

## **PAYMENT DIFFICULTIES ASSOCIATED WITH SMS LOANS**

### **1 The Purpose of the Study and Research Material**

Instant loans are credits applied for by SMS on a mobile phone, up to a maximum amount of a few hundred euros. The loan period is at its most a few weeks. In addition to the capital, the customer pays the lender a fixed cost. No yearly interest rate is charged.

In Finland the instant loan market has expanded greatly since 2005. There has been a host of both legal and financial problems associated with instant loans. Compared to conventional credit cards, SMS loans represent a more challenging form of credit, both for the person in need of a credit, and also for the authorities. The marketing of instant loans is more vigorous and the availability easier and quicker, and it is also more expensive. In addition, it is more difficult to disseminate information about the contract terms, and the risk of facing payment difficulties is greater.

This study has explored payment difficulties deriving from SMS loans obtained on a mobile phone. The purpose of this study has been to obtain basic data about the amounts and contents of SMS loans that have proceeded to legal debt collection. To this end, judgements on demands for payment issued by District Courts and the situation of debtors facing payment difficulties in enforcement have been examined. Also the working principles and contract terms of instant loan companies have been pictured in this study. Statistical data about the frequency of payment difficulties associated with SMS loans have further been presented, based on credit information register data.

The study is to its nature empirical and it is based on register data. The data and sources can be divided into three main categories. They are 1) information describing the background of SMS loans and contract terms, 2) data about payment difficulties associated with SMS loans in the credit information register of Suomen Asiakastieto Oy, and 3) register data from courts and enforcement authorities about the legal collection of SMS loans.

## 2 Summary of the Research Findings

### *The principles guiding the work of instant loan companies as reflected in the contract terms*

The contract terms of instant loan providers have been scrutinized based on data collected on the Internet in February 2008. From the contract terms published on the websites of instant loan companies, information was gathered about how to apply for a loan, different credit alternatives, as well as procedures for handling payment difficulties.

Instant loan companies have been criticised for granting loans also at night. However, the research data reveals that a major part of the companies do not grant loans at night. Only 15 percent of the companies informed that they grant loans 24 hours a day.

When applying for a SMS loan the customer normally has to send two text messages subject to a fee to the company's telephone number. An examination of the costs involved for the messages revealed that the companies charged an average of 1.90 euro per sent message.

After having obtained a positive decision for a loan the customer has to conform the loan application within a fixed time span. The data revealed that the customer's time for reflection was on average 60 minutes, after having received a decision that a loan was granted.

A major part (80 %) of the companies required that the applicant be at least 20 years old. The age of the applicant as well as earlier customer relations often also influenced the amounts of the granted loans. Almost all companies mentioned that they only grant loans to customers, who do not have entries about payment difficulties in the credit information register.

To facilitate the identification of a SMS loan applicant the instant loan companies normally grant loans only to persons holding a public mobile phone account. In part of the companies (15 %) it was possible to obtain a loan also without a public mobile phone account (ex. prepaid account).

The costs involved for the loan applicant for a SMS loans are normally not mentioned as interest rates but as processing and delivery costs. This study revealed that the average costs, for example, for a loan of 50 euro for 14 days was 12 euro. The highest administrative costs charged for a 50 euro loan amounted to 16 euro, whereas the lowest was 8 euro.

### ***Data on legal collection of small consumer loans in the credit information registers***

With the use of Suomen Asiakastieto Oy's data an assessment has been made of the frequency of legal debt collection and partly also of its content.

According to statistics there has been a robust increase in judgements on demands for payment in District Courts in the category consumer credits, from somewhat more than 20,000 to close to 58,000 during the years 2005–2007. In 2006 the share of such judgements increased by 73 percent since the previous year, whereas the increase was some 65 percent in 2007. During this same period there had, though, been a slight decrease in the share of all other judgement debts. In this category most court decisions have, among others, concerned housing rents, telecommunication debts and mail-order debts.

According to credit information register statistics there has been a manifold increase in judgements involving debts of less than 1,000 euro during the years 2005–2007. The number of legal debt collection cases involving loans of a maximum of 300 euro increased to a number exceeding 25,000 in 2007.

However, not all the 25,000 judgements concerning loans of less than 300 euro involved SMS loans. Also before the emergence of the instant loan market there have been legal proceedings to recover other small consumer credits, and this is still the case. In 2005 there had hardly been enough time for District Courts to issue very many judgements on demands for payment involving SMS loans. Notwithstanding, there were then close to 3,000 entries in the credit information register about judgement debts involving consumer credits of a maximum of 300 euro. For this reason judgement debts should be accounted for only to the extent that they exceed the “initial level” of the year 2005. Thus accounted for the result is some 22,000–23,000 cases.

In 2007 somewhat more than 11,200 persons received a recovery ruling for a consumer credit of less than 300 euro. Out of them a major part will probably be SMS loans obtained by mobile phone. If somewhat more than 2,800 persons equalling the “initial level” of 2005 is deducted from this number, some 8,000–9,000 persons have received a ruling about the recovery of SMS loans.

Data in the credit information register give a fairly clear picture of legal collection cases deriving from SMS loans. First, their number has increased manifold. Second, in 2007 some 22,000–23,000 judgements were issued on demands for payment involving 8,000–9,000 persons.

### ***Payment difficulties deriving from SMS loans in the registers of District Courts***

Out of the judgement debts involving SMS loans, handled by District Courts, the major part was cases in which the debtor had merely one unpaid SMS loan. In one fifth of the cases there were two outstanding debts and in the remaining cases the number of unpaid debts amounted to 3–5. The cases involving several debts were more frequent among men than women.

The judgement debts deriving from SMS loans concerned fairly modest sums; on average (median) 120 euro. In more than half the judgements, the average sum was 100–150 euro. The smallest debts (less than 150 euro) were more frequent among young adults. Conversely, the debts due in the age bracket 45–54 were on average bigger (150–400 euro).

Unpaid bills that have reached the stage of legal collection involve a great number of different costs for the debtor. According to the research data, payment default for a SMS loan resulted in an average collection cost of 59 euro and 192 euro for the legal proceedings. In legal debt collection the total costs for one unpaid SMS loan amounted to an average of some 250 euro. In addition to this, the debtor will have to pay penal interest on arrears and possibly also collection fees.

A scrutiny of the debtors' background revealed that the age group 20–24 was the biggest single group (43 %) among SMS loan debtors. However, more than half the debtors were at least 25 years old. The average age of the debtors in this study was 26 years. Some 40 percent of the judgement debts involved women and 60 percent men.

### ***Payment difficulties deriving from SMS loans in the enforcement registers***

Register data about the legal collection of judgment debts revealed that a major part of the debtors, who had received a judgement on demands for payment of a SMS loan, were also customers for legal debt collection. One debtor had an average of six cases of debt collection under way. The total debt balance to be collected per debtor was on average 2,700 euros.

Some 15 percent of the debtors' total balance in debt collection by way of enforcement was a maximum of 500 euro. It is possible that among these fairly small amounts the debtor's payment difficulties only concerned SMS loan payment defaults. Notwith-standing, close to half the debtors had a fairly big total balance in debt collection: at least 3,000 euro. Judged by the amount of the debts, it would appear that a considerable share of SMS loan

debtors had several debts for collection: either only outstanding SMS loans or other loans in addition to them.

The scope and duration of payment difficulties can be examined based on when a debtor for the first time has been registered as a customer for debt enforcement. The research material indicates that a major part (80 %) of the debtors were customers for debt enforcement already before a case involving a SMS loan was settled by a District Court. It would thus appear that merely for a small share of the debtors facing difficulties in paying SMS loans, was legal debt collection due only to payment default for a SMS loan.

All in all, it would appear that for a major part of the SMS loan debtors, payment difficulties originated in several unpaid loans. Indications of this are the large number of debt relationships, the high total balance of debts and the general frequency, by which debtors were customers for legal debt collection. This research material does, however, not allow a clear assessment of the extent to which the debtors' payment difficulties are specifically related to SMS loans. The research material did not contain specified information about the content of the debts. On the other hand, the big amounts in debt collection indicate that the loans would primarily be other than SMS loans.

### 3 Discussion

During a short time span tens of companies offering instant loans have been established in Finland. There has been a robust expansion of the instant loan market since 2005, and equally so of the demand for such loans. It would appear, though, that the most expansive phase is passed. Part of the companies operating in this market has already ceased their activities. In summer 2008 a total of 46 companies offered instant loans.

There has been public criticism in many quarters that companies offering instant loans do so on too loose criteria. According to the data gathered from the companies' contract terms, most companies had fairly tight conditions for granting a loan. First, a major part of the companies only grant loans to persons aged 20. Second, loans are not granted to persons having an entry about payment difficulties in the credit information register. Efforts are made to secure the debtor's ability to pay by not granting a new loan before previous loans are paid back.

The share of rejected loan applications is also an indication of instant loan companies' risk management. According to indications given by actors in the field, close to half the loan applicants receive a negative decision.

Most applications are rejected because of deficient personal identification, as well as because of marks about payment difficulties.

Notwith-standing, repayment of SMS loans causes severe difficulties for many debtors. According to Suomen Asiakastieto Oy's credit information register data, the share of judgement debts in the category consumer credits has increased considerably since 2005. The growth has been strongest in the category representing a maximum debt due of 300 euro, to which SMS loans obtained by mobile phone is counted. In 2007, 22,000–23,000 judgements on demands for payment were given concerning these credits. The judgement debts involved an estimated 8,000–9,000 persons. In 2007 a total of some 2.5 permille adult Finns had received a judgement concerning payment defaults for SMS loans.

Instant loan companies have been criticised particularly for young adults' payment difficulties. It has been suggested that particularly the vigorous marketing of the loans has induced young people to reckless borrowing. However, the research data from District Courts showed that the typical person facing payment difficulties because of SMS loans is somewhat older; on average 26 years old.

Although payment difficulties are not most frequent among very young people, they are, however, in most cases to their scope fairly severe. The District Court and enforcement data in this study revealed that a major part of the debtors had several unpaid loans. Furthermore, for a majority of them the debts were collected by way of enforcement. The great number of debt relationships and the high total balance in debt collection indicate that the severe payment difficulties SMS loan debtors face, are not merely due to unpaid SMS loans. It can be assumed that payment difficulties associated with SMS loans to some extent accumulate for some persons, who on the whole have difficulties in managing their economy.

How to intervene in the instant loan market is no clear-cut issue. There are several alternative means of correcting the problems that have emerged in the market. In the debate about these problems, arguments have been advanced both for a so called zero alternative, and also for a firmer grip on the part of public authorities. The strongest argument for maintaining the present situation is that the instant loan markets represent a small share of credit markets, and also that attempts have been made in many different ways to rectify the most significant problems. A stronger intervention by public authorities can also be argued for in various ways. The companies in the branch are not registered, the problems caused by the activity mainly affect young population groups, the contract terms leave much to be desired, self-regulation only cover part of the companies, and several regulations are in need of statutory reform.

The best alternative for remedying the instant loan market and problems associated with it would appear to be so called co-regulation. In other words, the situation could be rectified by improving the contract terms of instant loan companies and self-regulation within the business, as well as cooperation with authorities. Legislative changes should be restricted to matters, where workable solutions cannot be found with softer means of regulation.