IMPACT OF FINANCIAL MARKET REGULATION ON FAST LOAN LENDING IN LATVIA

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Abstract

Non-bank lenders have always been part of Latvian lending sector. During economic downfall, when commercial banks significantly decreased volumes of lending, fast loan companies gained momentum, benefiting from wide marketing campaigns. Non-bank lenders were not regulated by local financial supervision authorities, and also were not subject to state licensing. Although the fast loan portfolio is much less then total volume of bank loans the rising public interest is caused by the great number of people using fast loans and enforcement of government institutions to protect the interests of consumers. Topicality of the research also lies within the fact that operations of non-bank lenders in Latvia have not so far been practically studied.

The market regulation was introduced in November 2011 so the main purpose of the research is to study influence of financial market regulation introduced by state authorities on operations of non-bank lenders, incl. operations of fast loan companies.

<u>Research methods used</u>: analysis of statistical data, content analysis of internet sites, calculations of financial ratios, survey of fast loan companies and structured interviews with professionals involved in market regulation process.

The number of fast loan companies before introduction of regulation was found and compared with new licensed ones. The research showed that introduction of regulatory measures significantly decreased number of non-bank lenders and fast loan companies and therefore – the competition. It was established that introduction of financial market regulation does not leave negative impact on financial indicators of market leaders, but significantly decreased number of smaller fast loan companies.

<u>Limitation</u> of the research is study period from the first quarter of 2007 till the second quarter of 2012.

The research has practical implications for financial market regulation, fast loan companies and potential improvements in relation to non-bank sector.

Social implications of the research lies under promotion of socially conscious consumer lending that could help develop fair lending and drive environmental and economic sustainability.

<u>Originality</u> and value of the research lies under structured and well established operating characteristics of the non-bank lenders, using quantitative and as well qualitative indicators, including also moral and ethical implications.

Key words: financial markets regulation, non-bank credit market, non-bank lenders and fast loan companies.

1. INTRODUCTION

Lenders follow market situation and needs of consumers offering new credit products including consumer credits and adjusting these to the economic situation in the country. One of those are fast loans offered by non-bank lenders or fast loan companies. Fast loans could be compared to consumer credits offered by commercial banks but the disbursement is very quick (starting with 15 minutes) and creditworthiness assessment procedure – very simple for the customers and generally indirect – via internet (fast loan). It was public belief that sector of non-bank credit market is insignificant therefore non-bank lenders as non-deposit taking institutions until 2011 were not regulated and licensed by state authorities. In order to control non-bank credit market and development of fair lending, the Cabinet of Ministers regulation entered into effect only on November 1st, 2011, which was the last day for submission of licence applications by non-bank lenders. Licensing conditions caused wide dissatisfaction within a sector of non-bank credit market due to high license fees and equity capital requirements. Due to absence of market regulation even an actual number of fast loan companies was unknown and become available only after introduction of financial market regulation and licensing. Detailed information on credit market shares, volumes of liabilities and size of companies' assets is still not available. No studies were performed before in

Latvia on influence of market regulation and implementation of licensing system on non-bank credit market, which covers not only fast loan companies, but also companies offering pawnshop services, leasing and pledge based loans. This paper shows the role of non-bank lenders in Latvia credit sector and the impact of financial market regulation on the operation of fast loan companies and derives conclusions and suggestions for non-bank credit market. The authors performed analysis of statistical and literature data, content analysis of internet sites, practical survey of fast loan companies, calculations of financial ratios and the structured interviews with industry professionals.

2. ROLE OF NON-BANK LENDERS WITHIN FINANCIAL SYSTEM

Main objective of the financial system is to promote flow of financial means and efficient spread of financial means within the economic system (Kidwell et al., 2003).

Financial institutions promote flow of financial means thus providing funds for financing and investing activities of businesses, government and households (Kidwell et al., 2003). Financial institutions which are defined also as financial intermediaries (these two terms can be mutually substituted) are banks, credit unions, insurance companies, pension funds and non-bank lenders, which dominate financial environment worldwide and which are the institutions with whom majority of consumers handle their financial matters.

Financial markets and financial institutions operating in financial markets are subject to regulation. In determination of regulatory requirements for any kind of financial organisations the regulator should strive to set up regulation sufficient in order to ensure safety of market at the same time avoiding excessive requirements that could obstruct competition and decrease efficiency.

Overall financial system is made of financial intermediaries, financial regulators, governmental authorities and central bank, which operate in financial markets (see Fig.1.).

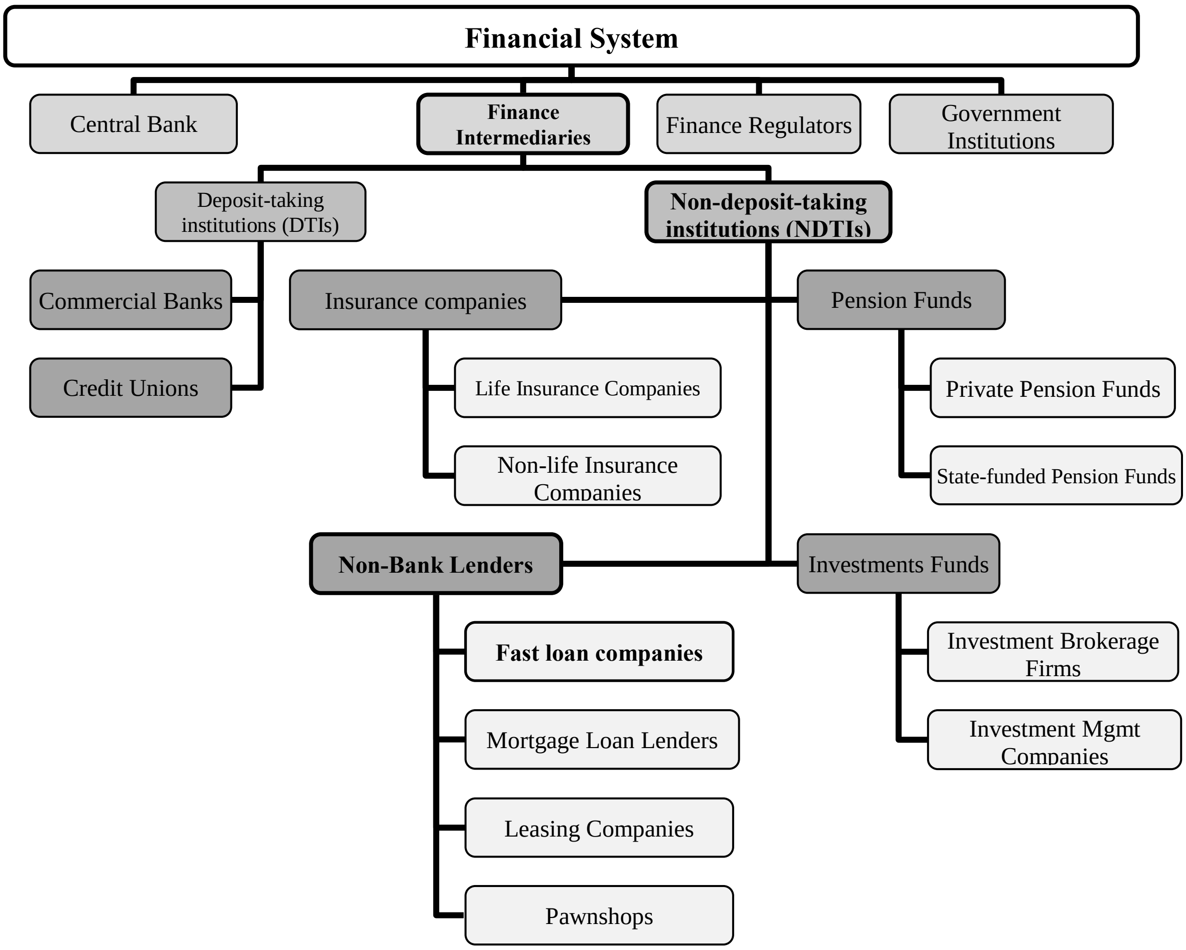

Figure 1. Position of fast loan companies within the financial system.

Figure 1. shows participants of the financial market or financial intermediaries, which are mainly classified by (Madura, 2006) as deposit-taking institutions (DTIs) and non-deposit-taking institutions (NDTIs).

DTIs are capital companies authorised to accept deposits from depositors and they can be considered as the safest institutions where depositories can deposit their free financial means (Mules, 2011). Commercial banks and credit unions are classified as DTIs (see Fig.1.) offering various kinds of saving accounts and term deposits, thus to finance various kind of consumption and entrepreneurial activities and lending.

NDTIs include insurance companies, pension funds, investment funds, investment management, broking companies and non-bank lenders like fast loan companies, mortgage loan companies, leasing companies and pawnshops (see Fig.1.).

Non-bank lenders is defined as financial institutions offering banking services, however no bank's licence is required because such financial institutions do not take deposits (Kidwell et al., 2003).

Non-bank lenders mostly specialised in issuing short-term loans to consumers with quick lending procedure are classified as fast loan companies. Traditionally fast loan lenders offer small amount short term loans, undertaking higher risks and taking much higher interest. However non-bank lenders specialised in issuing business loans also fall under this classification. They offer international trade financing, short-term financing for production needs, loans for re-financing of liabilities, as well as other types of loans not offered or not supported by commercial banks. Contrary to consumer loans, lending to business is usually secured by inventories, trade receivables or other kind of securities (Kidwell et al., 2003).

Non-bank lenders specialised in lending against real estate mortgage are classified as non-deposit taking mortgage loan lenders (Madura, 2006). While unsecured short-term loans often are not repaid and are in general difficult to recover, mortgage loans provide security to loan institutions in case of non-repayment of the loan. Therefore losses from such loans are low in comparison to unsecured short-term loans.

Non-bank lenders specialised in factoring and leasing are classified as leasing companies. Use of leasing services allows businesses to ensure flow of current assets in the company without sharp increase of funding required for acquisition of means of production or equipment (Kidwell et al., 2003). Factoring improves corporate cash flow and provides financing of current assets against trade receivables (Kidwell et al., 2003). Use of factoring and invoice discounting services provides businesses with even cash flow and facilitates its planning, decreases administration expenses, as well as lowers risk associated with trade receivables, thus allowing entrepreneurs to allocate more resources for its core activities.

Non-bank lenders specialised in issuing of pledge covered loans are classified as pawnshops. Theory defines pawnshops as lending institutions issuing loans to private individuals against pledge of property, i.e., pledge of tangible goods, e.g., jewelleries, and other kind of property, receiving such a property for storage (Kutuzova, 2001). Interest rates of pawnshop loans are much higher then for short-term credits issued by commercial banks. Interest rates of the pledge covered loans are not regulated, so the pawnshops are free to set level of interest at their own lending terms and conditions.

In order to be able to offer loans, non-bank lenders gain financing by borrowing funds from commercial banks. Some non-bank lenders set up their own equity basis using retained earnings, other ones issue shares (Madura, 2006).

Non-bank lenders are subject to regulation of financial markets set by the country of their operations. In Latvia sector of non-bank credit institutions started to be regulated by the Cabinet of Ministers Regulation No 245 (Latvijas Vestnesis, 2012), whereby Consumer Rights Protection Centre (CRPC) is nominated as a regulatory authority. CRPC is a state administration body supervised by the Ministry of Economy safeguarding protection of consumers' rights and interests (CRPC, 2012)

3. ANALYSIS OF NON-BANK CREDIT MARKET BEFORE INTRODUCTION OF FINANCIAL MARKET REGULATION

Following research of information provided by the Central Statistical Bureau of Latvia (CSB) on non-bank credit market before introduction of financial market regulation, the authors concluded that number of fast loan companies cannot be extracted from the total number of non-bank lenders.

According to data of CSB 422 non-bank lenders were operating in Latvia in 2010 within the following lines of statistical classification (NACE) (see Fig.2.): 64.20 “Activities of holding companies”; 64.30 “Merging of financing in trust, fund and similar financial entities”; 64.91 “Financial leasing”; 64.92 “Other credit granting”; 64.99 “Other financial service activities, except insurance and pension funding”.

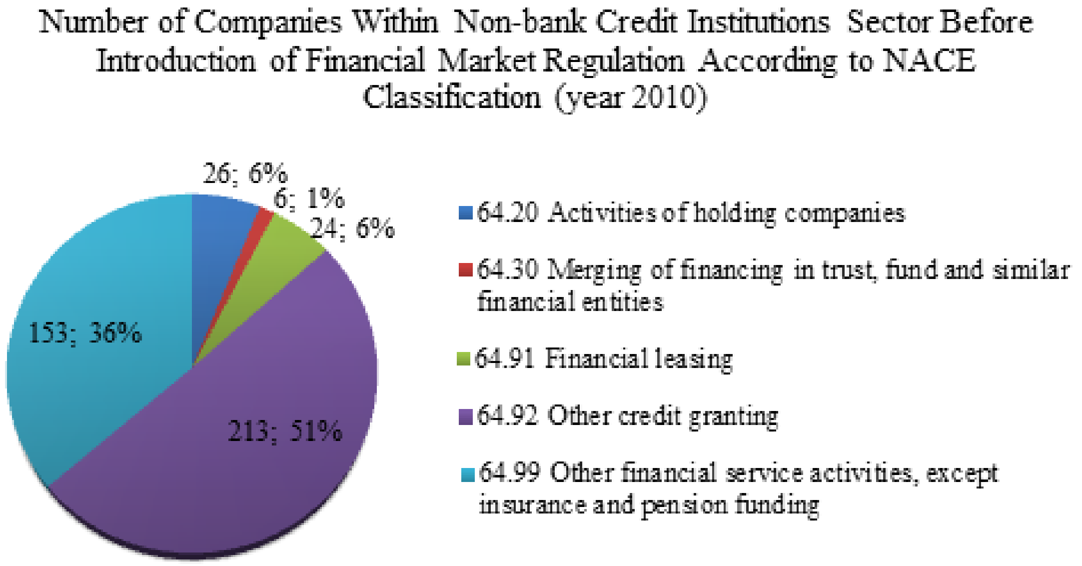

Figure 2. Number of companies within non-bank credit market before introduction of financial market regulation according to NACE classification (year 2010) (CSB, 2010)

Figure 2. shows that according to division of NACE classification above, non-bank lenders granting fast loans could conform only to NACE 64.92 classification “Other credit granting”. Before introduction of non-bank lenders licensing system only 213 did fall within this category. Unfortunately this classification covers not only fast loan companies, but also companies offering: fast loans, SMS loans, pawnshop lending, leasing, mortgage secured loans, etc. Before introduction of financial market regulation these companies were not licensed and all the above services did fall within the same NACE category, unfortunately it was not possible to extract exact number of fast loan companies out of these data.

In order to estimate actual number of fast loan companies and to determine market spread of non-bank lenders according to type of lending services offered, the authors performed manual study of web-pages of each of these companies and carried out analysis of services provided by them. All of 213 non-bank lenders classified under NACE 64.92 classification “Other credit granting” were studied and companies were grouped according to type of offered loans (see Fig.3.).

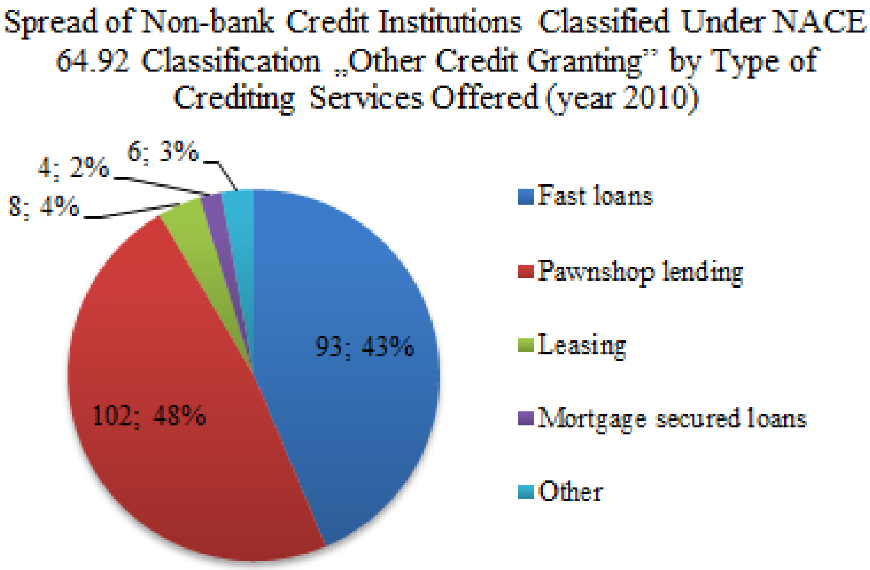

Figure 3. Spread of non-bank lenders classified under NACE 64.92 classification "Other credit granting" by type of lending services offered (year 2010) (CSB, 2010)

Such analysis showed that in 2010 fast loans in Latvia was issued by 93 companies (which is 43% from total number of non-bank lenders). 102 companies falling within this NACE 64.92 classification (or 48%) were pawnshops; 4% (8 companies) were leasing companies; 2% (4 companies) were active in real estate mortgage secured lending; 3% (6 companies) were other companies offering other lending services, e.g., corporate credit card services.

4. ANALYSIS OF NON-BANK CREDIT MARKET AFTER INTRODUCTION OF FINANCIAL MARKET REGULATION

Licensing of non-bank lenders started after introduction of market regulation allowed to discover an exact total number of legal fast loans companies by licences issued. It was concluded that total number of non-bank lenders has decreased significantly. Out of 213 companies operating before introduction of market regulation, in 2012 only 51 company have received special permit (licence) for consumer lending services (see Fig.4.) (CRPC, 2012). 45 companies have received licence for consumer credit services in 2011 and 6 new ones – in 2012 (CRPC, 2012).

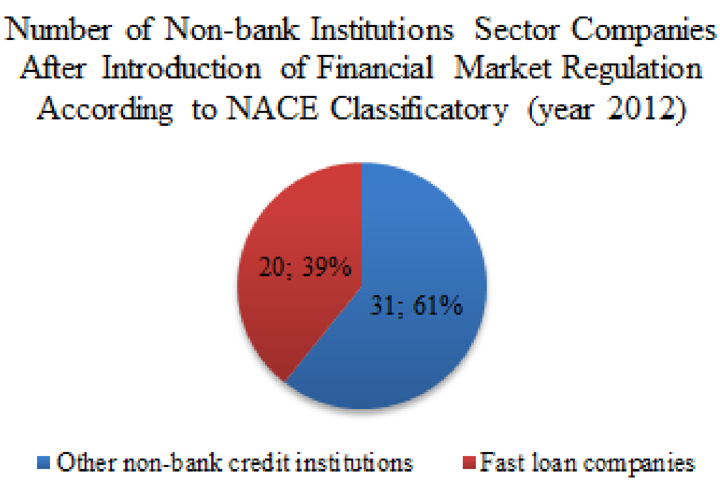

Figure 4. Number of non-bank lenders after introduction of financial market regulation according to NACE classification (year 2012) (CRPC, 2012).

It was established that out of 51 non-bank lender only 20 companies (39%) are fast loan lenders, while 31 companies (61%) are other non-bank lenders.

Licensed non-bank lenders include companies providing following types of consumer credits: fast loans and SMS credits or short-term loans, consumer credits, loans for purchase of goods or services, real estate mortgage secured loans, mortgage loans, loans secured by pledge of movables, loans secured by pledge of vehicle of transportation, loans for purchase of motor vehicles, leasing, etc. (see Fig.5.).

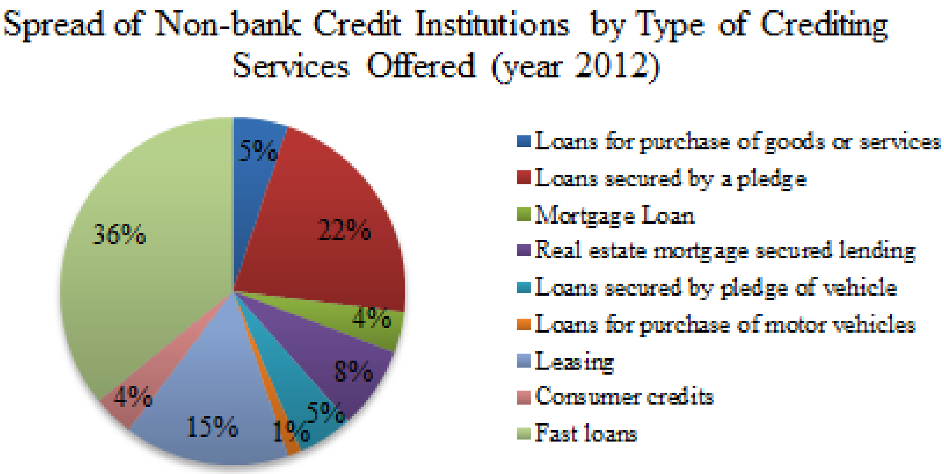

Figure 5. Spread of non-bank lenders by type of lending services offered (year 2012) (CRPC, 2012)

Analysis shows that 36% of non-bank lenders grant fast loans, 22% offer loans secured by a pledge, 15% offer leasing services, 8% were active in real estate mortgage secured lending; 5% offer loans for purchase of goods or services, 5% offer loans secured by pledge of vehicle, 4% – consumer credits and only 1% offer loans for purchase of motor vehicles.

Within framework of practical research the authors established that before introduction of financial market regulation in Latvia 213 non-bank lenders were providing lending services, out of which 93 were fast loan companies (see Fig.6.) The authors also concluded that after introduction of financial market regulation only 51 company out of former 213 have received special permit (licence) for consumer lending. Out of these only 20 companies were fast loan companies specialised in granting of short-term or fast loans.

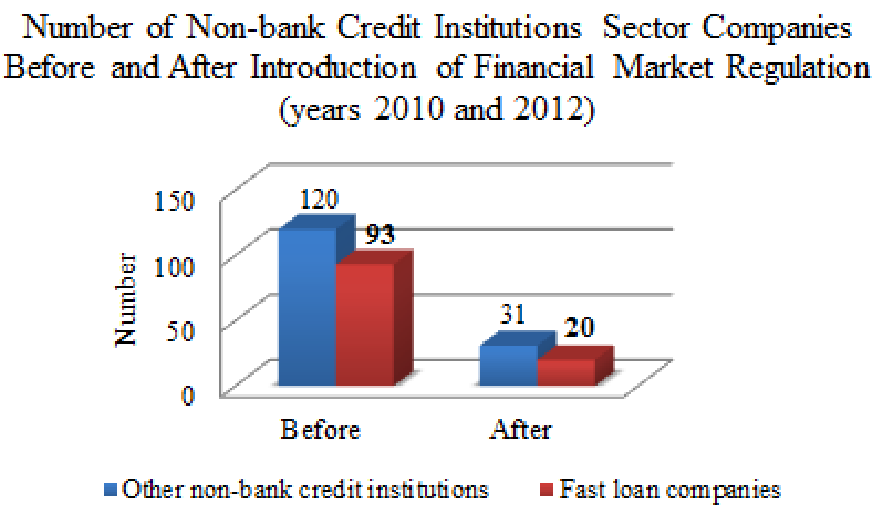

Figure 6. Number of non-bank lenders before and after introduction of financial market regulation (years 2010 and 2012).

The authors conclude that introduction of financial market regulation has significantly reduced number of non-bank lenders, incl. number of fast loan companies.

5. FINANCIAL OPERATIONS OF NON-BANK CREDIT MARKET

Introduction of financial market regulation (November 1st, 2011) resulted in certain corrections in the market. Thus only licenced non-bank market participants were permitted to provide consumer lending. This trend is reflected also in total volumes of loans issued by non-bank lenders from year 2007 to Q2/2012 (see Fig.7.). As it was indicated in previous sections, the authors succeeded a quite accurate number of fast loan companies before and after introduction of market regulation. Unfortunately due to shortcomings of CSB classification system, volumes of loans issued by fast loan companies currently cannot be separated from loans issued by other non-bank lenders, e.g., consumer credits, pawnshop loans, mortgage loans for purchase of real estate. Turnover of all these non-bank lenders is classified under one joint group. Only turnover of leasing companies can be separated, as these are classified separately under the NACE 64.91 classification “Financial lease”. Therefore Figure 7. reflects total amounts of loans issued by non-bank lenders (except leasing operations).

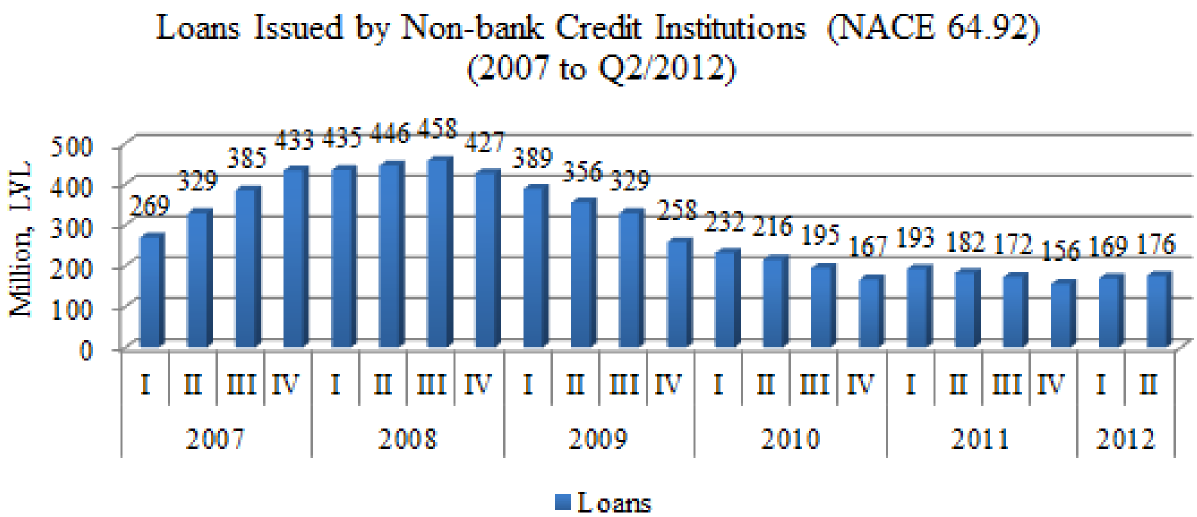

Figure 7. Loans issued by non-bank lenders (NACE 64.92) for the period from 2007 to Q2/2012 (CSB, 2012)

As of 2007 amounts of loans issued steadily increased until Q3/2008, reaching 458 million LVL, benefiting from favourable economic situation in the area of lending in Latvia. However starting from Q4/2008 the volumes started to decrease, in Q4/2009 reaching the level of Q1/2007 or 258 million LVL, which can be explained by deterioration of Latvian economic situation, further aggravated by global financial crisis, contributing to further decrease of amounts of loans issued in coming years. The lowest level of loans issued during the study period was reached in Q4/2011, when it fell down to 156 million LVL, which is caused by introduction of financial market regulation of non-bank lenders. But already in Q1/2012 the amount of loans issued had almost returned at the level of Q3/2011 and continue this growth trend also in further periods, reaching 176 million LVL in Q2/2012.

Figure 8. shows the volume structure of loans issued by non-bank lenders from long term and short term perspective.

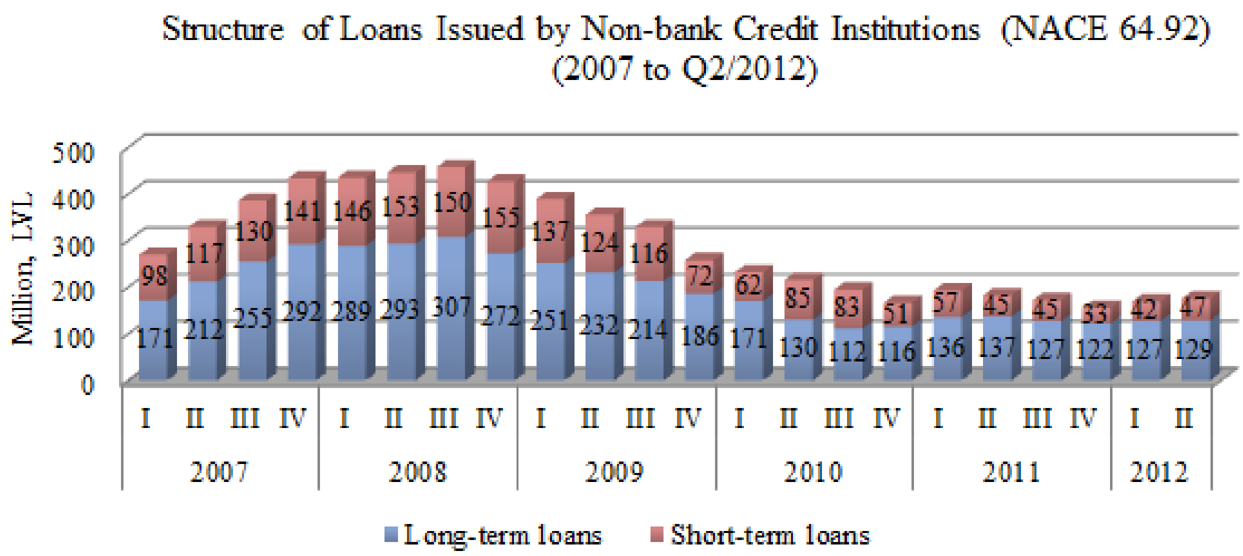

Figure 8. Structure of loans issued by non-bank lenders (NACE 64.92) for the period from 2007 to Q2/2012 (CSB, 2012)

One can see that in total volumes of non-bank loans only 25-33% are short term credits. Licensing of non-bank lenders caused brief decrease of total and short term volumes down to historically the lowest volume of short term loans – 33 million LVL in Q4/2011. Starting of Q1/2012 the market of non-bank lenders rather quickly normalised and ever since the amounts of short-term loans demonstrate growth trend.

Analysis of non-bank lenders offering fast loans revealed that majority of clients of fast loan companies are private individuals taking out mostly short-term loans (less often – mid-term), therefore it can be assumed that volumes of short-term loans granted as seen in Figure 8. in great extent are characteristic for volumes of consumer credits issued to private individuals by fast loan companies (fast loans).

Comparison of volumes of short-term loans issued by non-bank lenders (see Fig. 8.) with volumes of short-term loans (up to 1 year) issued by banks for the period from 2007 to Q2/2012 shows (see Fig.9.) that volumes of short-term bank loans tend to decrease.

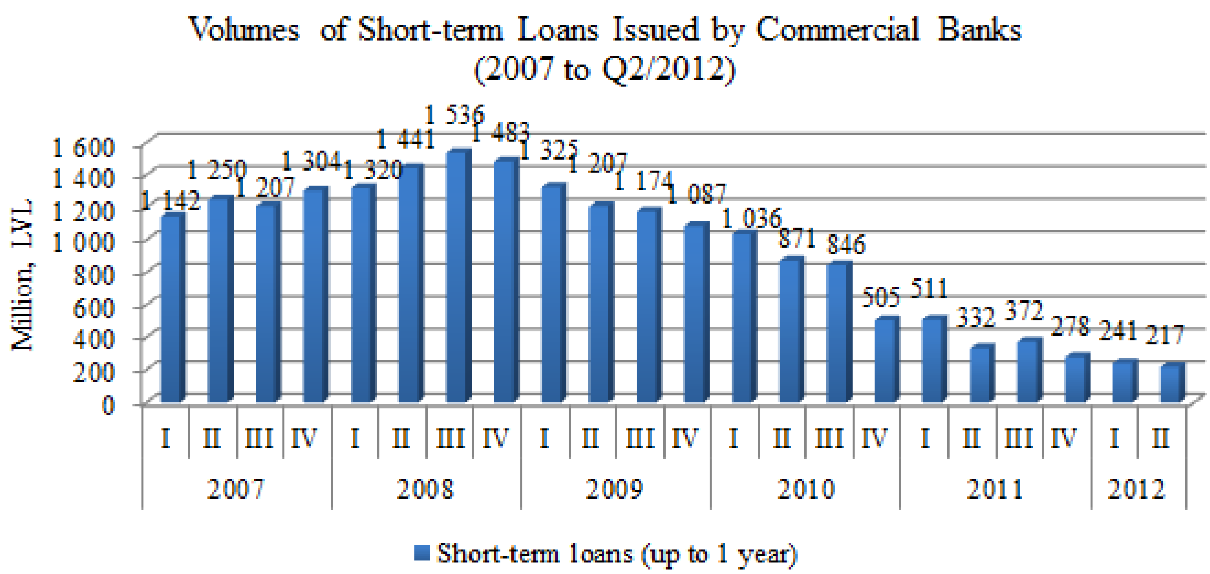

Figure 9. Volumes of short-term loans issued by commercial banks for the period from 2007 to Q2/2012 (Financial and Capital Market Commission, 2012)

Figure 9. shows that volumes of short-term bank loans after Q3/2008 started decreasing until the lowest point of 217 million LVL in Q2/2012. Although the volumes of short-term loans issued by non-bank lenders show upward trend starting from Q4/2011 (see Fig. 8.).

Figure 10. shows that not only short term loans but all consumer loans issued by commercial banks have a trend to decrease.

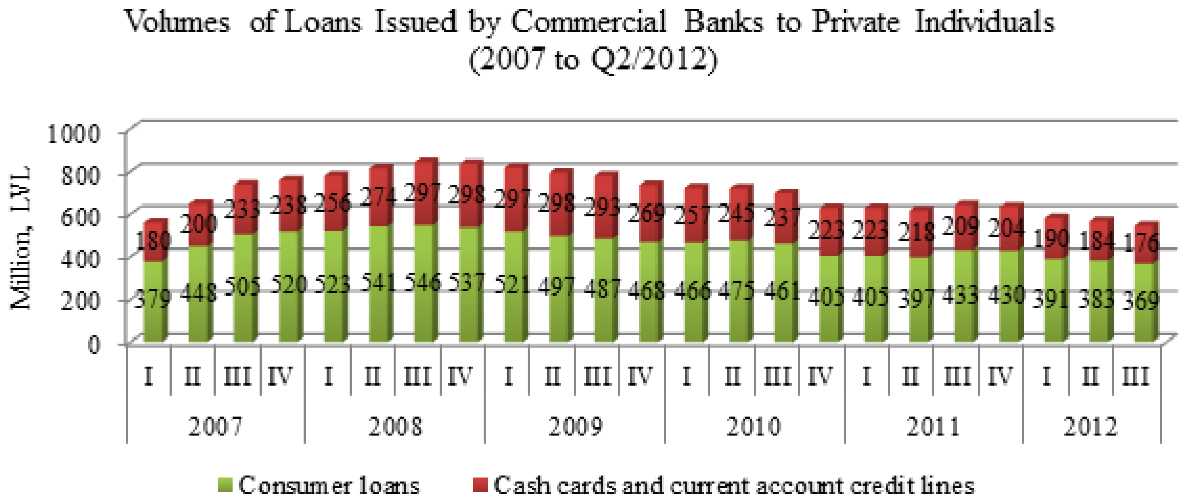

Figure 10. Volumes of loans issued by commercial banks to private individuals for the period from 2007 to Q2/2012 (Financial and Capital Market Commission, 2012)

While volumes of bank consumer loans steadily decreased from Q1/2009, in the non-bank credit market volumes of short-term loans started to increase from Q4/2011 (see Fig.8.).

It is believed before that volume of loans issued by non-bank lenders are negligible compared against loans issued by commercial banks. It is true in comparison with total volumes of bank loans. Therefore non-bank loans are not treated as significant part of the consumer credit market. This is one of the reasons why before 2011 no supervision and regulation was introduced in non-bank credit market. However, comparison of volumes of loans issued by non-bank lenders (see Fig.7.) with volumes of **consumer loans** issued by commercial banks to private individuals (see Fig.10.) allows to conclude that in this market segment volumes of loans issued by banks and non-bank lenders are comparable. Volumes of consumer loans issued by commercial banks for the period from 2007 to Q2/2012 in average were only 2-3 times higher than volumes of loans issued by non-bank lenders (Kreituss and Neimane, 2011). This proves that non-bank lenders play significant role in the consumer loan sector, and it continues to strengthen lately.

The authors analysed also volumes and structure of loans received by non-bank lenders. As it can be seen from Figure 11. largest share of resources attracted in the form of loans was in 2008 and mainly as long-term loans (see Fig. 11.).

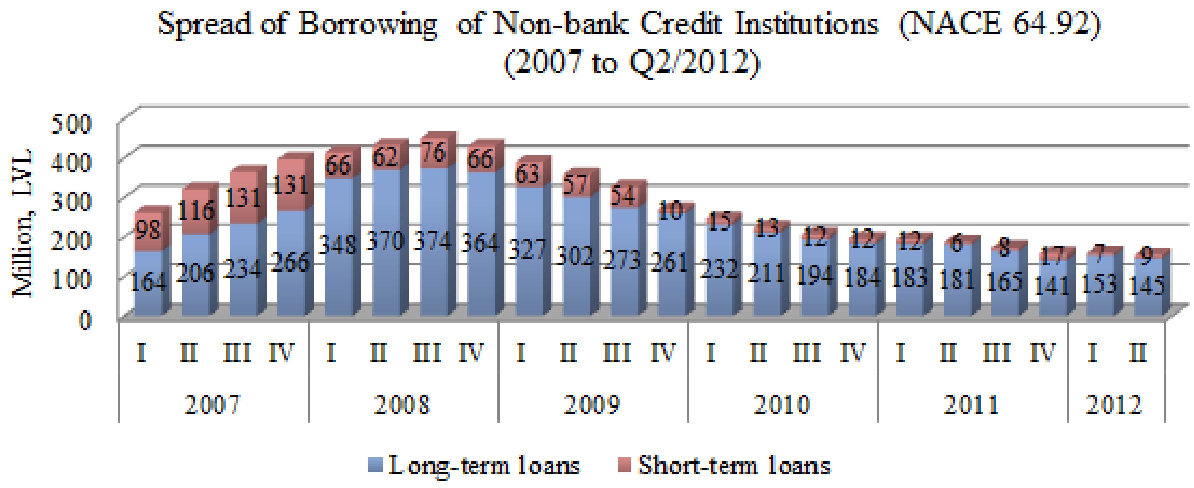

Figure 11. Spread of borrowing of non-bank lenders (NACE 64.92) for the period from 2007 to Q2/2012 (CSB, 2012)

Over the period from 2008 to 2012 the amount of borrowings of non-bank lenders has decreased almost 3 times. The authors had not studied in this research to what extent the changes driven by the supply of loans and to what – by the demand for fast loans. The share of short-term loans has decreased even more rapidly and currently non-bank lenders attract resources mainly in the form of long-term loans. This indicates certain financial stabilisation and strengthening of the sector.

The authors have analysed also profit and losses of non-bank lenders. Quarterly profit or losses of non-bank lenders have fluctuated from 5 273 000 LVL profit in Q2/2012 to 9 606 000 LVL losses in Q4/ 2009 (see Fig.12.).

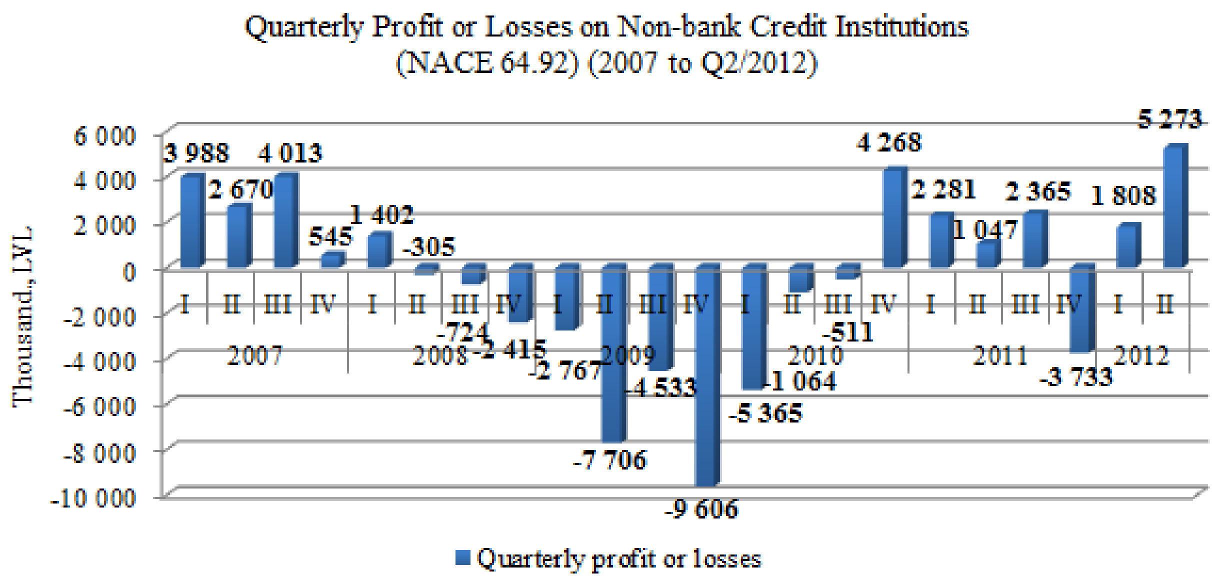

Figure 12. Quarterly profit or losses on non-bank lenders (NACE 64.92) for the period from 2007 to Q2/2012 (CSB, 2012)

Over the period from 2007 to Q1/2008 the non-bank credit market operations were profitable, however starting as of Q2/2008 the sector started experiencing losses, reaching the peak of 9 606 000 LVL in Q4/2009. Starting of Q4/2010 the non-bank credit market returned to profit until Q4/2011, when introduction of financial market regulation caused losses of 3 733 000 LVL. It could be assumed that losses suffered of this sector in Q4/2011 are in great extent associated with high fees of receiving licences. In Q4/2011 45 licences were issued causing 2 250 000 LVL expenses to licensed companies of non-bank credit market.

From 2012 the sector shows stabilisation and returning to profit, reaching the highest level of profitability of 5 273 000 LVL in Q2/2012, which could be explained by increasing of volumes of loans issued starting from Q4/2011.

6. ANALYSIS OF FINANCIAL RATIOS OF FAST LOANS COMPANIES

In order to determine influence of financial market regulation on non-bank lenders, the authors performed analysis of financial ratios of non-bank lenders and compared these with ratios of competitive companies for last five available reporting years (from 2007 to 2011), using data available from Lursoft data base. Since fast loan companies attract resources mostly from commercial banks, analysis of financial ratios was based on criteria usually used by banks for assessment of businesses creditworthiness. This should allow assessing ability of companies to receive long-term loans to finance granting of fast loans.

Fast loan companies for analysis of financial indicators were chosen based on two main parameters – market share of fast loan segment and availability of financial information of these companies for sufficiently long period of time.

To perform analysis of financial ratios were selected all fast loan companies offering only short-term loans from the list of 51 non-bank lenders licensed after introduction of financial market regulation, for whom annual reports of past five years were available. The following fast loan companies were selected: *FERRATUM LATVIA SIA* (www.ferratum.lv and www.skaidra-nauda.lv); *MCB Finance Latvia SIA* (www.credit24.lv); *NORDIC FINANCE SIA* (www.e-finance.lv, www.iespejukredits.lv and www.atrais.lv); *4finance AS* (www.smscredit.lv and www.vivus.lv) (annual reports available only for past four reporting years). Annual reports for past five reporting years of other fast loan companies in the list of licensed fast loan companies were not available.

In order to assess the second companies selection criteria, market shares of fast loan companies were studied by net turnover in 2011 (see Fig.14.).

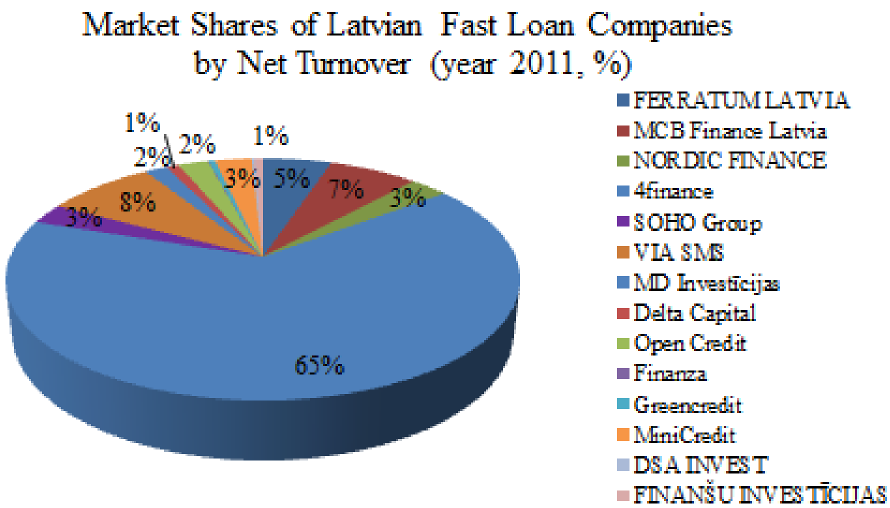

Figure 13. Market shares of fast loan companies by net turnover in Latvia, 2011 (Lursoft, 2012)

Figure 13. shows that in 2011 stable market leader with turnover of 11.2 mil. LVL and market share 65% was *4finance*. Then follow *VIA SMS SIA* (www.viasms.lv and www.viacredit.lv) with 8% or 1.4 mil. LVL, *MCB Finance Latvia* with 7% or 1.1 mil. LVL, *FERRATUM LATVIA* with 5% or 0.88 mil. LVL, and the fifth – *NORDIC FINANCE* with 3% or 0.49 mil. LVL. Other fast loan companies cover less than 3% of market shares of fast loan companies by net turnover.

Net turnover of fast loan companies offering only short term loans in 2011 was 17.2 mil. LVL. The companies selected for analysis of financial ratios are significant market players covering total of 88% of the fast loan companies' market.

The following financial ratios were used in financial analysis: liquidity ratios, activity rations, capital structure ratios, profitability ratios and ratios of financial debt ratios. The objective of the authors was not to decide, which of the given fast loan companies could receive the loan and thus attract resources. This would even be impossible, as analysis of financial ratios is just a small part of all factors to be considered within analysis of creditworthiness for purposes of making decisions regarding granting of a loan. The authors used these financial ratios in order to assess financial stability of companies and to analyse influence of new regulation of financial market. The financial ratios of fast loan companies for last two years have shown in Table 1.

Table 1.

Analysis of financial ratios of fast loan companies in 2010 and 2011 (Lursoft, 2012)

	2011					2010				
	FERRATUM LATVIA	MCB Finance Latvia	NORDIC FINANCE	4finance	Recommended value	FERRATUM LATVIA	MCB Finance Latvia	NORDIC FINANCE	4finance	Recommended value
Liquidity ratios:										
Current ratio	13,40	0,46	2,81	10,54	1-3	8,06	0,17	2,34	3,08	1-3
Cash ratio	2,55	0,06	0,06	0,24	0,20-0,25	0,74	0,09	0,07	0,03	0,20-0,25
Net working capital (LVL)	593 139	-1 942 652	950 513	10 457 486	>0	614 876	-2 120 959	859 977	84 786	>0
Activity ratios:										
Total assets turnover	1,32	1,00	0,32	1,56	>1	0,84	0,52	0,27	0,21	>1
Account receivables turnover	1,54	1,38	0,34	1,97	1,31	0,93	0,67	0,29	0,24	0,53
Receivables to sales (days)	238	265	1 079	185	442	392	547	1 263	1 530	933
Accounts payable turnover (days)	107	981	471	114	418	323	2 415	720	2 058	1 379
Capital structure ratios:										
Debt ratio	0,07	1,96	0,35	0,44	0,71	0,67	5,84	0,49	2,21	2,30
Equity ratio	0,93	-0,96	0,64	0,56	0,29	0,33	-4,84	0,50	-1,22	>0
Financial leverage	0,08	-2,04	0,55	0,80	<1	2,06	-1,21	0,97	-1,82	<1
Profitability ratios:										
Return on sales (ROS)	0,10	0,18	0,51	0,57	0,34	0,40	-0,88	0,50	-0,18	>0
Return on assets (ROA)	0,14	0,11	0,17	0,46	0,22	0,30	-0,81	0,14	-0,18	>0
Return on equity (ROE)	0,11	-0,02	0,20	0,72	0,25	0,63	-0,22	0,20	-0,64	>0
Financial debt cover ratios:										
Times interest covered	10,59	0,78	31,04	224,18	>3	19,26	5,24	16,09	2,32	>3
Times burden covered	1,82	0,06	0,54	1,18	>2,5	0,49	0,25	0,32	0,54	>2,5

Ratios falling below the set threshold are marked grey. Recommended value is the approximate value that banks consider as acceptable.

From the analysis of financial ratios of fast loan companies the authors concluded that after introduction of high licence fee and equity requirements in 2011 (see Table 1.) the ratios of fast loan companies in general have not deteriorated but for some companies (*4finance*) have even improved largely due to increasing of equity capital and net turnover volumes. However, creditworthiness of all companies in general still cannot be valued positively. This shows that not only *MBC Finance Latvia*, but other companies studied also would struggle to receive long-terms loans from commercial banks.

Evaluating conclusions regarding influence of market regulation on overall financial situation of non-bank lenders one can take into consideration some assumptions – e.g., only market leaders were analysed, which remained in business also after introduction of regulatory measures. The companies unable to meet new requirements were forced to leave the market. And, as it was demonstrated before, majority of companies were among those ones dropping out. Out of 93 fast loan companies only 20 were able to purchase licences, fulfil capital requirements and continue operations in non-bank credit market. The introduction of strong state regulation of financial market rapidly decreased number of market players and therefore – competition.

Level of the competition can be varified by the Herfindahl–Hirschman Index (HHI), a commonly accepted measure of market concentration. The HHI is calculated by squaring the market share of each firm competing in the market and then summing the resulting numbers

$$H = \sum_{i=1}^{N} s_i^2$$

where si is the market share of firm i in the market, and N is the number of firms.

Agencies generally classify markets into three types (U.S. Department of Justice & FTC, 2010):

- Unconcentrated Markets: HHI below 1500;
- Moderately Concentrated Markets: HHI between 1500 and 2500;
- Highly Concentrated Markets: HHI above 2500.

After the implementation of market regulation the Herfindahl–Hirschman Index of non-bank lenders market in Latvia almost twice exceeds the critical number and reaches 4451.

Analysis of financial indicators allows to conclude that regulatory measures of financial markets did not leave significant negative impact on the main market leaders of non-bank lenders, but in some cases even more – improved financial situation of the strongest companies due to increasing of turnover and share of equity as required by new regulation but basically – due to reducing of competition.

7. IMPACT OF FINANCIAL MARKET REGULATION

Authors consider, and it lies in agreement with opinions expressed by fast loan companies and in structured interviews by industry specialists, that the newly introduced license fees for non-bank lenders (50 000 LVL) and annual re-registration licence fees (10 000 LVL) set by the Cabinet of Ministers Regulation No 245 are too high. Too high equity capital requirements (300 000 LVL) also led reducing the number of market players.

Newly introduced terms of non-bank lenders market regulation in Latvia are in strong disagreement in comparison with other EU countries. For example in the UK licence fee for individual traders is 575 GBP (488 LVL), for companies 1 215 GBP (1 030 LVL) and fee for annual re-registration of licence to individual traders is 208 GBP (177 LVL), for companies 505 GBP (428 LVL) (Office Of Fair Trading, 2012). In the Ireland licence fee consists of two parts: minimum fee 1 250 EUR (975 LVL) and adjustable fee, which is calculated pro rate from total value of loans issued, which in 2012 was set at 0.254507%, limiting maximum payable amount to 45 000 EUR (31 500 LVL) (Central Bank Of Ireland, 2012).

Our survey showed that majority of fast loan companies consider that optimal state licence fee in Latvia for non-bank consumer lending services should be from 5 000 to 10 000 LVL, optimal state fee for re-registration of the licence – from 1 000 to 2 000 LVL. While the optimal amount of equity capital should be set from 25 000 to 50 000 LVL. Davis Barons, Head of Latvian Association of Fast Loan Companies (LAKDA) in structured interview confirmed that opinion of the LAKDA to decrease these fees was ignored during the process of drafting the Cabinet of Ministers Regulation No 245. This lead to majority of market players to leave the non-bank lenders market when the new terms came into force, thus narrowing competition with all well-known negative consequences. It is quite doubtful whether relatively insignificant state budget income from licence fees compensates the negative consequences of losing competition in non-bank lenders market.

As it can be seen from comparison with experience of other EU countries, licence fee set for non-bank lenders in Latvia is about 50 times higher than in the UK or Ireland. Re-registration fee of the licence in Latvia – 25 times higher. Irish experience of setting minimum licence fee and then adjusting it with the turnover of the company also could be considerable. In such a case leaders of the non-bank lenders could make relatively higher contributions into state budget.

CONCLUSIONS

1. It was widely believed that non-bank lending plays negligible role in Latvia's credit sector. That is why till November 1st, 2011 non-bank credit sector in Latvia was not supervised and regulated by any of local financial control authorities and non-bank credit operations were also not licensed by state authorities. The non-bank lending market developed without any regulation. Therefore no objective information was available on non-bank credit institutions. Even more – exact number of fast loan companies was not known.

2. Using data from Central Statistical Bureau, Register of Enterprises of Latvia and carrying out content analysis of non-bank lender's web-pages authors found that there were 213 active non-bank lenders in Latvia before introduction of financial market regulation. 93 of them were fast loan companies providing short term fast loans.

3. Authors shown that in short term consumer credit sector non-bank loan volumes were significant and comparable with the short term credit portfolio of the banks. Volumes of loans issued by non-bank lenders were only 2-3 times lower than done by commercial banks. Therefore the introduction of regulation of non-bank lending market should be recognised as legitimate and correct.

4. Authors concluded that regulatory measures introduced within non-bank lending market have caused several positive effects. New requirements to increase the equity capital of non-bank lenders strengthened the financial stability. Unified terms and conditions of credit agreements have been approved and interests of customers have started to be controlled. On the other hand, introduction of too high licence fees in Latvia (50 times higher than in the UK or Ireland), annual licence renewing fees (25 times higher) and setting up high equity capital requirements for non-bank lenders equity capital (300 000 LVL) caused negative consequences in non-bank lenders market.

5. Analysis of financial indicators of fast loan companies shown that introduction of strong regulatory measures of financial market did not leave significant negative impact on the largest non-bank lenders (in some cases even improved financial situation) but at the same time forced most of the smaller market players to leave the non-bank credit market. Authors found that number of non-bank credit institutions decreased significantly. From 213 non-bank lenders operating in the market before, only 51 company has received licences for consumer lending services. Number of fast loan companies decreased from 93 to 20. Furthermore – only 4-5 main of them basically shared the market and continued to offer fast loans in significant extent. The Herfindahl–Hirschman Index, characterizing the concentration of the market, in case of the non-bank lenders in Latvia almost twice exceeds the critical number and reaches 4451. While the banks are not ready to substitute this credit market niche due to high risks caused by fast lending procedure of the loss of competition does not allow to form competition determined market prices of fast loans. And now state authorities have to solve the problem – how to protect the interests of consumers.

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