

**EXPOSURE OF CREDIT CARDS OF THE BANKING  
SYSTEM OF MACEDONIA - ANALYSIS THROUGH  
THE PRISM OF RISK OF INDEBTEDNESS AND  
PERSISTANT DEBT<sup>1</sup>**

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**ABSTRACT**

Credit cards are very popular product not just as a facilitator for making payment transactions but also because of its flexibility. Customers can decide how quickly they repay their balance, choosing whether to repay it in full at the end of each month or to spread payments over a longer period. Also because of its revolving character the costumers can spend the amount that had previously paid. That opens the question about the risk of indebtedness of this some of the users of credit cards who have persistent debt. The aim of this paper is to analyze the exposure of Macedonian banks to credit cards and to determine if some regulatory measures need to be taken. The exposure towards credit card of Macedonian banking system is more than 15% of total retail exposure and the exposure is stagnant through the years. Also, this exposure compared by number of employed workers on average is 1,5 higher than the average wage. Above 10% of the exposure is toward a clients that continuously have utilization rate of more than 90%. This is a strong indicator about persistent debt that requires regulatory measures in order to be resolved.

**KEY WORDS:** credit cards, banking system, Macedonia, indebtedness, persistent debt

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## INTRODUCTION

A credit card is a payment card issued to users (cardholders) to enable the cardholder to pay a merchant for goods and services based on the cardholder's promise to the card issuer to pay them for the amounts so paid plus the other agreed charges (O'Sullivan, Arthur; Steven M. Sheffrin, 2003). The card issuer (usually a bank) creates a revolving account and grants a line of credit to the cardholder, from which the cardholder can borrow money for payment to a merchant or as a cash advance. In other words, credit cards combine payment services with extensions of credit. The concept of credit card is the 20-tieth century and as a grand-father of the modern credit cards can be named Charga-Plate which was promoted in 1928.

There are a lot of advantages both for the clients and the merchants with the credit card usage. For merchants, a credit card transaction is often more secure than other forms of payment, such as cheques, because the issuing bank commits to pay the merchant the moment the transaction is authorized, regardless of whether the consumer defaults on the credit card payment. Also, cards are even more secure than cash, because they discourage theft by the merchant's employees and reduce the amount of cash on the premises. Finally, credit cards reduce the back office expense of processing checks/cash and transporting them to the bank. With the credit cards the merchants have greater turnover because they can buy goods and services immediately and is less inhibited by the amount of cash in pocket and the immediate state of the customer's bank balance. The disadvantage for the merchants is that banks and processing companies charge interchange fee which increase the price of the product/service. Also, the POS terminals require some preconditions for their functioning which must be full field.

For the clients, the credit card is very effective way of payment. First of all, it enables the clients to carry large amounts of money with less risk regarding robbery than coins. They are small, easy to carry and the protection and security is achieved with a lot of security measures. Also, with the credit card you can afford to buy something even if you do not have the sufficient funds because you can use the line of credit. Than you can repay your debt with monthly annuities. Credit cards are accepted on for internet payments also, so for the alternative channels of payment they are very convenient. With a lot of them nowadays are connected loyalty programs which are of secondary importance than the previous mentioned. Certainly not only advantages can be determined from the

credit card usage. The interest rate and other charges of the credit card are much higher than the other products which makes them the most expensive retail product. So the risks because of inability of banks in timely manner to determine the worsening of the credit position of the customer because of the revolving principle of the product and the higher level of default leads to higher risk margin. Also, higher exposure of individual on this product can lead to indebtedness and persistency of debt. Analyzed through time, the persistence of debt points to a client that cannot decrease the exposure but only pay interest. One of the key features of credit cards is that customers can decide how quickly they repay their balance, choosing whether to repay it in full at the end of each month or to spread payments over a longer period. Subject to a contractual minimum repayment, customers can choose how much to repay each month. Any spending on the card reduces the remaining credit available and repayments make credit available again. However, the flexible nature of credit cards and the lower minimum repayment, in comparison to a personal loan for the same sum, means that it is possible for customers to carry a large balance for a long period of time without significantly reducing their debt. The ability to make minimum repayments for a period is one of the flexible features of credit cards valued by many customers, but where the customer has an interest-bearing balance over a long period of time this can be a very expensive way of borrowing in comparison with other credit products.

This paper will not focus on the advantages of credit card usage but on the negative impact from them that can result in indebtedness for some clients. Having in mind that, this paper will analyze the macro-prudential measures that can be taken in order to resolve the exposure towards these clients.

#### CREDIT CARD MARKET STUDY OF FINANCIAL CONDUCT AUTHORITY

The Financial Conduct Authority of England in 2016 has published the results of the credit card market study (FCA, 2016). This study is first of its kind in the world and defines some critical aspects as what persistent debt is and how big the problem of indebtedness from credit cards in England is. Also this study has analyzed the effects of the competition on the phenomenon of persistence of debt. This study is the starting point for the analysis of this phenomenon in the Macedonian banking sector. The main idea behind this study is that there is a significant group of consumers who carry potentially problematic debt for a

number of years. Also, the study was focused to discover whether the market is working well in the interests of consumers.

According to this study as a persistent debt are found those consumers who have an average credit limit utilization of 90% or more while also incurring interest charges over 12 months and under systematic minimum repayment behavior are defined consumers who have made nine or more minimum repayments, while also incurring interest charges over 12 months. This group of clients are indebted and there is need for systemic support, especially from regulator, in order to resolve their issue. The study found that in 2014, around two million people (almost 7% of credit card customers) were in arrears or had defaulted. Further two million people had carried a debt greater than 90% of their credit limit for at least 12 months, and that an additional 1.6 million people were repeatedly making minimum payments on their credit card debt.

FCA suggested proposals for resolving the issue with persistent debt at credit cards and suggested package of remedies. For clients whose debt falls under the definition of persistent debt there is strict schedule that must be followed:

- At 18 months the clients must be informed that continuing low repayments for a further 18 months may mean the firm suspends use of the card and makes a report to a credit reference agency;
- At 28 months the same step as before should be taken;
- At 36 months for client who have repaid more in interest and charges than principal for two consecutive 18 month periods, firms must take steps to help them repay their outstanding balances more quickly. They must write to the customer proposing options for repayment plans, based on repaying their debt over a reasonable period, usually between three and four years. The customer would be made aware that their use of the card will be suspended.

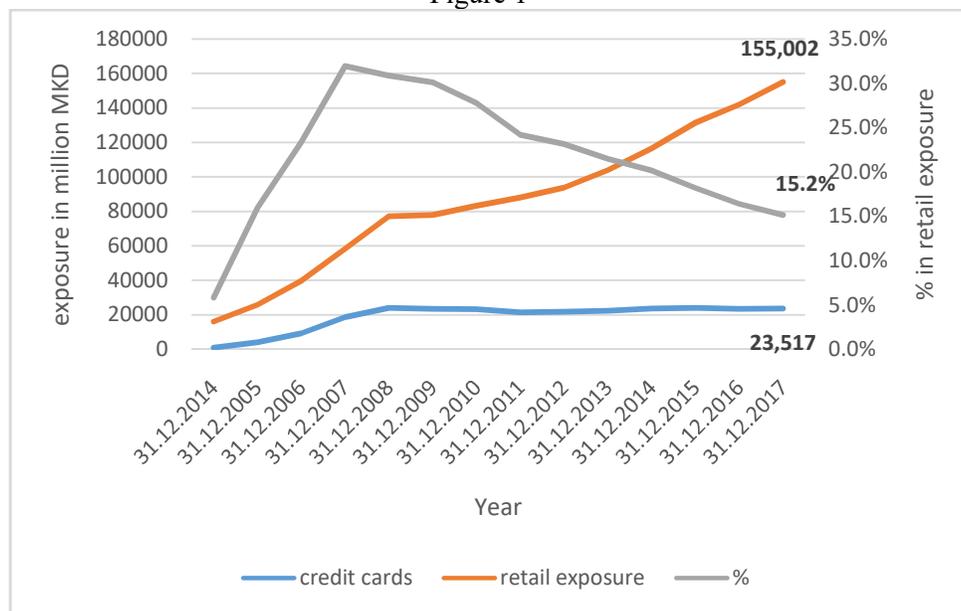
For clients that are not able to repay their debt, banks must offer forbearance measures.

Also, enhancement of the systems for monitoring of credit cards through following the patterns of spending of the buyers are required. This will increase the power of banks to identify potentially highly exposed clients and to take remediate actions.

#### HOW BIG THE CREDIT CARD MARKET IN MACEDONIA IS AND IT'S EVOLUTION THROUGH TIME

In Macedonia there are 372.123 credit cards that are issued at 30.09. 2017 and their number is in continuous growth. The volume of transaction with credit cards is greater than 14 billion of denars (MKD). As can be seen in Figure 1, credit cards as a product are relatively new in Macedonian banking system. Until 2005 the exposure towards them was very low. The expansion in exposure toward credit cards began in 2006 and the peak was reached in 2008. After that, the exposure toward this product is stable.

Figure 1-

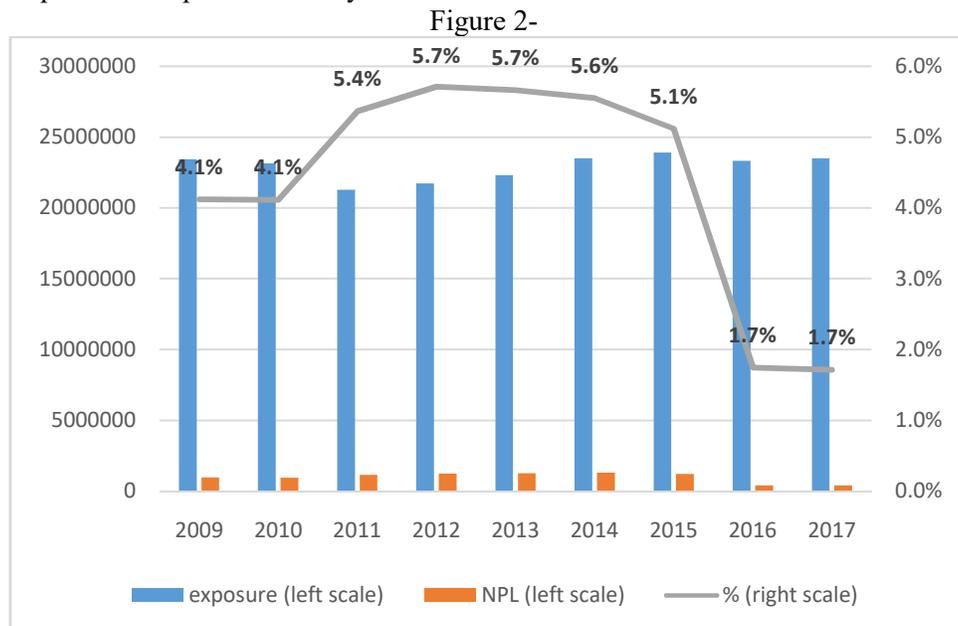


Source: NBRM

If we analyze the share of exposure of credit cards in total retail exposure, the peak was reached in 2007 and 2008 when credit cards were 1/3 of the total retail portfolio. After that, as a result of the measures of Central bank and also the first signs of the quality of this portfolio, the growth was stopped. After that, till 2017 although the rest of the retail exposure is growing the exposure of credit cards is stable. Also, the trend of share of credit cards is influenced by the NBRM regulation for write off of exposures with 100% impairment two years in a row. Still, the share of credit cards is unusually large compared with the countries in the region which makes the topic of persistence of debt especially interesting. The hypothesis is that banks created debt in the period 2006-2009 and big share

of the clients cannot repay that debt. For example, the share of credit cards in household loans in Croatia (HNB, 2017) is around 4% which is more than times less than the share of this product in Macedonia. The credit card portfolio of the Serbian banking system (Serbian Central bank, 2018) constitutes only 5% of the total retail portfolio.

The quality of the portfolio of credit cards is at the average of the whole retail portfolio. After 2010, when the growth has stopped, there was little deterioration of the quality of the portfolio. After 2010, the quality of the portfolio till 2015 was stable. In 2016, the quality of the portfolio was influenced by NBRM regulation with which banks were obliged to write off the loans that were 100% impaired for a period of two years.



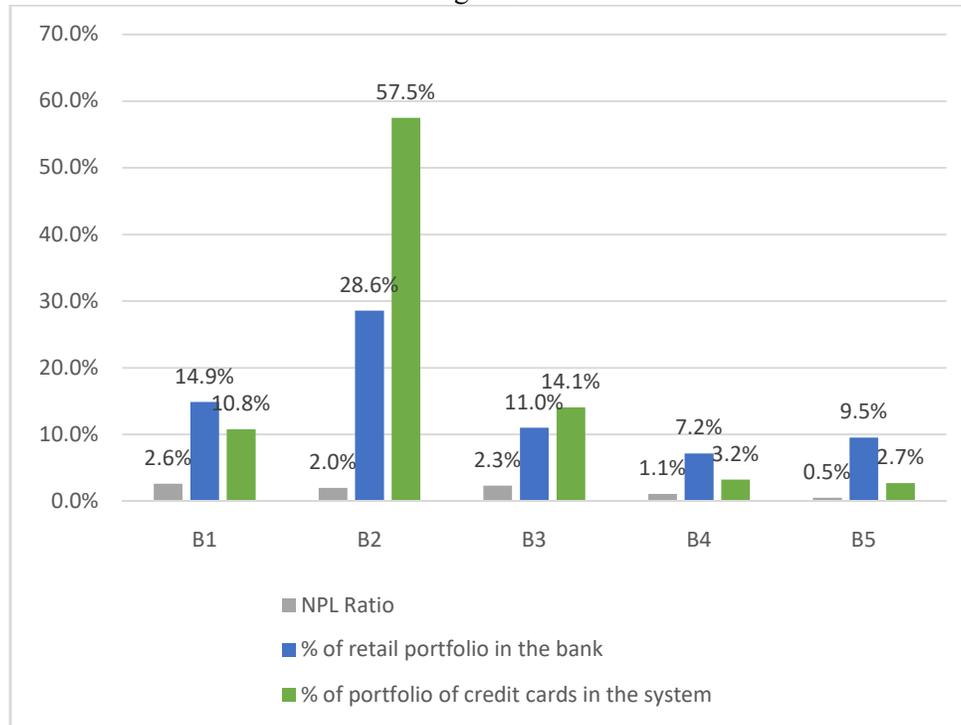
Source:NBRM

So, the figures about the size and share of the portfolio of credit cards in Macedonia can lead to the conclusion that the phenomenon of persistence of debt is present because the portfolio after 2009 when is reached its peak as a result of two figure uncontrolled loan hasn't decreased at all. So in this portfolio maybe there are clients that were exposed then and until now repay only interest because they do not have the capability repay or decrease the exposure. But

equally important question is why the banking sector hasn't taken any measures in order to decrease the size of this portfolio through some stabilization measures. Off course the main reason is the profitability of this product where banks have more than double margin then let say the consumer loan.

From the audit reports of the five banks with higher retail exposure for 2016, it becomes very clear that one bank has 57% of the exposure toward credit cards of the total banking system. Also, the share of this portfolio in the total retail portfolio of this bank is almost 30%. The share of the second and third bank in the total credit card exposure is 14% and 11% and in the bank retail exposure, their share is 15% and 11%. So the main issue regarding persistence of debt is mainly coming from the leading retail bank in Macedonia because of the size of the credit card portfolio, its share in the banking system and in the retail exposure of the bank.

Figure 3-



Source: Audit reports of the sample banks for 2016

## PERSISTANCE OF DEBT FROM CREDIT CARD EXPOSURE IN MACEDONIA

In order to determine how large the exposure towards credit cards is that is persistent first we must define what persistent debt is. Starting point is the definition that FCA has used for the market study with some modifications. First criteria are clients who in the last 24 months have more than 90% of utilization rate of the credit card limit. The second criteria is credit card exposure toward clients that hasn't declined in the last 24 months.

If we apply the definition from the first criteria, clients who in the last 24 months have more than 90% utilization of their limit, more than 23.600 clients fulfill this condition and they have exposure of 2.413.462 thousands MKD.

Having in mind the second criteria, clients who in the last 2 years didn't decreased their exposure of credit cards, there are 60.675 clients with exposure of 4.100.021 thousand MKD.

The approach that was applied in order to calculate the numbers has some limitations, only data for 12.2015 and 12.2017 were used. So, maybe part of this clients have higher utilization rate only on this dates because it is the end of the year. So the figures can be little lower if we apply whole series of 24 months. Still, the numbers that we have calculated are quite intuitive about the size of this portfolio. According to the first criteria, almost 10% of the total exposure is towards clients that have persistent debt. Regarding the second criteria, 17% of the total exposure has this kind of mark. Still, the second criteria is very rigid because doesn't take in to account the utility rate of the limit. So if a client has used only 10% of the credit card limit probably the exposure doesn't decrease because of some behavioristic reasons and not because of the inability to decrease the debt. So the results from the first criteria are more realistic.

In order to resolve the issue of inability to decrease the credit card debt at these clients, regulatory push up must be applied. The banks are focused only of the quality of the portfolio of credit cards and their primary focus is not to generate days past due in order not to impair the exposures. So their activities are targeted towards design and implementation of effective system for collection which requires closely monitoring of days of delay and contacts with the clients in the early stages with even 5 days of delay. If banks implement some programs for this clients and reduce their credit card limit, the quality of

the portfolio will deteriorate and also the interest margin will decrease because all the other products are less expensive.

The regulatory approach must consist of few phases. First, clear definition of persistent debt in order banks and the regulator to be able to identify the clients. Second, the client from this group must be notified and be given chance to decrease their debt in order to divide the clients who do not have ability and will to decrease the debt. The third step should be freeze of their limit and they can be allowed only to decrease the debt or they can chose to refinance their credit card debt with consumer loan with installments. With this process on the clients will be given opportunity to repay their debt with lower interest rate and smaller interest charges.

## CONCLUSION

There are a lot of advantages both for the clients and the merchants with the credit card usage. They are more secure, easy to carry and operate, they provide with opportunity to buy something on few installments, facilitate the trade and turnover of merchants etc. On the other hand, the interest rate and other charges of the credit card are much higher than the other products which makes them the most expensive retail product. So the risks because of inability of banks in timely manner to determine the worsening of the credit position of the customer because of the revolving principle of the product and the higher level of default leads to higher risk margin. Also, higher exposure of individual on this product can lead to indebtedness and persistency of debt. The flexible nature of credit cards and the lower minimum repayment, in comparison to a personal loan for the same sum, means that it is possible for customers to carry a large balance for a long period of time without significantly reducing their debt. The ability to make minimum repayments for a period is one of the flexible features of credit cards valued by many customers, but where the customer has an interest-bearing balance over a long period of time this can be a very expensive way of borrowing in comparison with other credit products.

In Macedonia there are 372.123 credit cards that are issued at 30.09. 2017 and their number is in continuous growth. The volume of transaction with credit cards is greater than 14 billion of denars (MKD). What is interesting is that the share of credit cards is unusually large compared with the countries in the region (15%), compared to Croatia (4%) or Serbia (5%) of the total retail portfolio. So, the figures about the size and share of the portfolio of credit cards in Macedonia

can lead to the conclusion that the phenomenon of persistence of debt is present because the portfolio after 2009 when is reached its peak as a result of two figure uncontrolled loan hasn't decreased at all. So in this portfolio maybe there are clients that were exposed then and until now repay only interest because they do not have the capability repay or decrease the exposure. But equally important question is why the banking sector hasn't taken any measures in order to decrease the size of this portfolio through some stabilization measures. Of course the main reason is the profitability of this product where banks have more than double margin then let say the consumer loan.

In this paper two definitions of what persistent debt is are used. Starting point is the definition that FCA has used for the market study with some modifications. First criteria are clients who in the last 24 months have more than 90% of utilization rate of the credit card limit. The second criteria is credit card exposure toward clients that hasn't declined in the last 24 months. If we apply the definition from the first criteria, clients who in the last 24 months have more than 90% utilization of their limit, more than 23.600 clients fulfill this condition and they have exposure of 2.413.462 thousands MKD.

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