euros. Only a few providers offer short instant loans, also with stricter conditions and longer loan period. Third regularly occurring product is long-term instant loan with payback period of at least one year and the amount is usually several thousands. Due to security conditions, extended payback period and bigger amounts, only a few of these products can be considered as instant loans.

The changes indicate that short-term, small and unguaranteed loans are not profitable to offer under the current restrictions. With inflexible regulation, the instant loan companies have almost without exception extended the loan periods, which decreases the annual percentage rate of charge, but increases the amount of interest earned. Higher loan amount enables covering the necessary expenses related to granting a loan with lower expense ratio. By adjusting upper limit of 2000 euros for the interest rate cap, it enabled to charge higher total interest by raising the loan amount. Hence, lending with annual percentage rates of 100-200 percent has continued with the flexible credits, which are beyond the interest rate cap. In this respect, the regulation has not had the desired effect.
In the future, the expected trend is the decrease of high risk lending together with the increase of the loan period and in the amount, so that the annual percentage rate would continue to decrease. The development identified in the study has already taken the instant loan industry towards consumer credits and the parallel development means basically the end of instant lending. The situation may turn out to be problematic for consumers, who are outside of the regular consumer credits. However, the supposition is, that the advantages are greater than the disadvantages, because the regulation was desirable to introduce.

Focus of the research has been to study the effects of the interest rate cap on instant loan markets from the perspective of products and companies. The generalisability of the results is limited by rather short period under review and the ever-changing nature of the products. These restrictions have been attempted to respond by making use of mutually supporting product information and statistics. Companies in the research are limited within the scope of research, to companies offering instant loans, which are registered in the lending register. In addition, the product comparison would have been more rewarding, if more detailed information on past products had been available. In practice, however, the availability of such information is very limited, so in the thesis the image of the instant loan products before the regulation is created based on different research, law work and statistics.

The situation in the instant loan market is rather new and the industry still lives in a turning point after the interest rate cap became effective in 2013. In 2016, a new act on the law on amending chapter 7, section 17a of the Consumer Protection Act was made to change the section, to prevent the bypassing of interest rate cap. The amendment would change the interest rate cap to be effective for the raised amount, even if it were a flexible credit. This would remove the loophole from the legislation. Those who are against the act say for example, that credit cards would become unprofitable, since the act prevents the monthly or annual fees of the cards. On the other hand, instead of the ever-increasing and intensified regulation of the industry, new measures should be considered. For example, ways to improve responsible lending, like positive lending register should be studied more closely, to move from limiting the market to self-management and healthier competition. In the future, it would be interesting to see how the industry develops, especially since new acts have already been proposed.

Interesting further research topic would be to learn about the instant lending industry from the perspective of consumers and their situation in the market. Legislative reforms concerning the sector are unilaterally justified by consumer protection, so it would be crucial.
to find out whether the changes have improved the position of consumers, as assumed when adjusting the laws, or have the changes had negative consequences. Another interesting subject for further research would be the connection of payment defaults to the instant loans. How much of the payment defaults are caused by instant loans, compared to the total? When familiarising with the problems caused by consumer credits, the research should be expanded from instant loans to other consumer credits, which are usually forgotten.
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