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Keeping clients first in microfinance

Digital Financial Services and Client Protection: Time for Celebration or Concern?

October 2018

Social Performance TASK FORCE

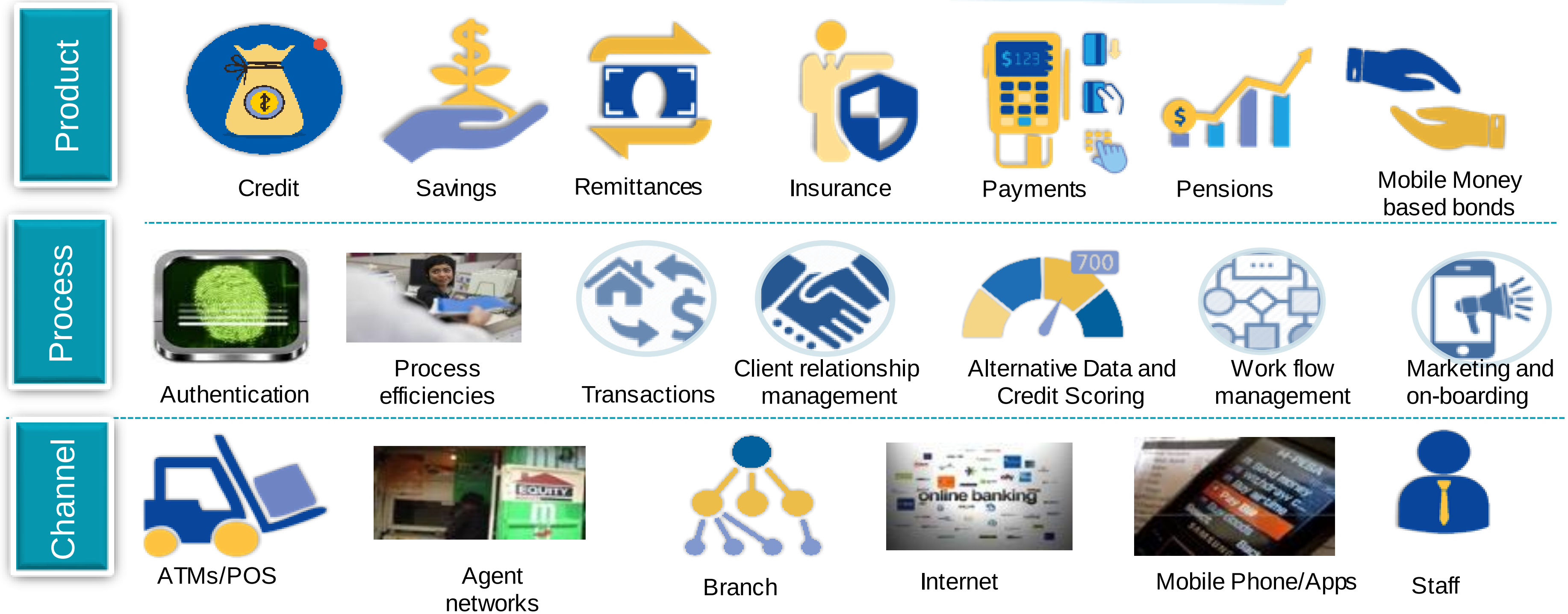
Session Objectives

- Clarification on concepts
- Kenyan Digital Financial Services at a glance
- Digital Financial Services: Client Protection Opportunities, Risks & Emerging Evidence
- Going further:
  - What can be done to prevent fintech digital services drift from providers?
  - How can I play a role as a technical service provider in this digital financial services landscape?

Definition of Terms (1)

Digital Financial Services:

Access to and **use of** formal **financial products and services(including transfers,payments,stored value,savings,credit,insurance and more)** by the end consumer through **digital channels**, leveraging **technology enabled/oriented processes.**



Source: CGAP Definition of Digital Financial Inclusion

Definition of Terms (1)

- **Mobile Financial services (MFS)**: Include both mobile banking (m-banking) and mobile payments (m-payments)

- **Mobile Banking**: The use of a mobile phone to access banking services and execute financial transactions. This covers both transactional services, such as transferring funds, and non-transactional services, such as viewing financial information on a mobile phone

- **Branchless banking**: The delivery of financial services outside conventional bank branches. Banking beyond branches uses agents or other third-party intermediaries as the primary point of contact with customers and relies on technologies such as card-reading point of sale (POS) terminals and mobile phones to transmit transaction details

Source: AFI, Digital Financial Services Basic Terminology, Guideline Note No. 19, August 2016

Definition of Terms (2)

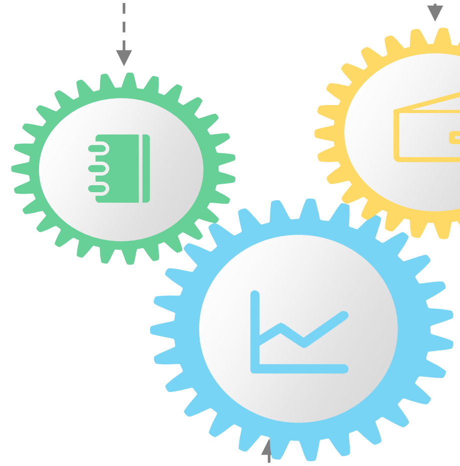
- **Mobile network operator (MNO) / Telco**: A company that has a government-issued license to provide telecommunications services through mobile devices
- **Agent**: Any third party acting on behalf of a bank or other financial services provider (including an e-money issuer or distributor) to deal directly with customers under contractual agreement
- **Fintech**: or Financial Technology refers to organizations combining innovative business models and technology to enable, enhance and disrupt financial services

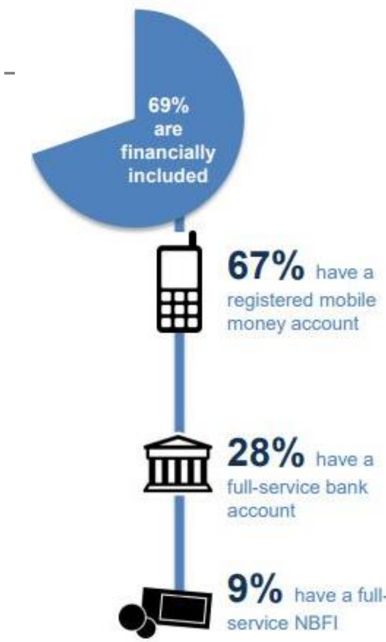
Source: AFI, Digital Financial Services Basic Terminology, Guideline Note No. 19, August 2016

Kenya: Demographic Overview (1)

Mobile penetration stands at **84% with approximately 36.1 million subscriptions** to the various mobile network operators

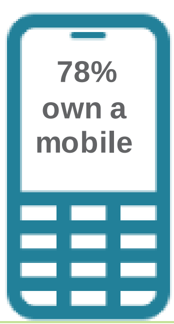
27% of Kenyan adults (>18 years) are digital borrowers (Estimated Kenyan adult population = 23.5 mil)

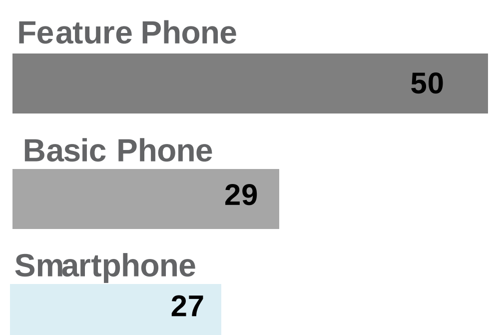




One of the key drivers to financial inclusion is access to finance. Digital platforms have been used as a channel to drive access and with this, innovative financial products like digital credit have been rolled out in Kenya and are set to increase.

However a growing numbers of clients have been blacklisted on Kenya's credit bureaus for outstanding loans of >90 days. In the last three years, 2.7 million people (circa 10% of the adult population of Kenya) are said to have been blacklisted on Kenya's TransUnion credit reference bureau for non-repayment of digital credit loans.





[Source: FinAccess Household Survey-2016-FSDK](#)
[Quarterly Report, Communication Authority of Kenya, March 2017](#)

Kenya: Demographic Overview (2)

Structure of the mobile money market in Oct-Dec 2017

Providers	Agents	Subscriptions (million)	Number of transactions (million)	Value of transactions (KSh billion)	Mobile commerce transactions (million)	Mobile commerce (KSh billion)	p2p transfers (KSh billion)
M-Pesa	152,077	23.42	493.06	1,409.83	372.0	907.32	492.61
Airtel money	23,515	2.79	2.61	1.58	3.23	2.99	1.01
Equitel	-	1.93	110.51	350.54	65.95	258.95	102.02
Mobikash	16,749	1.77	0.81	0.12	0.06	0.09	0.22
Mobile Pay	5,893	0.89	0.40	1.46	0.00	0.00	7.76
TOTAL	**198,234**	**30.00**	**607.41**	**1,763.55**	**441.24**	**1,169.35**	**603.62**

Source: Quarterly Report, Communication Authority of Kenya, May 2018

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Agency Banking in Kenya, 2017

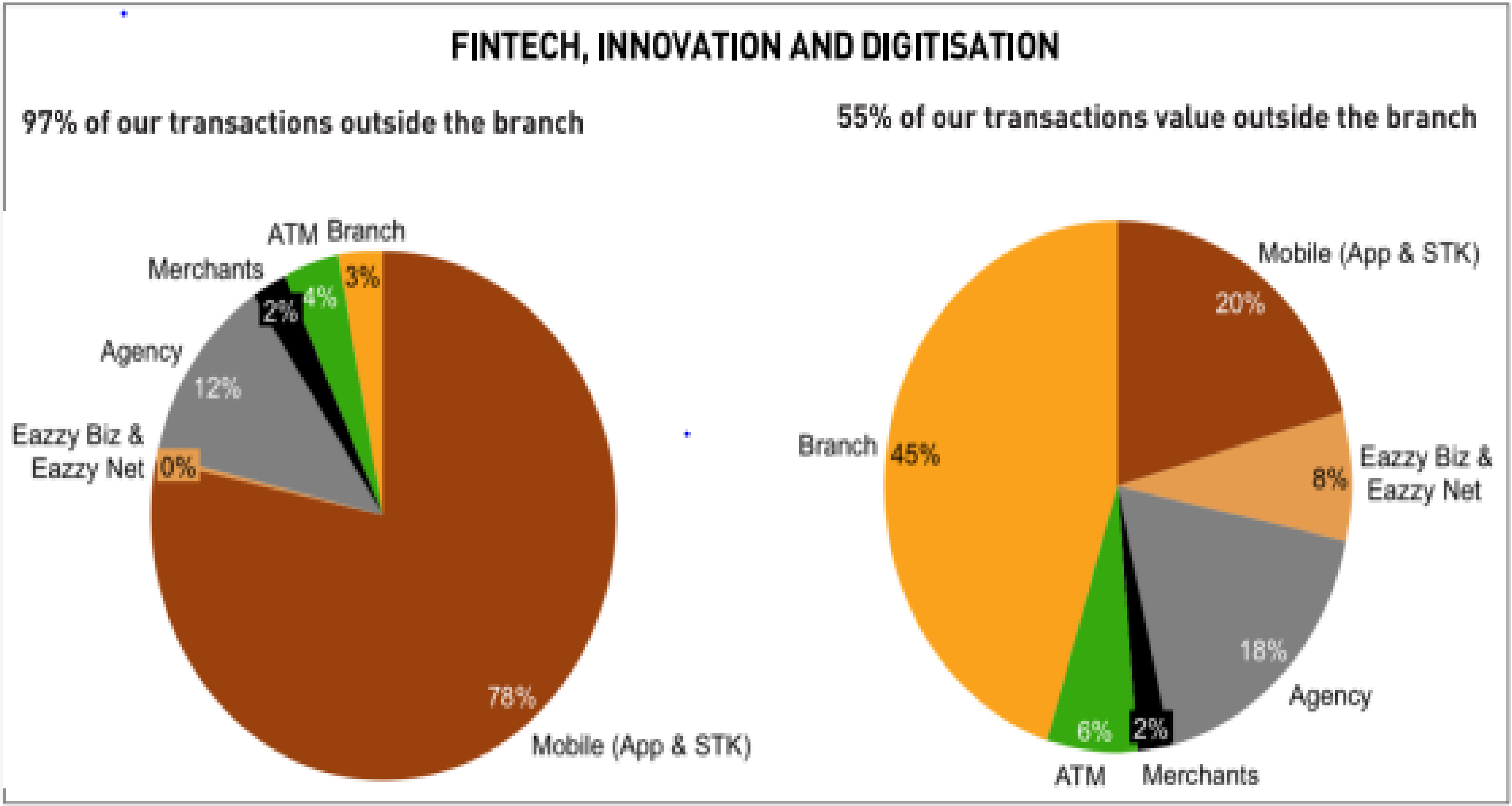
- Delivery of financial services through agent banking model continued to increase in 2017 with 18 commercial banks and 5 MFBs contracting 61,290 and 2191 agents
- Over 89% of the approved commercial bank agents were concentrated in 3 banks: Equity Bank (28,663), KCB (14, 466) and Cooperative Bank (11,207)
- Over 94% of the MFBs agents were contracted by the largest MFB – Kenya Women MFB
- The number of banking transactions undertaken through bank agents increased by 34.1%

Table 20a: Type of Transactions	Number of Transactions			
	2016	2017	% Change	Cumulative (2010-2017)
Cash Deposits	56,056,750	72,021,597	28.5%	225,102,799
Cash Withdrawals	33,280,161	48,981,216	47.2%	165,787,764
Payment of Bills	1,283,300	1,937,698	51.0%	4,129,740
Payment of Retirement and Social Benefits	2,029,458	2,352,493	15.9%	5,558,586
Transfer of Funds	15,490	5,193	-66.5%	41,897
Account balance enquiries	11,338,113	14,228,339	25.5%	59,360,776
Mini statement requests	117,889	150,638	27.8%	488,239
Collection of loan applications forms	75	-	-0.0%	77
Collection of account opening application forms	71,217	74,015	3.9%	1,665,686
Collection of debit and credit card application forms	1,006	-	-	118,064
Collection of debit and credit cards	-	-	-	60,580
Total	**104,193,459**	**139,751,189**	**34.1%**	**462,314,208**
Number of Agents	**53,833**	**61,290**	**13.9%**	

Source: CBK

Central Bank of Kenya: Bank Supervision Annual Report 2017

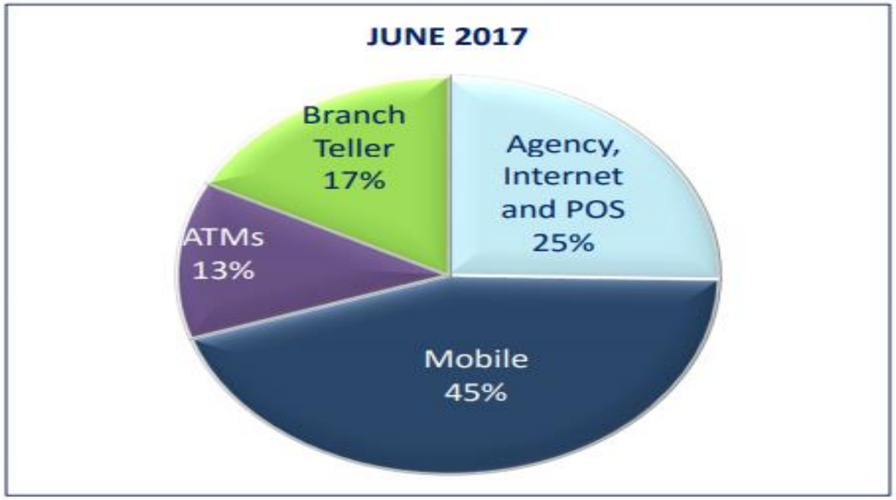
Key Trends in Innovation and Digitization (1)

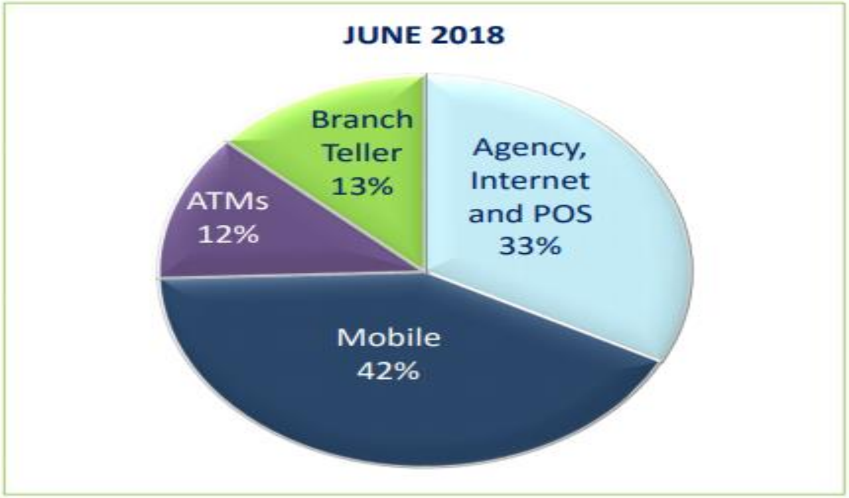


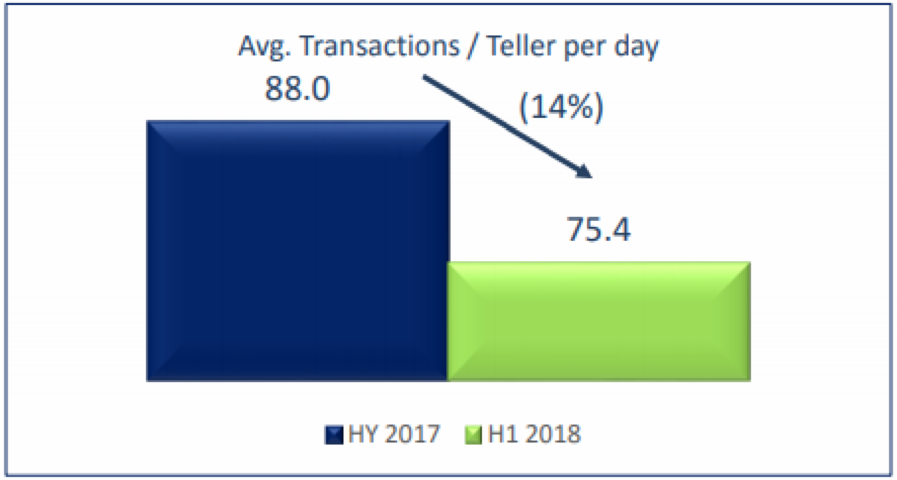
[Equity Bank Half Year 2018 results]()

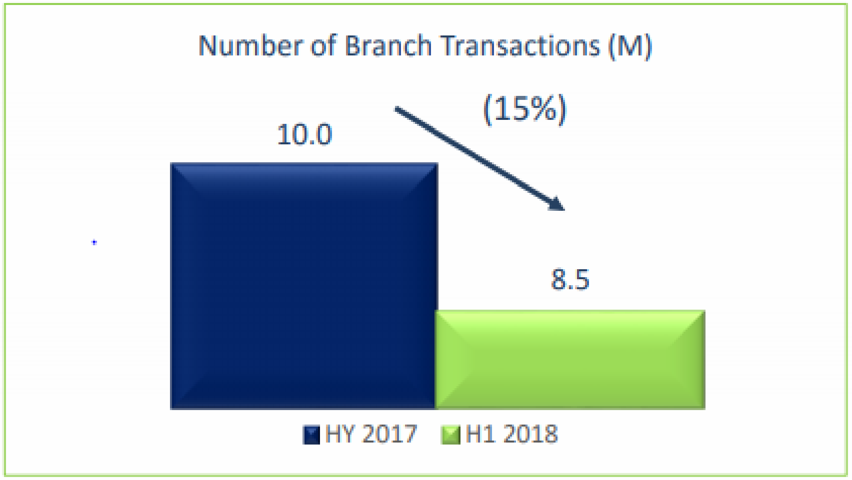
Key Trends in Innovation and Digitisation (2)

87% of transactions performed outside the branch





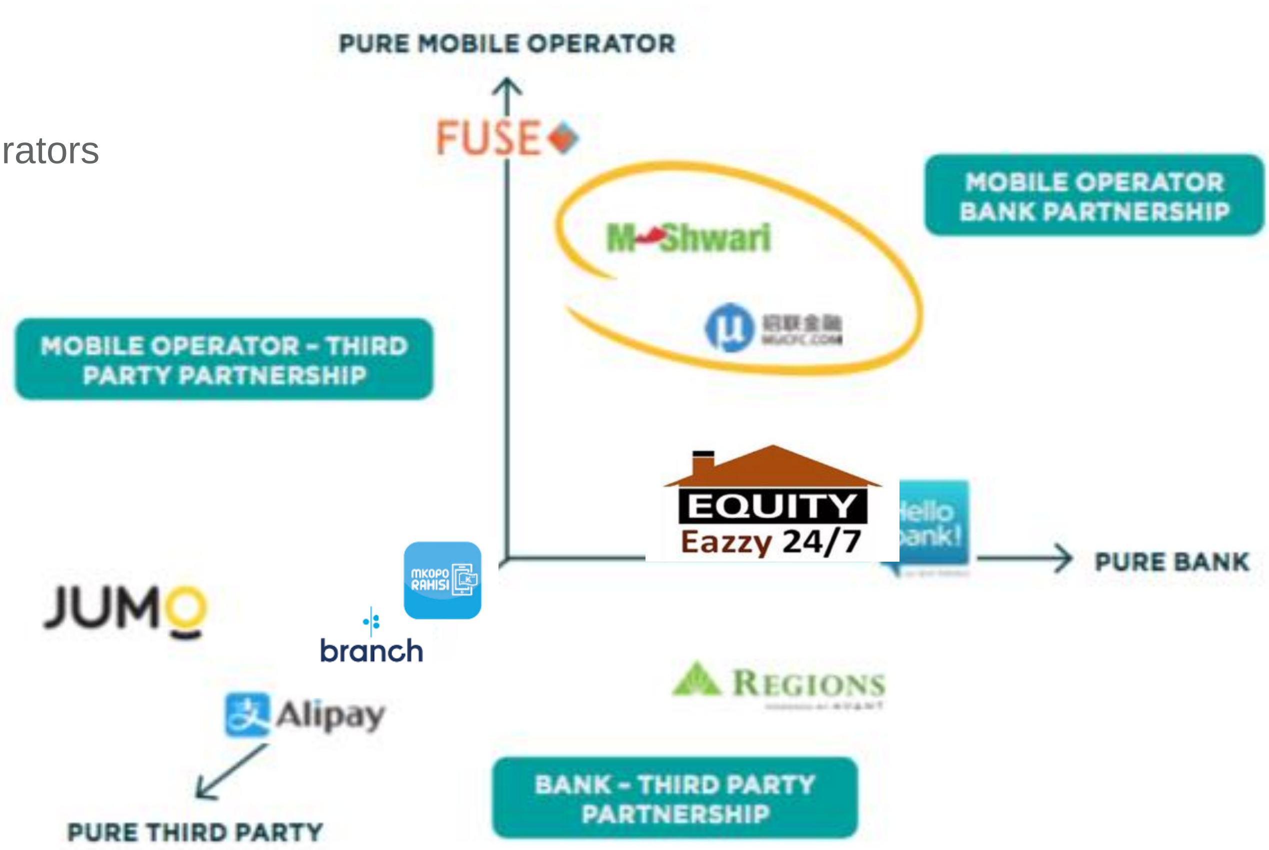




Categories of Digital Credit Providers

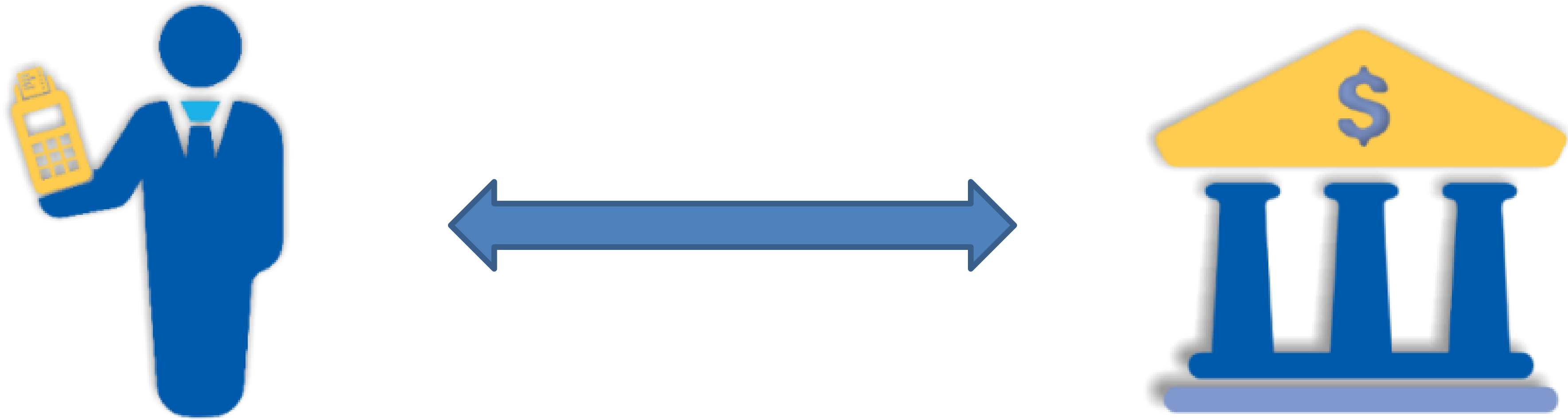
Digital credit is offered by various providers, such as:

- Banks
- Mobile Network Operators
- Third Parties
- Partnerships



Sources: MOBILE CREDIT: REGULATORY CHALLENGES AHEAD. ITU Working Group , Jason Blechman
Mobile Lending. The new Frontier in Mobile Financial Services

Variations of Digital Credit Models (1): Business To Customer



- A personal loan that is originated by and disbursed by an institution over a digital platform
- The credit risk is based on each individual consumer
- Scoring models could be based on alternative data
- Credit worthiness is revised based on repayment behaviour

KCB M-PESA ACCOUNT | Juvo | M-Shwari | branch

Mynt A FRESH LOOK AT MONEY | JUMO | Tencent 腾讯

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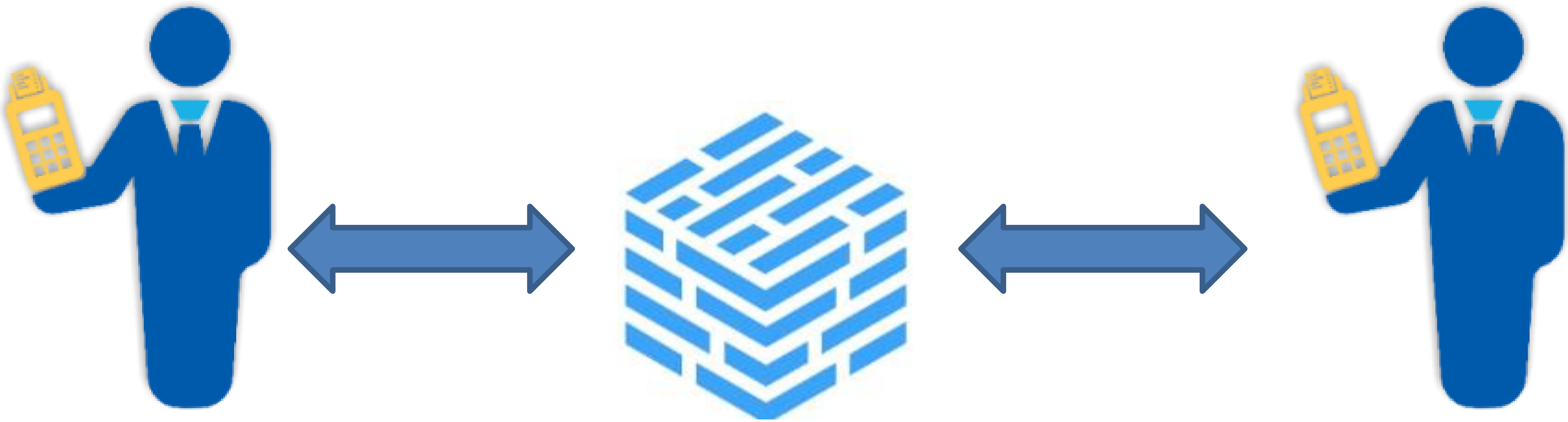
Variations of Digital Credit Models (1): Business To Business

- Credit is offered to enhance value chains or to finance operations
- The credit risk is based on business transactional history
- Credit is offered based on long standing business relationships
- Collection is typically done from sales or transactional accounts

TIENDA PAGO | ZOONA LET'S MAKE IT REAL | KOPO KOPO | konfio | ECOCASH

Variations to Digital Credit Models (1): Person To Person



- A personal loan that is offered by an individual and disbursed to an individual or business over a digital platform owned by an institution.
- The platform owner makes the decision on the loan terms
- If the platform owner is a social enterprise they will only charge an administration fee and no interest
- If the platform is "for profit" and seeks to attract investors, they will charge an interest fee

WeLab
zidisha
LendingClub
kiva

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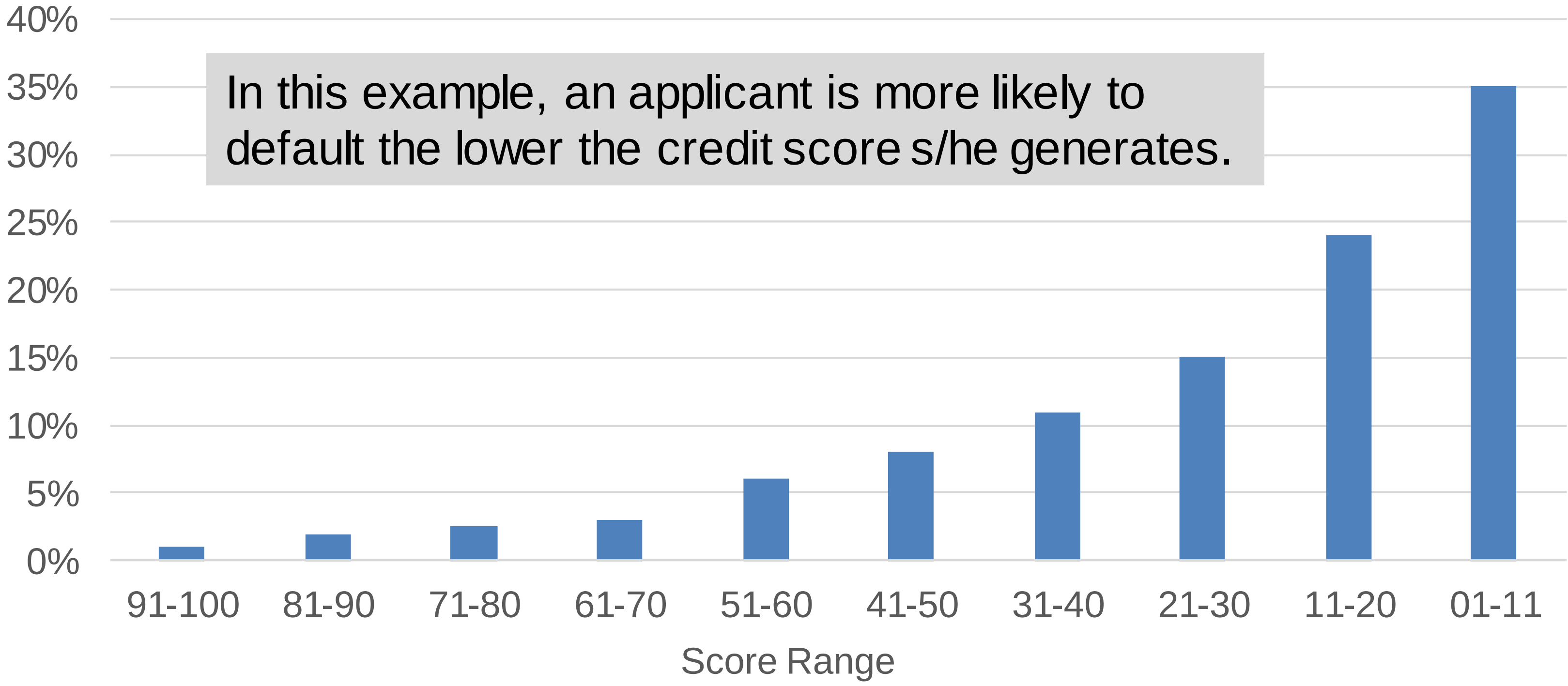
Credit Scoring Definition

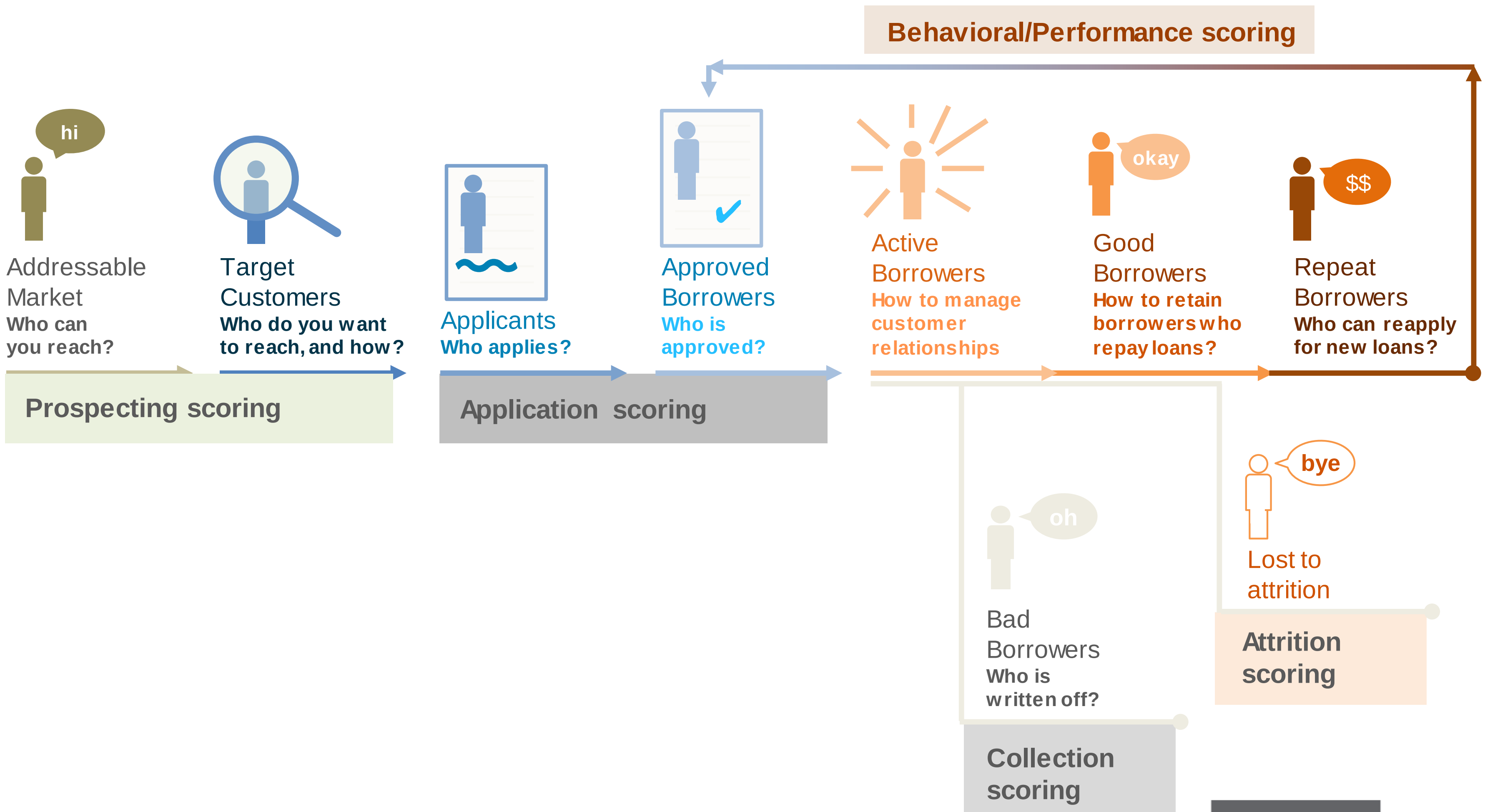
It is an analytical tool that evaluates an applicant's probability of default. This tool uses past data to predict future probabilities of **"good" or "bad" repayment behavior**.



Sources : An Introduction to Digital Credit: Resources to Plan a Deployment (CGAP)

Credit Scoring Definition

Scoring happens at **various stages** of the digital credit delivery cycle. For each stage, a **different scoring model** with different sets of data variables is used.



Consumer Protection in Digital Credit

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MicroSave Study Identified Various CP Issues

In March 2017, *MicroSave* conducted a study on Digital Credit in Kenya

Hypothesis

It is easy to access multiple digital credit products in Kenya and consumers do not adequately understand the responsibilities and risks associated with them

Why?

- The uptake of digital credit has been on the rise
- A growing number of clients have been negatively listed on CRB

Evidence

- The uptake of digital credit has been on the rise
  - There are **19** digital credit providers
  - Quick application turn around time - near to real time
  - A growing number of loans issued with Mshwari at **63m,** KCB Mpesa at **4.1m** and Equitel at **3.6m**
- A growing number of clients have been negatively listed on CRB
  - **2.7** million Kenyans have been listed in the last three years
  - **400,000** of this have been listed for amount less than **2 dollars**

Study Findings: Three Personas of Digital Credit

Defaulter: ignores digital loans repayment, unaware and does not understand the repercussions of being negatively listed on credit reference bureau

Repayer: repays loan on time as digital loans used to replenish business stocks

Juggler: services many loans both conventional and digital credit. Prioritizes repaying traditional loans. Animates loans e.g. M-Shwari is for school fees; SACCO loans are for investment etc.

Study Findings

The study identified 4 key factors and the behaviour of the customers

Repeated push SMS designed to make loan qualification seem as an opportunity not to be missed; drives loan uptake when borrowers do not have prior intention or serious need to borrow

Desire to uphold reputation within a community drives clients to prioritize repaying traditional loans over digital loans, which are private and virtual

Additional steps required to access terms and condition means that many (almost all) customers accept loans without reading them

Instant gratification prompts customers to take loans amounts higher than their income through gaming the system

This causes customers to borrow even when they do not really need to and thus sometimes default

Lack of personal touch with digital credit means they are last to be repaid, leading to default and negative listing on CRB

Many end up unable to repay because their income cannot sustain the debt

Customers do not understand the repercussions of not repaying on time, default easily and may be negatively listed

Key Consumer Protection Principles

The digital credit customer protection issues can be summed up in 7 broad categories

	CHALLENGES	OPPORTUNITIES
APPROPRIATE PRODUCT DESIGN AND DELIVERY	Unsuitable Product Design Unsuitable Product Delivery	Suitable Product Design: Dissipated risk aggressive sales by front-line staff
TRANSPARENCY	Full disclosure of loan terms and conditions. Product comparison platforms	Easy accessible T&Cs
PREVENTION OF OVER INDEBTEDNESS	Aggressive push marketing	Targeted communication on credit use and repayment
PRICING	Responsible pricing	Affordable pricing that is profitable to providers
REPORTING AND INFORMATION SHARING	Multiple data sources	Single source of data for providers credit scoring
PRIVACY OF CLIENT DATA	Commercialization of data	Data should be used only for credit issuance
GRIEVANCE MANAGEMENT	Customer communication access channel	Multiple customer access channels and resolution mechanisms

Appropriate Product Design & Delivery

Successes

- Suitable Product Design
  - Responds to short-term liquidity needs
  - Loan size limit increases with client's history
  - Instant, remote (if fully digitized)
- Dissipated risk aggressive sales by front-line staff (if fully digitized)
- Sophisticated dropout analysis

Risks

- Unsuitable Product Design
  - Low loan amount
  - Low flexibility (repayment term and schedule, …)
- Unsuitable Product Delivery
  - Exclusion of illiterate people
  - If no internet access and no Airtime agent/distributor
  - Agent illiquidity and service downtime
- "Push" marketing methods and temping offers
- No waiting or cooling off periods

Sources. Digital Credit in Africa: Are Nano Loans Safe for Consumers? CFI Blog. September 2016
CGAP Digital Credit in Kenya: Time for Celebration or Concern?

"Push Marketing Methods"

Examples of unsolicited credit offers

Source: http://www.cgap.org/blog/digital-credit-kenya-time-celebration-or-concern

Transparency (1)

Confirming client understanding

Transactions confirmed

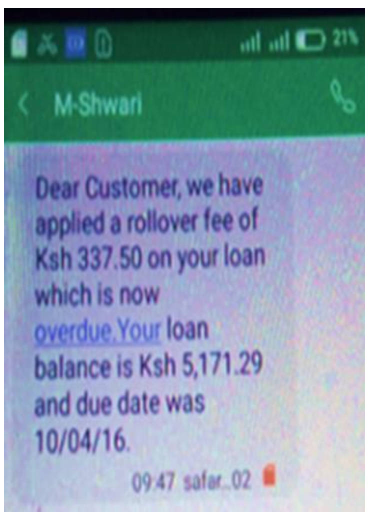
Simple reminders of T&C

Low understanding of the product

Third party fees

Complicated disclosure

Difficult to compare different pricing structures



M-Shwari loan charge not interest, CBA tells customers

MONDAY SEPTEMBER 19 2016

A Commercial Bank of Africa (CBA) branch along Kirinyaga road on March 10, 2016. The Commercial Bank of Africa (CBA) says it will not reduce the facilitation fee it charges on M-Shwari. FILE PHOTO | SALATON NJAU

By VINCENT ACHUKA

The Commercial Bank of Africa (CBA) says it will not reduce the facilitation fee it charges on M-Shwari as demanded by the Consumers Federation of Kenya (Cofek), saying the charge is not interest and, therefore, does not fall under those affected by the Banking Amendment Act 2016.

"There is no interest levied on M-Shwari loans. What we have is a one off facilitation fee of 7.5 per cent charged at disbursement."

Sources: *MOBILE CREDIT: REGULATORY CHALLENGES AHEAD. ITU Working Group*

Transparency (2)

It is very important for digital credit providers to continuously communicate to customers all the information about the product in a language that is easy to understand. The critical parameters are:

Terms & conditions

1. Opt in and opt out options for T&Cs
2. Easy to understand language
3. Easy to access T&Cs
4. Simple key facts

Cost information

1. Interest rates, exchange rates, penalties and fees
2. 3rd party fees, commissions and early termination fees
3. Total cost of credit and APR

Non-cost information

1. Waiver rights
2. Switching barriers
3. Repayment channels

Timing of disclosure

1. Before uptake
2. During contracting
3. After uptake
4. Cooling off period
5. Account statements

Confirming understanding

1. Full disclosure during application
2. Checklist management
3. Location of disclosures
4. Referrals/guarantors

Partners

1. Onboarding agents
2. Collection agents
3. Credit reference bureaus
4. Researchers

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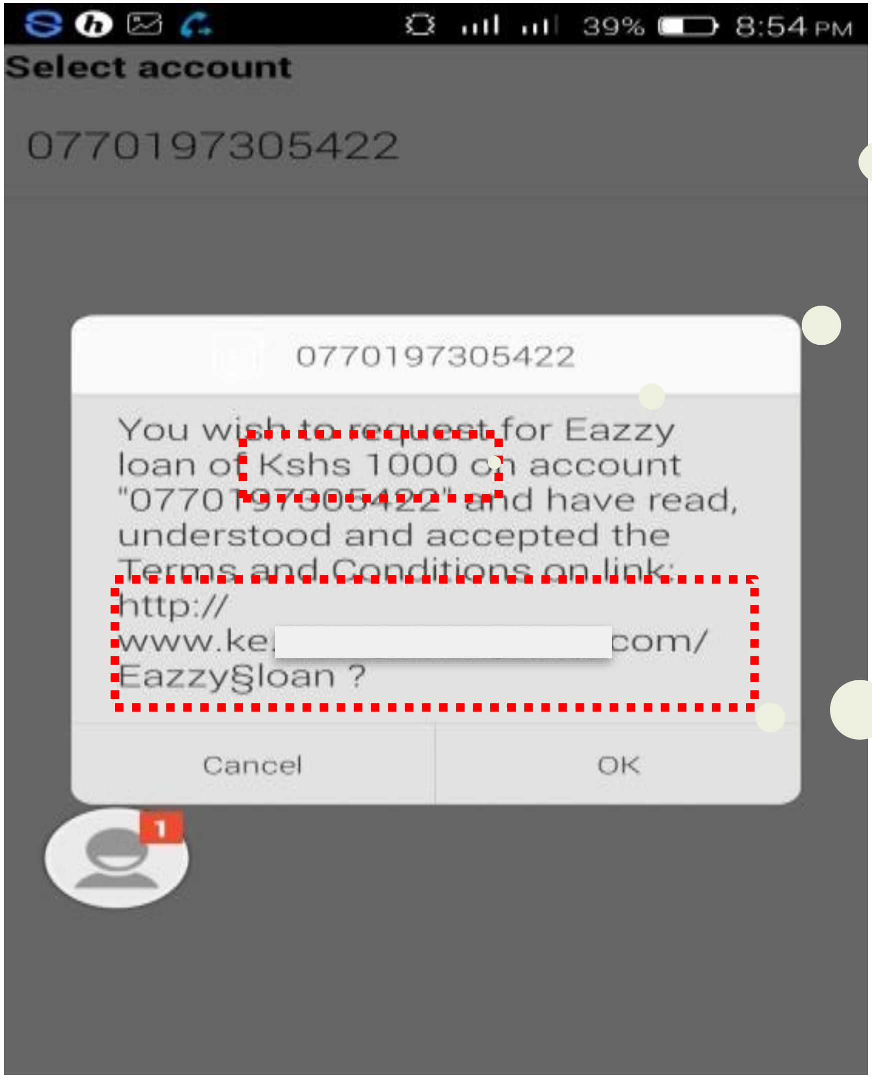
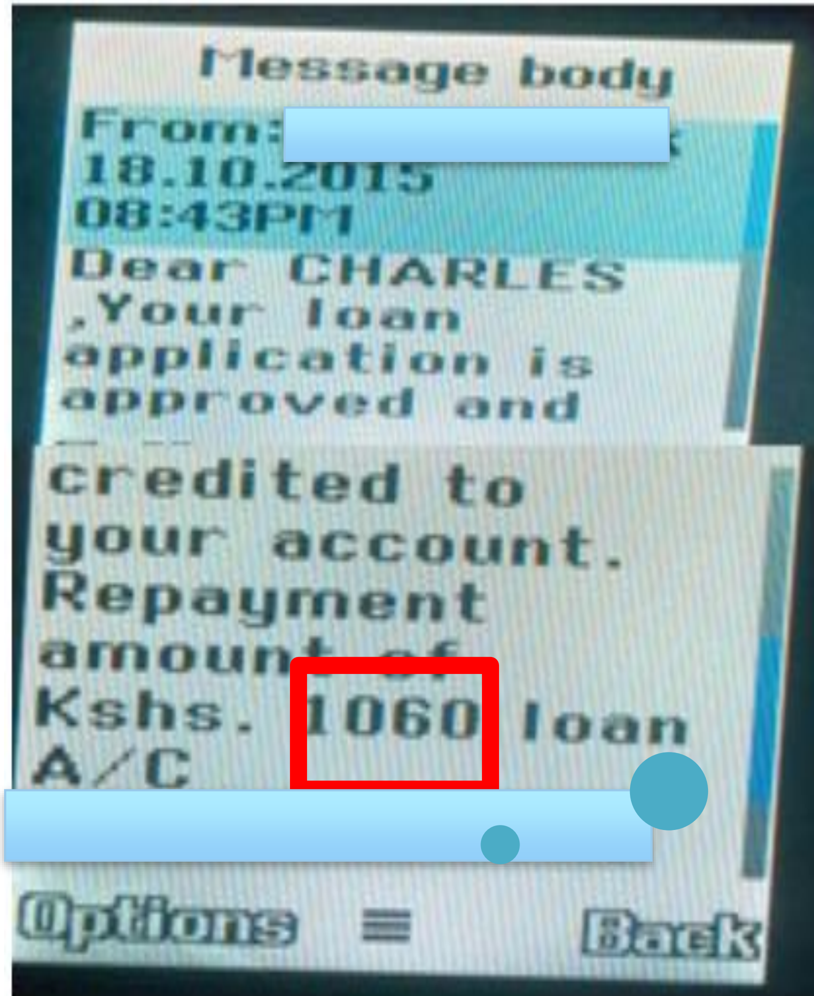
Poor Disclosure in High Cost Consumer Credit (1)



No fees mentioned however, the loans have a fee

Customer are redirected to open the URL to view the loan Terms and Conditions leaving out **those with feature phones and the customers who do not have internet connectivity**

Poor Disclosure in High Cost Consumer Credit (2)



Most borrowers thinks that the interest rate on this loan product is **2%** but varies between 2%-10%.

- In this case the interest rate is **6%**. **Information released post-purchase.**

Directives Issued by the Competition Authority

SAFARICOM TO REVEAL M-PESA TRANSACTION COSTS

Posted on Feb 16, 2017

Prevention of Over indebtedness (1)

- Starting small
- Consistent credit appraisal
- Create a credit record/profile
- Real-time monitoring of portfolio quality
- Can reduce delinquency rate

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Pain of Kenyans blacklisted for amounts as small as Sh100 in mobile loans, bank fees

FRIDAY SEPTEMBER 9 2016

email print

Amounts as little Sh100 have become a pain to thousands of Kenyans who have to face the torment of being blacklisted as defaulters and denied access to loan facilities. PHOTO | FILE

In Summary

- More than 400,000 Kenyans are listed with the credit reference bureaus (CRBs) for outstanding mobile loans of less than Sh200.
- A survey by TransUnion Credit Reference Bureau (CRB) found that 316,456 people in a

By GEORGE NGIGI

Try to figure out what you would do with Sh100.

For many workers in Nairobi, this amount is barely enough for a day's commute to work by public

- Focus on client's willingness to repay and not capacity to repay
- Algorithm growing pains
- Multiple borrowing (can be) invisible
- Cycle of repeated debts periods
- Client blacklisting

Daily Nation. Kenya.

Prevention of Over Indebtedness (2)

Poor product design will more often than not lead to bad practices and over indebtedness. It is the responsibility of providers to ensure customers are taking up loans that they are able to effectively pay back.

Loan Terms & Conditions

Collateral management & flexible repayment terms and period.

Responsible Marketing

Appropriate messaging before, during and after loan uptake

Monitoring Systems

Relationship based delinquency management

Financial Education

Empowering customers with better skills to identify and manage good loans

Responsible Pricing

- FI’s transaction costs reduced
- DFS should theoretically translate to cheaper credit
- Risk of multiple transaction costs due to communications breakdown or network instability
- Expensive way to qualify for a larger loan
- Risk of saving depletion


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“There is no interest levied on M-Shwari loans. What we have is a one off facilitation fee of 7.5 per cent charged at disbursement.”

Data shows high APR

Provider	APR
Branch	12%–170%
Equitel Eazzy Loan	27%
Equitel Eazzy Plus Loan	21%–27%
Jumo/ Kopa Cash	183%
KCB-M-Pesa	73% (30 Days) 61% (90 Days) 49% (180 Days)
Kopa Chapaa	310%–621%
M-Shwari	91%
Okoa Stima	521%
Pesa na Pesa	521%
Pesa Pata	365%
Pesa Zetu	85%–130%
Saida	91%
Tala	61%–243%

Sources: MOBILE CREDIT: REGULATORY CHALLENGES AHEAD. ITU Working Group

Fair and Respectful Treatment

- Dissipated risk of in-person abusive collections (if all the process is digitized)

> *"Most of the loan officers from financial institutions are the ones that ask for bribe in order to process loans…I don't trust them…others harass us a lot when we go to the branch…"*
> *- M-Pawa User, Tanzania*

- Risk of fraud
- Risk of disrespectful treatment if external agent
- Big data and discrimination
- Risk of digital harassment
  - Names publication
  - Kopa leo example

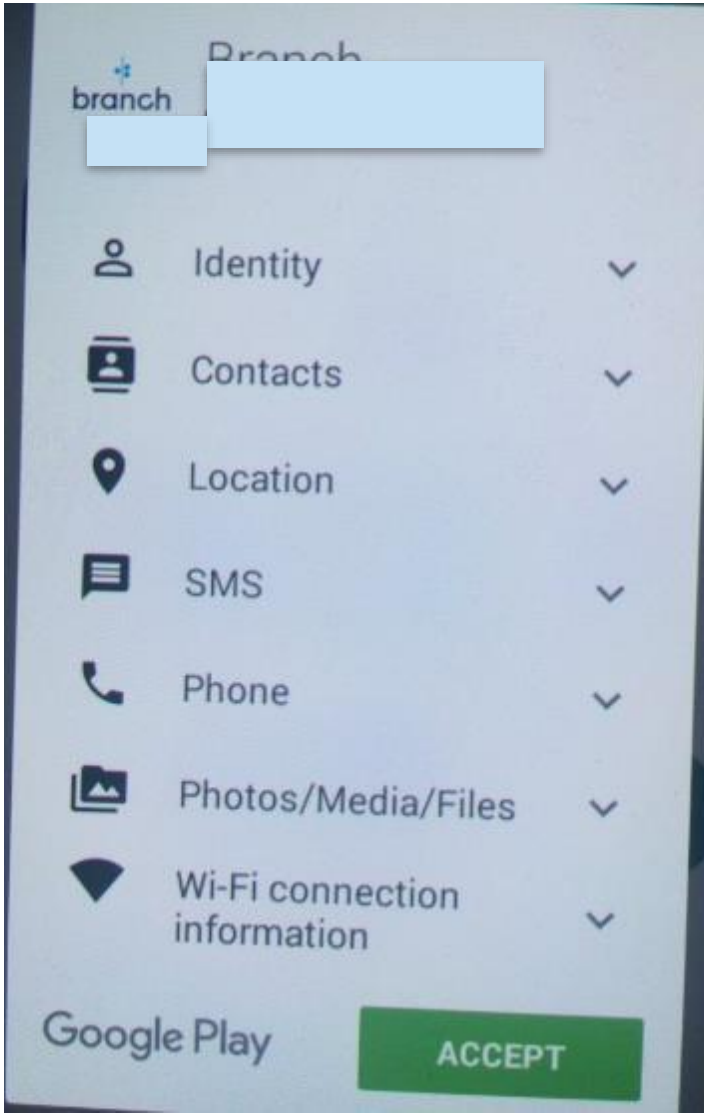
Privacy of Client Data

The privacy of client data will be respected in accordance with laws and regulations The data will only be used for the purposes specified at the time the information is collected or as permitted by law, unless otherwise agreed with the client. Providers should have internal procedures that cover key aspects

- Definition of what client data is covered by the privacy policy
- What organizational position in the financial institution bears overall responsibility for ensuring client data privacy
- What data is obtained, who obtains it, the sources of the data, and the purposes for which the data are used
- The legal and regulatory requirements for collecting, sharing and using information
- Advising the client about the legal and regulatory requirements for collecting, sharing and using information Procedures to be followed for mandatory sharing of information
- Procedures to be followed for sharing information with outside service providers, such as marketing companies, data processing companies, collections agencies, etc., including ensuring the adequacy of their data privacy policies and procedures
- Ensuring that sales agents and other third parties involved in the application process follow appropriate data privacy procedures

Data Usage & Ownership in Digital Credit

Accept Terms & Conditions



Standard Form Contract Data Usage Disclosure

"Each time you visit one of our sites or use one of our Apps we may collect the following information:

technical information, including the types of mobile device you use, unique device identifiers (for example, your Device's IMEI or serial number), information about the SIM card used by the Device…

Information stored on your device, including contact lists, call logs, SMS logs, contact lists from other social media accounts, photos, videos or other digital content…"

First Access Tanzania

A little informed consent could go a long way

<u>Responsible Data Usage Features</u>

- <u>Consumers opt-in</u> to allow mobile and other records to be used to credit score
- Third-party: <u>Lender never sees customer data</u>
- <u>One-off:</u> Consumer only opts in for single usage of their data

SMS Disclosure Approved by Regulators:

"This is a message from First Access: If you just applied for a loan at Microfinance Bank and authorize your mobile phone records to be included in your loan application, Reply 1 for Yes. Reply 2 for More Information. Reply 3 to Deny."

Supplemental SMS Developed by CGAP/First Access:

"This is a message from First Access: Mobile phone records are information captured when you use your phone, including phone calls, SMS, airtime top-ups, or a mobile money account. Questions? Call First Access 12345678"

"This is a message from First Access: First Access ONLY uses your mobile phone records to make a loan recommendation to lenders. We NEVER share your personal information with anyone. Questions? Call First Access 12345678"

Pricing, Reporting and Information Management

Pricing

- Providers should price their products in a manner which will meet their strategic objectives and inspire customers to pay back.
- Whether the provider is pricing for impact or commercial value it is important to identify customer's ability to payback.
- Providers furthermore need to be able to distinguish between complete product pricing, fees and taxes. Ideally customers should receive one amount that incorporates all the factors.

Reporting and Information Management

- Industry providers ideally should have a shared data source for credit scoring and delinquency management.
- A simple and affordable process should be instituted by providers and reference bureaus for customers who are listed and manage to repay pending loans
- Historic customer data can be used by providers to offer "good customers" favorable pricing, enhanced customer experience and better loan terms.

Grievance Management

- Have you provided customer centric access points?

- Do you have policies and procedures around customer complaints?

- Do you have customer feedback mechanisms?

- Are you able to effectively respond and solve queries / issues your customers may have

Mechanisms for Complaint Resolution

Convenience and anonymity	Technology can enable more interactive feedback loops (IVR etc.)	Faster "test and learn" application
Records and analysis facilitated	Customers not informed about the complaint process	Diffuse feedback loop if done by third-party
Soft-touch discourages complaints	Disruption/service downtime	

Potential of Digital Financial Services

Digital financial services is defined as access to and use of formal financial products and services (including transfers, payments, stored value, savings, credit, insurance and more) by the end consumer through digital channels, leveraging technology enabled/oriented processes.

for the clients?

"*Digital financial services have significant potential to provide a range of affordable, convenient and secure banking services to poor people in developing countries.*"

CGAP

for the providers?

Sources : Lessons learned Digital financial services for smallholder households. IFAD
An Introduction to Digital Credit: Resources to Plan a Deployment (CGAP)
Quotation: http://www.cgap.org/topics/digital-financial-services

So, what is the way forward for institutions?

Get trained on digital transformation to get a holistic view of the whole change

Source for technical expert(s) to help your institution implement digital finance

Co-finance an upgrade project in digital finance for digital transformation of your institution

Digital Transformation Training Covers…..

Session Title	Session Coverage
Financial Inclusion and Digital Financial Services' Ecosystem	• Overview of Digital Financial Services and its role in financial inclusion • Digital Financial Services ecosystem and role of different components/players
Importance and Relevance of Digital Transformation for banks and MFIs	• Importance of Digital Financial Services for financial services industry • Impact of Digital Transformation on Banks and MFIs • Fintech and Financial Services: Key lessons and learning
Strategic Planning for Digital Transformation	• Strategies for Digital Transformation and innovation • Key considerations for Strategy Design for Digital Transformation • DFS Opportunities
Product Innovation for Digital Transformation	• Market segmentation • Product innovation and development • Innovations in product design
Process Re-engineering for Digital Transformation	• Digitising and automating front-end and back-end processes
Delivery Channel and Distribution Design	• Digitising traditional channels • Incorporating new digital channels • Leveraging on partnerships
Risk Management for Digital Transformation	• Emerging risks from Digital Transformation • Risk management framework and approaches
Implementing Digital Transformation	• Project and change management • Key challenges faced in implementation of Digital Transformation

Q & A Session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Resources

- Institute of Risk Management: Risk Culture
- MicroSave: Where Credit is Due
- CGAP: Consumer Risks and Rewards Amid Increased Competition in Kenya
- CGAP: Consumer Protection in Digital Credit
- The Smart Campaign: Client Protection Principles