

AMENDMENTS TO THE LAW ON FINANCIAL COMPANIES IN THE SPIRIT OF PROTECTING CITIZENS' INTERESTS

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Abstract

Nonbank financial companies, also known as financial companies, are financial institutions that offer various financial services, such as: approving loans to individuals and legal entities, issuing and administering credit cards, factoring and issuing guarantees, as well as advising on various financial and leasing activities. Unlike banks, for the establishment of a financial company, a simpler procedure is foreseen, even a license from the National Bank is not required, but only permission from the Ministry of Finance. The establishment, operation and supervision of financial companies in the country is governed by the Law on Financial Companies. As institutions that are in their infancy in the country and given the still insignificant impact on the financial sector, it is expected that the legislator will often make changes and additions to the legal regulations for financial companies. The purpose of these changes in the legislation of financial companies is to provide an operating environment for them between the protection of the users of services from financial companies and the increase of reliability towards these companies. In this paper, the author, in addition to analyzing the legislative platform and the recent changes in this platform, but through the statistical method provides an overview of the activity of financial companies in the Republic of North Macedonia.

Keywords: financial institutions, banks, Law on Financial Companies, infancy, activity, changes.

Introduction

The local legislator, through the Law on Financial Companies,¹ defines the financial company as a non-banking financial institution that performs financial activities.² The financial company sector consists of institutional units that are independent legal entities and market producers, and whose principal activity is the production of financial services.³ A financial institution is a company engaged in the business of dealing with financial and monetary transactions such as deposits, loans, investments, accounting, insurance, asset management, credit cards, brokerage and currency exchange.⁴ Usually they are companies specializing engaged in the loan of money against collateral or speculatively to manufacturers and retailers, especially one specializing in the financing of hire-purchase contracts.⁵ When it comes to the financial company as an integral part of financial institutions, financial activities include primarily the following activities: approval of loans, issuance and administration of

¹ *Law on Financial Companies*, Official Gazette of the Republic of North Macedonia, no. 158/10. Correction of the Law on Financial Companies, Official Gazette of the Republic of North Macedonia, no. 169/10. Law on Amending and Supplementing the Law on Financial Companies, Official Gazette of the Republic of North Macedonia, no. 53/11, 112/14, 153/15, 23/16.

² Article 3 of Law on Financial Companies. According to International Monetary Fund, among the things money can buy, there is a distinction between a good (something tangible that lasts, whether for a long or short time) and a service (a task that someone performs for you). A financial service is not the financial good itself - say a mortgage loan to buy a house or a car insurance policy - but something that is best described as the process of acquiring the financial good. In other words, it involves the transaction required to obtain the financial good. The financial sector covers many different types of transactions in such areas as real estate, consumer finance, banking, and insurance. It also covers a broad spectrum of investment funding, including securities. <https://www.imf.org/external/pubs/ft/fandd/2011/03/basics.htm> [accessed: 02.11.2023].

³ <https://www.ons.gov.uk/economy/grossdomesticproductgdp/compendium/unitedkingdomnationalaccountsthebluebook/2022/financialcorporations> [accessed: 02.11.2023].

⁴ <https://www.investopedia.com/financial-companies-6828966> [accessed: 02.11.2023].

⁵ <https://www.collinsdictionary.com/dictionary/english/finance-company> [accessed: 02.11.2023].

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credit cards, factoring and issuance of guarantees. In addition to the listed financial activities, financial company can also perform the following activities: counseling related to the above mentioned financial activities; and rental of movable and immovable property to third parties, including operating leasing.⁶ Although they carry out banking services, they are not obliged to obtain a license from the National Bank. The local legislator, when determining the framework of activities that can be exercised by financial companies, has expressly provided that these companies are not allowed to exercise activities other than those provided above. This is done in order to prevent the exercise of other related activities exercised by other non-financial companies. More specifically, this limitation keeps them outside the scope of conventional oversight from financial regulators.⁷

Mario Massari, Gianfranco Gianfrate & Laura Zanneti rightly argue that if there is a lesson from the on-going economic crisis, it is that financial companies play key role in the economic life of nations. The understanding of how banks, insurance companies, and other financial institutions actually work is therefore of paramount importance, not just for scholars but also for managers, investors, regulators, and policy makers. A sound understanding of how financial companies work should be reflected in reliable methodologies in order to value them.⁸ This is because that, the pace of economic development of a nation depends on the effective and efficient functioning of its financial system.⁹

Establishment of the financial company

A financial company shall be established as a company with limited liability, a joint stock company, or a subsidiary of a foreign trade company, in accordance with the Law on Companies. A financial company shall be established with a basic capital of at least MKD 30.000.000.¹⁰ The basic capital of the financial company must not ever decrease under the amount above referred.¹¹ The financial company shall be obliged to use the words “financial company” or the abbreviation “FC” in the name.

A prior license for establishment and operation from the Ministry of Finance shall be necessary for establishment and operation of a financial company.¹² The financial company shall acquire the status of a legal entity upon the entry in the trade register kept by the Central Register.¹³ Furthermore, the Ministry of Finance shall keep a Register of Financial Companies in an electronic form.¹⁴

Status of Activity of Financial Companies in the Republic of North Macedonia

Financial companies are one of the most dynamic segments of the financial system. They represent a small, but one of the fastest growing segments of the financial system, and the interest in establishing new financial companies still exists. The credit activity of these entities is primarily aimed at natural and legal persons who face more difficult access to bank loans or who have an urgent and short-term need for funds. Financial companies in themselves do not

⁶ Article 4, Law on Financial Companies.

⁷ <https://www.investopedia.com/terms/n/nbfc.asp> [accessed: 02.11.2023].

⁸ Mario Massari, Gianfranco Gianfrate, Laura Zanneti, *The Valuation of Financial Companies: Tools and Techniques to Value Banks, Insurance Companies, and other Financial Institutions*, John Wiley & Sons, 2014, vii.

⁹ C Rama Gopal, *Management of Financial Services*, Vikas Publishing House PVT LTD, 2014, 2.

¹⁰ The value of MKD 30,000,000 has been foreseen with the amendment of the Law in 2023 because otherwise earlier a lower value of only MKD 6,000,000 was required. The goal of the legislator with the increase of the capital necessary for the establishment of the financial company was to increase the seriousness of the founders and to increase the legal security for their clients.

¹¹ Article 7 of the Law on Financial Companies.

¹² Article 8(1) of the Law on Financial Companies.

¹³ Article 15(1) of the Law on Financial Companies.

¹⁴ The register led by the Ministry of Finance currently counts 35 financial companies, https://finance.gov.mk/wp-content/uploads/2023/09/Registar_FD_septemvri.pdf [accessed: 15.11.2023].

pose a risk to overall financial stability. They are non-deposit institutions that are well capitalized and have an insignificant connection with other segments of the financial system.¹⁵

In 2018, the number of licensed financial companies increased by three compared to the preceding year and it equals 22. The expansion of the activities of these companies continued, whose total assets increased by MKD 639 million, or 30.9% compared to 2017 (107.6% in 2017). Within the assets, the short-term loans had the highest contribution (84.5%). The increase in the activities is supported by the growth of other short-term and long-term liabilities. The expansion becomes evident by the number and the value of newly concluded contracts, especially with natural persons.¹⁶

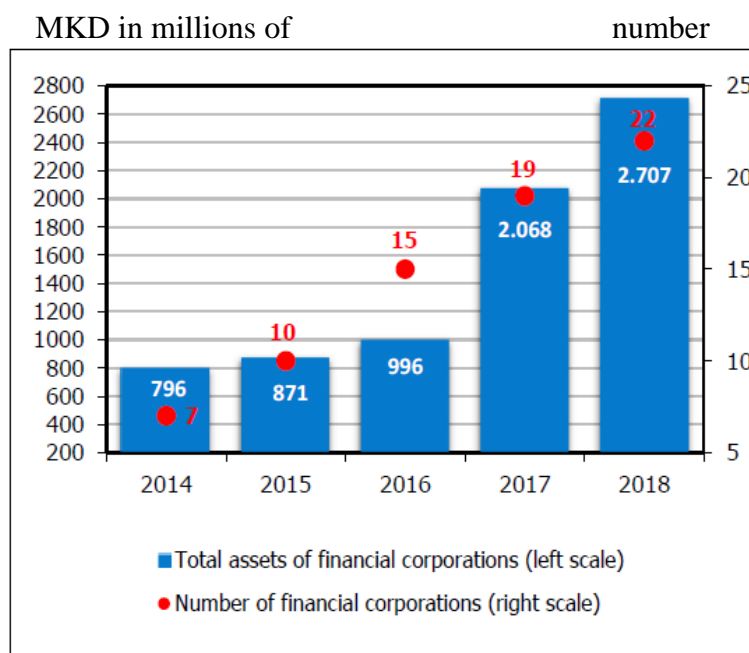


Chart 1 – Total assets and number of financial companies
Source: Ministry of Finance

In 2019, the financial companies' assets continued the multiannual trend of dynamic growth and registered the highest change rate between individual segments of the financial system. Namely, in 2019 the financial companies' assets increased by 52.2% (or by MKD1.414 million), which is a significantly rapid growth compared with the previous year (30.9% or MKD 639 million). In the group of non-bank financial institutions which deal with lending and leasing, the financial institutions assets is twice bigger than the savings houses liabilities, and is getting closer to the size of leasing companies, which are still the largest within this group of institutions. The number of licensed financial companies increased by five, and by the end of 2019 reached 27 companies (out of which, two were inactive on 31.12.2019).¹⁷

The rate of capitalization of financial companies in 2020, measured as the share of capital and reserves in total assets remained at almost the same level as in 2019. The total receivables of financial companies based on loans, guarantees, factoring and credit cards are 2.7 times higher than capital and reserves (2.6 times in 2019), while the legal maximum for this ratio is 10 times (in other words), the capitalization rate of financial companies is almost four times higher than the legal minimum in this domain.¹⁸ In conditions of health and economic crisis,¹⁹

¹⁵ *Financial Stability Report in the Republic of Macedonia in 2022*, Skopje: National Bank of the Republic of North Macedonia, 2023, 139.

¹⁶ *Financial Stability Report in the Republic of Macedonia in 2017*, Skopje: National Bank of the Republic of North Macedonia, 2018, 133.

¹⁷ *Financial Stability Report in the Republic of Macedonia in 2019*, Skopje: National Bank of the Republic of North Macedonia, 2020, 187.

¹⁸ *Financial Stability Report in the Republic of Macedonia in 2020*, Skopje: National Bank of the Republic of North Macedonia, 2021, 112-113.

the indicators for the exposure of financial companies to credit risk are deteriorating. In 2020, the share of receivables based on active contracts with customers that are charged with a delay of more than 90 days in total receivables increased, which is mostly due to the growth of uncollectible receivables from individuals (annual growth of 46.9%). Despite the high diversification of the loan portfolio, given the predominant approval of small loans, the share of overdue loans is relatively high. The overall analysis shows that almost 80% of the receivables of the financial companies are collected with a certain time delay, and the highest is the share of receivables that are collected with a delay of up to 30 days (45.2% on 31.12.2020). Hence, not only are financial companies inherently exposed to credit risk, but the level of risk realization is quite high, which may be the reason for embedding high risk premiums in the price of their services as compensation for the high costs caused by the realization of the risks. Thus, in 2020, with an annual growth of 56.3%, the cost of impairment exceeded the amount of realized profit in the income statements of financial companies and reached a level of about 160% of the profit of this segment (versus about 90% from the profit for 2019).²⁰

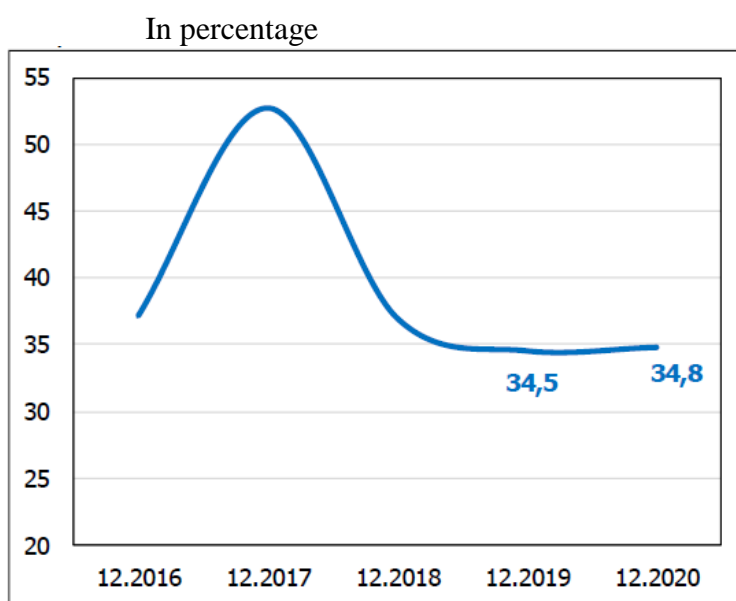


Chart 2 - Share of capital and reserves in total assets

Source: National Bank calculations based on data submitted by the Ministry of Finance

In 2021, financial companies registered accelerated growth compared to the previous year, while the interest in incorporating new financial companies remains. Credit risk is the major risk the financial companies are exposed to throughout their operations. Almost 60% of the claims of financial companies are collected with a certain time delay, whereby the share of claims on active agreements with customers charged with a delay of more than 90 days in total claims increased and reached 27.4%.²¹

¹⁹ In order to alleviate the debt burden of individuals and legal entities that are users of services from financial companies, in conditions of a coronavirus pandemic, at the beginning of April 2020, a Decree was adopted with legal force for the application of the Law on Financial Companies during of state of emergency (Official Gazette of Republic of North Macedonia, no. 90/20). Pursuant to the provisions of this Regulation, the financial companies have facilitated the repayment obligations of the borrowers, for a period of up to six months, from April 1 to September 30, 2020. Thereby, the terms of the loan agreements were eased for about 60% of the natural borrowers and about 7% of the legal entities - borrowers. As of September 30, 2020, the period of facilitated repayment of liabilities based on loan agreements has expired and starting from October 1, 2020, borrowers have an obligation for regular repayment of liabilities under the agreement.

²⁰ *Financial Stability Report in the Republic of Macedonia in 2020*, 112-113.

²¹ *Financial Stability Report in the Republic of Macedonia in 2021*, Skopje: National Bank of the Republic of North Macedonia, 2022, 123.

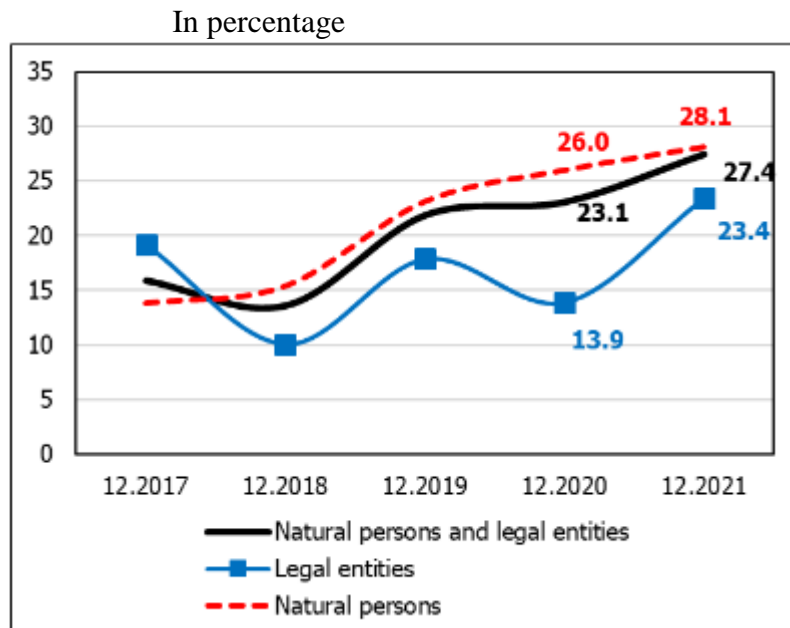


Chart 3 - Claims based on active contracts with customers not collected for more than 90 days on any basis, from the due date, to total claims

Source: National Bank calculations, based on data submitted by the Ministry of Finance

In 2022, also for financial companies, legal and reputational risk will become more and more important, which is connected with the ever-present information in the public about the misuse of the personal data of natural persons by other persons when taking online credit from financial companies. It is necessary to significantly strengthen the procedures for the identification of customers when approving online loans, in order to minimize the possibilities for such abuses, but also to preserve the reputation and future survival of these companies.²²

Financial companies are non-deposit institutions and most of their sources of financing are from related entities (almost 40% of the liabilities of financial companies¹⁸⁹ arise from related entities of the companies), and above all in the long term. Participation in loans and loans from the country's banks is very small and insignificant in terms of the balance sheets of the banks, while mutual relations with other financial institutions are absent. Thus, the small share of the assets of these companies in the total assets of the financial system and, on the other hand, their very low connection with the other segments of the financial system are indicators of the low importance of these companies for systemic stability.²³

The basic indicators of the profitability of financial companies have improved. The growth of the net profit by MKD 304 million, or by 150.4%¹⁹³, contributed to the improvement of the indicators for the return on invested capital and reserves and the return on the assets of financial companies (by 2.9 percentage points and 2 percentage points, respectively), compared to the previous year. The indicator for the ratio of operating expenses to total revenues also recorded an improvement (by 7.9 percentage points).

²² Ibid, 141-142.

²³ Ibid, 143.

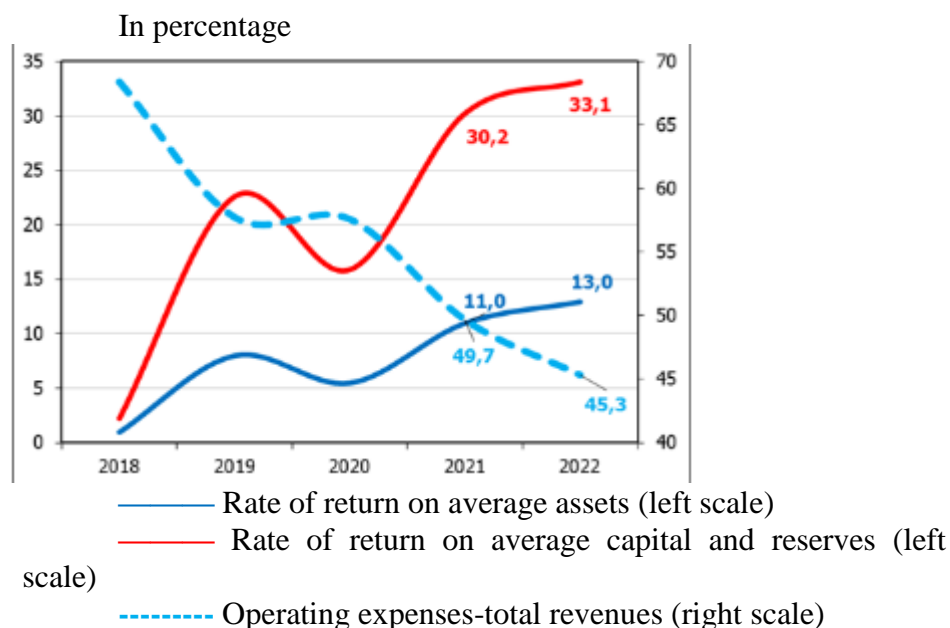


Chart 4 - Selected profitability indicators

Source: National Bank calculations based on data provided by the Ministry of Finance

Review of key amendments to the Law on Financial Companies

In July 2023 at the proposal of the Ministry of Finance as the competent authority for financial companies, amendments and additions to the Law on Financial Companies²⁴ were adopted, with the aim of providing greater protection to citizens who use the services of financial companies, to increase trust in these companies, as well as to establish greater control of the risks that may arise from their operations. Such a thing can be seen from the tightening of the criteria for the establishment of the financial company. Thus, the capital needed for its establishment has increased fivefold, from MKD 6,000,000 to MKD 30,000,000.²⁵ Also, for the establishment, it is prohibited for the founder to be a person who does not possess a reputation, which could endanger the safe and stable work of the financial company. An obligation is also introduced for the manager to be an employee of the financial company, to have a reputation, etc., and additional criteria are introduced regarding the reputation, integrity and financial condition of the founders when establishing new financial companies.²⁶

The amendments to the Law strengthen the requirements for the protection of the clients of the financial companies and the users of consumer loans approved by these companies. Within those frameworks, the maximum amount of all costs related to the loan is determined, the possibility of taking a loan to close a previously due loan in the same financial company is abolished, and the possibility of commercial companies holding a permit or license in accordance with the Law on Games of Chance is also abolished. and for entertainment games, to be able to be credit intermediaries of a financial company, that is, to offer credit products.

The amendments provide that the financial company cannot conclude a consumer credit agreement, if the agreement or the services related to it stipulates a fee or more fees that are not included in the calculation of the annual rate of total costs, and which alone or in combination with any other fees exceed or may exceed 60% of the amount of the approved loan. Fees in this sense are all costs that the consumer pays or has the obligation to pay during

²⁴ Law on amendments and additions of the Law on Financial Companies, Official Gazette of Republic of North Macedonia, no. 154/23. This law complies with Regulation (EU) no. 910/2014 of the European Parliament and of the Council of 23 July 2014 on electronic identification and confidential services for electronic transactions in the internal market and repealing Directive 1999/93/EC (CELEX No. 32014R0910).

²⁵ Article 6 of the Law on amendments and additions of the Law on Financial Companies.

²⁶ Article 7 of the Law on amendments and additions of the Law on Financial Companies.

the entire period of validity of the agreement, expressed as a percentage or in absolute amount, and which arise from or are in any way related to the consumer credit agreement or with the services related to it, except for the costs incurred in the enforcement procedure and the legal penalty interest. The financial company that approves consumer loans is obliged to publicly publish the tariff list with the previously mentioned fees on its website, and if the financial company does not have a website, it is obliged to highlight the tariff list in a visible place in its working premises. There is also a provision that the financial company should carry out its activities in at least one business premises.²⁷

Furthermore, the list of activities that financial companies can perform is supplemented by the activity of providing payment services through the establishment of special payment institutions, i.e. trading companies established in accordance with the Law on Payment Services and Payment Systems, for which a permit will be issued The National Bank. With the legal changes, the financial activity - factoring - is adjusted.²⁸

The Law also strengthens the supervision over the operation of financial companies, for which a special regulation should be prescribed and the measures are strengthened, if the financial company does not operate in accordance with the provisions of the Law.²⁹

Conclusion

The financial companies are one of the most dynamic segments of the financial system. In recent years, the number and assets of this financial sector segment, have constantly increased, but without significant changes in the relative importance to the financial system, i.e. they remain at its margins. The relatively high services prices charged by financial companies, and the expectation of high profit margins are one of the most important reasons for the high interest in this market segment, which is one of the largest by number of financial institutions (right after the insurance-brokerage companies segment). Financial companies are mainly focused on the market segments that have urgent need for short-term assets, but also on unbanked clients who have difficulties meeting the stricter credit standards of banks and savings houses.

The study argues that financial companies as entities that exercise financial activities are both the newest and most dynamic segment of the financial system, which are welcomed in the first place for individuals and simultaneously legal entities that have difficulty in reaching credit products from banks or they don't like transactions with banks. Such companies have a short history of existence in the Republic of North Macedonia a little over ten years, while their dynamism can be seen in the relatively high number of their establishment for period of time. Analyzing the statistics of the activity of financial companies in the past five-year period, it results that the number of these organizations with a financial character is constantly increasing, while their participation in the financial system in the country is progressing slowly. In this direction, to improve this situation in a positive aspect, there have been the efforts of the legislator through the continuous amendment and completion of the Law on financial companies. The most prominent appears to be the latter made in 2023, by the way of greater protection of citizens, using the services of financial companies and boosting the confidence in financial companies are part of the goals under the amendments.

²⁷ Articles 19-a to 19-f of the Law on amendments and additions of the Law on Financial Companies.

²⁸ Article 19-b of the Law on amendments and additions of the Law on Financial Companies enumerates the types and contracts of factoring.

²⁹ Articles 27-28 of the Law on amendments and additions of the Law on Financial Companies.

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