



Bank debt recovery in Poland as a determinant of information asymmetry¹

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ABSTRACT

The following article depicts bank debt recovery in Poland as a determinant of information asymmetry. Information asymmetry is one of a few market failures and it means an unequal access to information for various subjects, also in relations between the bank and the customer. Drawing on the model of Helmut Bester, debt recoveries have been analyzed on the example of bank consumer credits in Poland. The indicator based on such values constitutes an effective measure of information advantage for the borrower. Data on unpaid consumer credits illustrate the information asymmetry on the market. The main hypothesis assumes that data about unpaid consumer credits illustrate the level of information asymmetry on the market- the bigger information asymmetry is, the bigger the recovery.

Keywords: debt recovery; information asymmetry; consumer credit

1. INTRODUCTION

The following article depicts an analysis of debt recovery as shown on the example of bank consumer credits in Poland. The non-payment of instalments may result in termination of contracts by the bank and a quick initiation of executive proceedings. The wallets of

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commercial banks' receivables from non-financial sector subjects are to a great extent burdened with receivables at risk. Currently, one can observe on the global scale the growth of interest of various institutions (both international and regional) in diagnosing locations and reducing the adverse phenomenon of information asymmetry on financial markets.

The first fragment of my work presents the essence of information asymmetry and consumer credit in the banking sector. The second part, in turn, depicts an analysis of bank debt collection. The last fragment presents empirical study results in the form of an analysis of creditor-borrower relations from the perspective of game theory (that is, from the perspective of Helmut Bester's model). An overview of the specialized literature has been included and research methods, such as descriptive and comparative analysis have been used. Also, the ongoing topic of international experiences regulating the problem of an excessive debt of natural persons have been mentioned. I also present in my work forms of credit risk management, as well as dilemmas as to the code of conduct in case of a late repayment to the bank.

Interest in the subject of information asymmetry on the consumer credits' research market in Poland is not only a matter of cognitive issues. The possibility of applying the analyses and research results in the functioning of the banking sector as well as formulating conclusions about the shaping of information asymmetry is one more reason why to discuss this subject.

2. THE ESSENCE OF INFORMATION ASYMMETRY VERSUS A CONSUMER CREDIT

The act on consumer credit effective from December 2011 (Act, 2011) is the result of the implementation of European Parliament and the Council directive to the domestic law (Directive, 2008). It is aimed at creating a common market based on responsible crediting and running into debts. This act introduced significant changes in consumer crediting. It defined a couple of normative regimes for consumer credits (among others, for mortgage loans). It also introduced a number of new obligations for banks to provide information before signing up the credit agreement. The act defined in detail the contents of the credit agreement, as well as it obligates more obligations on credit intermediaries to provide the borrowers with comprehensive information. Also, it modified significantly the previous consumer credit act (Czech, 2012).

New regulations stimulate reflections on the impact of the newly adopted solutions on the functioning of consumer credit market, informative obligations put on banks and, finally, on the situation of market participants.

Information asymmetry is one of a few imperfections and it means an uneven access to information for various members. Relations between the borrower and the lender in consumer credit agreement are characterized by information asymmetry. This asymmetry results from the informative advantage, as well as from lack of information and it refers not only to borrowers, but also to banks and it has some negative consequences in the process of crediting (Tassel, Vishwasrao, 2007). A risk to interests of the consumer applying for a credit results from his relatively weaker position, as compared to the position of the lender. The credit agreement does not constitute an individually negotiable credit. The choice of the credit is actually restricted to analysing standard credit offers which are currently accessible on the

market. The credit offer of the bank is a certain package which can be modified in a limited scope so that it meets the client's expectations (e.g. the choice of optional products of the credit, i.e. cross-selling).

The fundamental problem when conducting research about information asymmetry is the difficulty of measuring it. It is because one can quantify the level of information asymmetry only on the basis of indicators suggesting its different levels (Wette, 1983). G. Akerlof, M. Spence and J. Stiglitz created basics for analyses of the phenomenon of information asymmetry. For this work, those economists were awarded a Nobel Prize in economy in 2001. They established the foundations of general theory of markets where information asymmetry is characteristic. They come to the conclusion that even minor deviations from rationality are the cause of significant macroeconomic changes. Then, the economy strikes a balance below the optimal use of resources.

Akerlof built one of first formal models describing negative selection which can be observed when there is information asymmetry between market participants. In the article entitled „*The Market for 'Lemons': Quality Uncertainty and the Market Mechanism*” he analysed the situation common on used cars' market. He made an assumption that the seller has more comprehensive knowledge about the condition of the vehicle than the prospective buyer. The latter, who does not know the factual conditions of the car at hand, is prone to pay an average market price for a car of a given model (Akerlof, 1970).

M. Spence, in turn, proved that the problem of information asymmetry can be partly solved by taking up costly activities by subjects aware of their own merits, which will show their merits in a credible way in their surroundings. The scientist also indicated that on many markets, the employer is not able to assess skills and predispositions of a newly-hired worker, because some time must pass after he can be able to form some opinion about him.

However, the worker can (when he bears some costs, e.g. of further education) signal to the employer the level of his skills (Spence 1973).

On the contrary, J. Stiglitz believes that information asymmetry and, consequently, the necessity to pay costs of obtaining information are the reasons why one of assumptions of classic economics, saying that competitive markets is a sufficient condition to allocate resources and maximise welfare, does not really match the reality. Stiglitz described the mechanisms of selection (and, to be more specific, self-selection) on the insurance market. It is about the fact that using a set of alternatives (e.g. two types of insurance policies) implies a certain reaction of prospective insured clients as well as the possibility of their own selection (auto-selection) for two risk groups (Stiglitz, 1981).

3. AN ANALYSIS OF BANK DEBT COLLECTION

Debt collection market in Poland consists of all subjects concerned with debt recovery, debtors, auxiliary institutions helping debt collectors and all the regulations determining relations between members of debt collection market, as well as their relations with their surroundings.

According to research carried out by Economic Information Bureau InfoMonitor, at the end of 2011 Polish debtors were in arrears with their bills for almost PLN 3 billion (Infodług, 2011). It means that the total amount of due payments in the whole country amounted PLN

35,48 billion. An average debt in Poland amounts to PLN 17 000. According to research, only 5,5% of subjects pay their debts in time (Gazeta Prawna, 2011).

According to the reports of the World Bank, Poland belongs to countries of the most excessive lengthiness of debt recovery proceedings (Doing Business, 2004). The average time needed to enforce the payment (estimated for 1000 days) is more than four times longer than the average (measured by the median) for UE countries (212,5 day), and more than twenty times longer than in Holland (48 days), where the debt recovery takes the least time. There are only two countries, namely Italy and Slovenia, where it takes longer (1390 and 1003 days respectively) to recover dues from debtors. The recovery process is relatively long – quite often it lasts a few years- this means that normally one has to wait until full information about amounts gained back by debt collectors is gathered.

As stated in the literature on this topic, the average time of debt recovery of bank credits is 3,5 years in Germany and 2,5years in France. It is worth noticing that there is a substantial dispersion in the resolution of values which means that a considerable part of debt recovery processes is often significantly higher than expected (Grippa, Iannotti, Leandri, 2005). Bank's recovery claims, as they are connected with the bank's business operations, become time-barred after 3 years, according to Article 118 of the Civil Code. The starting date for calculating how much a credit instalment is due are payout terms that are described in the credit agreement. If the bank has terminated the credit agreement, instalments that used to be unmatured, become matured with the end of the period of notice. From that day on there is limitation period of three years. An application for a declaration of enforceability interrupts the limitation period- it has to be counted from the beginning (Act, 1964).

Poland came the twentieth in a ranking of 26 countries (and was the last in the group of countries accepted to EU in May,2004), with an average below 4 points (on a scale from 0 to 10) in EBRD report. It evaluated regulations and procedures of legal securities. This result was not influenced by the low evaluation of regulations, but by the low evaluation of very long and complicated processes of pledging and execution of collaterals (1,6 points). The amount clawed back was also lower than in the majority of countries (4,4 points, according to Transition Report, 2003). The World Bank research shows that excessive formalism of enforcement procedures very often hinders debt recovery because complex legal procedures are often the cause of lengthiness of proceedings. It is worth noticing that number of formalities that must be carried out to resolve the dispute is the smallest for rich countries, especially „common law” (Australia and Great Britain), as well as in Denmark, Norway and Switzerland.

The basic conception of models analyzing risk of nonperformance of financial obligations is concerned with the use of data to determine key factors describing probability of delay in repayment of the loan. Credit decision is made considering the classification of borrowers, and the division into risk classes is made on the basis of one or more variables which enables assessment of how probable it is that the debt will not be paid (Colquitt, 2007). In reality, it is possible to restructure the credit agreement in view of new financial projections and the use of an altered credit repayment schedule. Yet, the entrepreneur's attitude should be active so that it leads to bank's withdrawal from vindication procedures, considering the financing stabilization with a possibility of additional funding (Ruth, 1999).

The existence and type of financial collateral is strictly connected with the level of debt privilege. The collateral determines the position of a creditor in the course of the recovery procedure. The New Capital Accord illustrates the significance of type and value of collateral

in shaping the recovery rate. In a standardized approach for the first pillar, the capital requirement depends on the type of collateral, where the lowest risk weights are attributed to subjects are secured by a mortgage on the property. Lower risk weights are also attributes to some corporate credits which are secured by a mortgage from commercial property (Resti, Sironi, 2005). In turn, the amendment to the Banking Law Act allowed banks to entrust bank debt recovery to other enterprises, as well as to disclose information covered by the banking secrecy. Solutions enabling debt execution, access of creditors to information about borrowers, and preventing debtors from discarding property have been introduced by the amendment to Civil Procedural Code (Act, 1997).

The expected value of recovery rate in case of insolvency can be influenced not only by differences in law systems of particular countries, but also by legislative changes. Because of that data from periods of time, when there were the same or similar regulations, should be used for comparison. For instance, in Poland, the results of expected recovery rate for bank credits (based on data before 2004) could turn out to be significantly different from the ones that are based on more recent information. This results from the fact that banks' position in enforcement proceedings has greatly improved after the revision of regulations in 2004, which was introduced based on recommendations of the banking sector. The report of General Inspectorate of Banking Supervision about the effectiveness of bank debt recovery in Poland presents a conclusion, that a new Bankruptcy and Composition Act has introduced many solutions that are convenient for creditors. For example, this Act has limited the possibility of further appeals by the borrower at the time of recovery. Also, it has enabled the introduction of a new code of conduct (the so-called recovery proceedings) in a risk of insolvency. It has also enabled creditors to have control over trustee, court supervisor or administrative receiver's actions. They can conclude agreements, too, which improves to a large extent the creditors' influence on insolvency proceedings (GIBS, 2004). There is a strong interrelationship between financial situation of subjects within a country and the development of debt collection market.

The worse financial situation on the market, the higher demand for recovery services. This demand is also influenced by the contractor financing policy adopted by undertakings, as well as banks' crediting policy, and finally, regulations and recommendations of institutions that supervise creditors. Acceptance of high levels of indebtedness of entrepreneurs and natural people sooner or later leads to the development of debt collection market. Regulations concerning vindication procedures can be found in a big number of legal acts, which means that only a small number of people can master them. It is a significant obstacle for safe and predictable recovery proceedings. It is worth noting that creditors are not treated equally by regulations. The legislation supports the development of debt recovery market to the same extent, to which it prevents creditors from seeking claims. It also fosters the increase in debts. Other social determinants, which have a positive effect on the development of debt collection market are among others: disparities in income, disparities in wealth and the consumerism, which results from living on credit.

However, J. Dermine and C. Neto de Carvalho claim that banks do not always seek absolute and immediate debt collection, because this would stifle restructuring processes and in some way discourage other subjects from borrowing money there. In other words, in the debt collection process the bank takes into account not only the losses resulting from nonpayment of the debt, but also prospective benefits that can be lost because of impaired contact with current and potential clients (Dermine, Neto, 2005).

4. CREDITOR-BORROWER RELATIONS FROM THE PERSPECTIVE OF GAME THEORY - HELMET BESTER MODEL

The issues concerning borrower selection as well as creating a credit agreement that will protect the bank's interests have been a vital element of numerous research papers. Models built with the use of game theory attempt to explain the functioning of various subjects in economy in the conditions of information asymmetry. This aspect contains also a lot of financial models, especially those of banking nature. Game theory is excellent in modelling variants of parties' behaviour in a situation when there is not enough information provided about the parties' intentions as well credit risk and results of investment that is funded from credit. From the perspective of banking theory, H. Bester's model proved to be the most useful. Also, many times it has been subject to empirical and theoretical research.

The aim of Bester's model, which has been illustrated by the so called „repayment tree” was to find conditions, where there is some balance struck in the terms of information asymmetry and lack of credit rationing for all subjects in demand of credits with given interest rates and collaterals (Jaffe, Russel, 1976).

Parameters applied in this model consist of i.a. number of credits which are paid on time, number of credits that are subject to vindication and restructuring, and finally, the degree, to which debt has been collected. The condition necessary to prevent credit rationing is presenting a set of credit agreements that differ from each other in the level of interest rates as well as the value of collateral in such a way that prospective borrowers make optimal choices from their perspective of risk. Bester proved that, when there is information asymmetry, the collateral is a tool to select borrowers that differ in risk level. Borrowers with higher risk choose credit agreements with higher interest rates and no collateral while borrowers who are less risky choose a credit agreement of lower interest risk and some collateral (Bester, 1985).

When renegotiation is possible, the creditor-borrower relations can be significantly changed. Also, Bester proved that credit repayment is possible when mixed strategies are used. Using those strategies, the borrower tries to force the bank to cancel part of his debt, in spite of the fact that he has enough return on investment and good prospects to pay the debt. In turn, the bank with a high degree of repayment probability, does not agree on restructuring and takes over the collateral. H. Bester's model indicates that the higher the risk, the more frequently collateral is used. This result is seemingly contradictory with the signaling role of the collateral, in which borrowers who want to take less risk present bigger collateral. Yet, there is no contradiction here- the risk of credit agreement is clear from the beginning and it is only payment on time and its consequences which are known to the borrower. Thus, there is some dose of uncertainty which results only after signing up the credit agreement and leading to moral hazard (Bester, 1994).

The main cause of low efficiency of debt collection processes is, most frequently, inefficient functioning of judiciary system and lengthiness of court proceedings, i.e. in applications for a declaration of enforceability for banks, sluggishness and low effectiveness of debt collectors and, finally, limited access to information about debtors and their possessions which result from regulations concerning banking secrecy and protection of personal data.

According to banks, current regulations do not provide the creditor with any protection from debtors' dishonest activities.

A 30 days period contract termination, which is mentioned in Art. 75 (2) of the Banking Law is long enough for the debtor to get rid of possessions that potentially could be used by the bank as repayment.

He, too, can lawfully (with no consent of creditors which have real estate collateral) establish limited rights in rem to third parties or sell objects covered by a pledge or mortgaged properties. In such situations, the last purchaser becomes an owner in good faith. The bank can file an actio Pauliana (Art. 527-534 of Civil Code), but this solution rarely brings any positive results because of lengthiness of court proceedings and difficulties in gathering proofs of guilt (i.e. of conscious and intended actions that cause harm to the creditor).

5. CONCLUSIONS

Competition in banking sector increases banks' efficiency and stimulates financial innovations by opening new markets. It constitutes a source of many dangers, such as information asymmetry, which is often believed to be the factor which triggers financial crises. Consumer credit market, which is one of the elements of financial services market is strictly regulated by provisions of both domestic and international law. The fact that consumer credit agreements are constructed in a very complicated way is the cause of the phenomenon described as information asymmetry.

In spite of much information revealed to banks in credit applications, the borrowers' advantage in the amount of information concerning their real creditworthiness impedes the effectiveness of credit risk management process.

Information about unpaid consumer credits constitute the informative advantage for the borrower. Data illustrating the number of unpaid consumer credits which are being recovered, indicate i.e. failure of scoring methods used by bank experts because the creditworthiness has been miscalculated. Bank workers who assess credit applications, take into account client's risk of bankruptcy as well as nonpayment of credit, but they never possess full knowledge about borrowers- this is information asymmetry and it is a situation, when clients have advantage over banks.

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