Digital Credit: Key Risks to Consumers & Emerging Regulatory Mitigants

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New and enhanced consumer risks arising from digital credit

1) Disclosure and transparency
2) Marketing practices via remote channels
3) Unfair lending
4) Data privacy and alternative data
5) Algorithmic scoring
6) Regulatory perimeter

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Disclosure and transparency

Key risks	Regulatory mitigants
Information on pricing often incomplete or non-transparent *(range of methods to convey pricing, finance charges not disclosed separate from principal, fees for third-party charges not disclosed)*	Require prominent disclosure of both total cost metrics + breakdown of costs (including third-party fees); encourage greater standardization in presentation of fees/pricing
Incomplete terms and conditions, lengthy T&C that are difficult to understand	Require disclosure of key T&C in channel being used for transaction; risks given equal prominence to benefits; access to full T&C after transaction completed
Poor format of disclosure and user interface	Require plain language without technical jargon; standardize presentation adapted to digital channels (e.g. bite-sized chunks of info provided in consistent manner); layer info and provide access to offline channels for further info; user-friendly and easy to navigate UI
Timing and flow of disclosed information	Require order and flow of info to enhance transparency and comprehension; disclose pricing early in transaction process; leverage behavioural insights to encourage consumers to engage with info (e.g. confirmation or acknowledgement to move forward)

Marketing practices via remote channels

Key risks	Regulatory mitigants
"Push" marketing and unsolicited offers encourage impulse borrowing	• Explicit warnings on risks of short-term, high-cost credit (+ alternatives to such loans, contact details for helpful resources) • Ban sales practices that focus on ease of obtaining credit, trivialize credit, or target vulnerable consumers • Slow down process of transacting digitally to allow consumers more time for reflection and deliberation (e.g. intermediate steps/screens, adding a review screen) or appropriate cooling-off period • Presentation of loan options that is beneficial to consumers and not exploitative (e.g. banning default selection of max loan size)
Exploiting behavioural biases *(e.g. encouraging borrowing maximum possible, trivializing loans)*	
Misleading ads targeting vulnerable consumers *(e.g. emphasizing benefits, unrealistic offers with hidden conditions, marketing on weekend evenings)*	
Remote nature of digital channels and rapid speed of transactions increase consumer vulnerability	

Unfair lending

Key risks	Regulatory mitigants
High prices *(APR from 12% to 621%)**	• Require providers to assess the ability of prospective customers to repay loans and only grant loans where they are affordable to consumer (principle-based vs prescriptive approaches) • Provide limited, temporary exception for "lend-to-learn" models and require internal segmentation and monitoring • Adapt suitability rules to digital credit (e.g. strengthen customer segmentation, target and sell only to appropriate segments) • Limit rollovers and multiple borrowing to decrease risk of over-indebtedness (e.g. max of two rollovers in UK, no charging of fee if credit used to refinance another short-term, high-cost loan in Australia) • Consider exception to credit reporting for very low-value loans
Business models based on high loss rates *(large late payment fees relative to size of loan)*	
Mass marketing to consumers with little assessment of individual consumer circumstances or ability to repay *("lend-to-learn" model)*	
Poor practices such as rolling over loans or encouraging multiple borrowing	

** Kaffenberger, Michelle and Patrick Chege. Digital Credit in Kenya: Time for Celebration or Concern? CGAP Blog, October 2016.*

Data privacy and alternative data

<table>
<tr><th>Key risks</th><th>Regulatory mitigants</th></tr>
<tr><td>Personal data used without consumer consent or used inappropriately</td><td rowspan="6">Expand personal data to address alternative data
Clearly disclose use of all consumer data to consumers, including alternative data
Active, tiered consent required for different types of personal data and data usage
Limit use of personal data to legitimate use, regardless of consent
Encourage privacy-by-design, data minimization
Data portability</td></tr>
<tr><td>Consent not informed, overly broad, or compelled from consumers</td></tr>
<tr><td>Poor disclosure regarding use of personal data to consumers</td></tr>
<tr><td>Overly broad permission required when signing up for mobile phone or mobile wallet</td></tr>
<tr><td>Lack of real choice in accepting data privacy policy</td></tr>
<tr><td>Lack of clarity on application of traditional data privacy rights to alternative data</td></tr>
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Algorithmic scoring

Key risks	Regulatory mitigants
Bias *(training data incomplete, inaccurate, or reflects historical inequalities)*	• Extend anti-discrimination laws to algorithms • Establish appropriate safeguards during development stage, testing stage, and monitoring of implementation of algorithms (with proper documentation and oversight) • Require external auditing of algorithmic processing (including input data and output decisions, development process, governance and controls) • Transparency to consumers regarding use of algorithms • Consumer right not to be subject solely to automatic processing, request human intervention
Discrimination based on proxies reflecting sensitive attributes	
Consumers unaware or powerless regarding use of algorithm	
Regulators lack technical expertise to evaluate algorithmic systems; proprietary nature of algorithms	

Regulatory perimeter

Key risks	Regulatory mitigants
Unlevel playing field depending on institutional model of digital credit	Regulate by activity, not by provider type
Unregulated providers, particularly app-based lenders	Regulate by activity, not provider type; be opportunistic and leverage existing powers, i.e. competition, telco, general consumer protection authorities, or via payments regulation Non-regulatory approaches: encourage platforms to establish/enforce standards, encourage industry codes of conduct/self-regulation
Digital credit providers based outside of country	Cross-border coordination

Thank you!

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