



Digitalisation of short-term, high-cost consumer credit

Guidance to supervisors

Consultation Paper

November 2018

Consultation paper

Guidance to supervisors in the field of digitalisation of short-term, high-cost consumer credit

Acknowledgements

The International Financial Consumer Protection Organisation (FinCoNet) would like to acknowledge the efforts of Standing Committee 2 in developing this project. Standing Committee 2 consists of representatives from Australia, Brazil, Canada, China, Germany, Indonesia, Ireland, Portugal and the United Kingdom and had the assistance of staff from the OECD Secretariat.

In particular, we would like to thank Pedro Dias, as Chair of the Standing Committee, as well as Aisling Ní Leidhin, Anthony Thompson, Antonio Guimaraes, Colm Kincaid, Diogo Jose Sousa da Silva, Filipa Alves, Francisco José Barbosa da Silveira, Greg Kirk, Guangyuan Zhang, H. Hudiyanto, Hiroko Suzuki, João Ramiro dos Santos, Jorge Pinheiro, Maria João Gomes, Matthias Aust, Melanie Spong, Sam Stoakes, Steve Trites and Yoni Simhon for their work in writing and producing the consultation paper and, also, to Miles Larbey, Peter Gillich and Sally Day-Hanotiaux, from the OECD Secretariat.

About FinCoNet

FinCoNet was established in 2003 as an informal network to enable discussions among financial consumer protection regulators and supervisors regarding consumer protection issues of common interest. It is recognised by the Financial Stability Board and the G20.

In November 2013, FinCoNet was formally established as a new international organisation of financial consumer protection supervisory authorities.

The goal of FinCoNet is to promote sound market conduct and enhance financial consumer protection through efficient and effective financial market conduct supervision, with a focus on banking and credit.

FinCoNet members see the Organisation as a valuable forum for sharing information on supervisory tools and best practices for consumer protection regulators in financial services. By sharing best practices and by promoting fair and transparent market practices, FinCoNet aims to strengthen consumer confidence and reduce systemic consumer risk.

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FinCoNet's work on responsible lending

Responsible lending has been an important issue for FinCoNet since its foundation. In 2013, FinCoNet established a standing committee ('SC2') focused on identifying regulatory and supervisory approaches and tools for supporting responsible lending practices.

The objective of the standing committee's work is to help jurisdictions share information about current supervisory developments and supervisory approaches and tools with respect to responsible lending practices. This work aims to facilitate and strengthen the development and use of effective supervisory tools and approaches to deter unsuitable or irresponsible lending practices. This work will also help jurisdictions identify gaps and weaknesses in their existing regulatory regimes, including their supervisory and enforcement capabilities.

Following its 2016 Annual General Meeting, FinCoNet agreed that SC2 should adapt the focus of its work to the supervisory challenges associated with the digitalisation of short-term, high-cost consumer credit ('STHCCC'), building on FinCoNet's previous and comprehensive work in the field of responsible lending, which includes the 2014 *'Report on Responsible Lending'*¹, the 2016 *'Report on Sales Incentives and Responsible Lending'*² and, also, the 2016 *'Guidance to Supervisors on the setting of Standards in the field of Sales Incentives and Responsible Lending'*³.

FinCoNet's work on digitalisation of STHCCC is also part of its wider focus on emerging technology and its implications for financial consumer protection. FinCoNet began addressing these issues with a focus on online and mobile payments⁴ and is currently expanding its area of analysis to more broadly cover risk-based supervision in the digital age.

¹ FinCoNet, 2014, 'Report on Responsible Lending' (available at <http://www.finconet.org/FinCoNet-Responsible-Lending-2014.pdf>).

² FinCoNet, 2016, 'Report on Sales Incentives and Responsible Lending' (available at http://www.finconet.org/Report_Sales_Incentives%20Responsible_Lending.pdf).

³ FinCoNet, 2016, Guidance to Supervisors on the setting of Standards in the field of Sales Incentives and Responsible Lending (available at http://www.finconet.org/Guidance_SS_Sales_Incentives_Responsible_Lending.pdf).

⁴ FinCoNet published the 'Report on Online and Mobile Payments : Supervisory Challenges to Mitigate Security Risks' in 2016 (available at http://www.finconet.org/FinCoNet_Report_Online_Mobile_Payments.pdf) and, in 2018, issued the 'Report on Online and Mobile Payments: An overview of supervisory practices to mitigate security risks' (available at http://www.finconet.org/FinCoNet_SC3_Report_Online_Mobile_Payments_Supervisory_Practices_Security_Risks.pdf). FinCoNet is continuing work in this field to identify effective and potentially innovative supervisory approaches regarding the mitigation of security risks in the digital ecosystem.

In 2017, FinCoNet published the *'Report on the digitalisation of short-term, high-cost consumer credit'*⁵ (hereinafter, the 'Report'), which presented the findings of a detailed survey of supervisors in 25 jurisdictions, as well as a literature review on the topic of digitalisation of STHCCC.

The Report found that, when used properly, digital channels have the capacity to positively transform the availability and provision of consumer credit. However, it may also introduce new risks and exacerbate the risks already associated with the provision of STHCCC.

Based on the findings of the Report and on the good practice observations described in the 2014 *'FinCoNet Report on Responsible Lending'*, FinCoNet identified several topics, explored in greater detail below, that it considers particularly relevant for supervisors to take into consideration when overseeing the provision of STHCCC through digital channels.

These topics are the basis on which FinCoNet is informing the development of guidance to supervisors in the field of digitalisation of STHCCC.

What is Short-term, High-cost Consumer Credit (STHCCC)?

For the purposes of this Consultation Paper, STHCCC has the same meaning set out in the Report.

According to the Report, STHCCC refers, in general, *'to the practice of lending to consumers:*

- *amounts of money that are small relative to other forms of credit in the market,*
- *for short periods of time (according to the Survey, these loans were most commonly for durations of under 12 months),*
- *at a rate that is considered to be high compared to other products in the market.'*

The Report also found that, depending on the jurisdiction, STHCCC *'may be referred to under different names such as payday loans, small amount credit contracts or moneylending agreements'*.

⁵ FinCoNet, 2017, Report on the Digitalisation of Short-Term, High-Cost Consumer Credit

(available at <http://www.finconet.org/Digitalisation-Short-term-High-cost-Consumer-Credit.pdf>).

Digital consumer credit: new risks for consumers and new challenges to supervisors

The digitalisation of consumer credit offers many potential benefits to lenders and consumers. Digital channels allow lenders to reach a greater number of consumers while reducing operating costs and consumers may benefit from increased convenience and speed in access to credit products.

However, digitalisation of consumer credit also raises serious consumer protection concerns. The financial digital environment poses new risks to consumers, such as those related to digital security and data privacy. Moreover, the digital environment has made it easier for new providers to join the market as well as for the provision of consumer credit across borders, which increases concerns related to regulatory and supervisory arbitrage. These disruptive impacts arising from the digitalisation of consumer credit may lead to serious consumer detriment, especially in relation to consumers with low levels of digital financial literacy.

In addition, the use of digital channels may also intensify some of the risks that are usually associated with the provision of consumer credit and, specifically, STHCCC. The Report found evidence that specific aspects of digitalised STHCCC, such as the speed and anonymity of the borrowing process, may cause consumers to behave differently in comparison to the conventional borrowing process and may increase, for instance, the risk of consumers becoming over-indebted. Other traditional concerns, such as those related to the disclosure of information and assistance to consumers, are also significantly influenced and impacted by the use of online or mobile channels to provide credit.

In this context, supervisors are required to keep up with the pace of innovation and adapt their supervisory approaches and oversight tools to promote sound market conduct and enhance financial consumer protection. This is particularly relevant where, as demonstrated by the Report, most jurisdictions do not have specific rules applicable to the provision of STHCCC through digital channels. Supervisors should, therefore, endeavour to ensure that consumers benefit from the same level of protection granted by their jurisdiction's legal framework irrespective of the channels used to provide those products or services ('technological neutrality').

With the purpose of supporting supervisors undertaking this task, the proposed Guidance seeks to help supervisors effectively address the main drivers of financial consumer protection risks relating to the provision of STHCCC through digital channels.

The Guidance is supported with specific actions, based on existing supervisory approaches, that supervisors may carry out in order to pursue those principles. This is done with a view to equipping

supervisors with a framework for seeking approach and solution in their area of competence, in order to enhance the effectiveness of consumer protection and facilitate a consistent approach to this topic across jurisdictions. It is understood, however, that the ability of supervisors to implement those actions will vary depending on the unique characteristics and capabilities of their jurisdictions.

The table below structures the Guidance that FinCoNet intends to set out in the field of digitalisation of STHCCC:

<p>Guidance 1</p> <p>Comprehensive and extensive regulatory framework</p>	<p>Supervisors’ oversight should cover all types of STHCCC provided through digital channels and all providers and credit intermediaries (including innovative players), preventing ‘regulatory gaps’ and ‘regulatory shopping’.</p> <p>Supervisors should also seek to ensure that consumers are adequately protected regardless of the provider or channel they use to avail of credit.</p>
<p>Guidance 2</p> <p>Appropriate oversight tools</p>	<p>Supervisors should make use of a set of effective tools to oversee that the provision of STHCCC through digital channels complies with the applicable rules, including not only traditional but also innovative tools specifically designed for the digital environment.</p>
<p>Guidance 3</p> <p>Consumer access to recourse mechanisms</p>	<p>Supervisors should ensure that consumers of digitalised STHCCC have access to adequate recourse mechanisms through digital channels, including complaints handling and independent alternative dispute resolution mechanisms.</p> <p>Supervisors should also confirm that providers of digitalised STHCCC convey this information to consumers through digital channels and clearly define responsibilities for complaints handling and dispute resolution.</p>
<p>Guidance 4</p> <p>Disclosure of information</p>	<p>Supervisors’ oversight should seek to ensure that information provided to consumers in relation to digitalised STHCCC, at all stages of the borrowing process, is:</p>

	<ul style="list-style-type: none"> • clear, transparent and complete, does not convey false or misleading information and promotes responsible borrowing; • disclosed in an easy and timely manner and presented in a way that enhances consumer comprehension and minimises adverse behavioural biases.
<p>Guidance 5</p> <p>Assessment of the consumer’s interests</p>	<p>Supervisors’ oversight should ensure that providers of STHCCC through digital channels:</p> <ul style="list-style-type: none"> • take into consideration the interests, objectives and characteristics of the target market when products are being designed and brought to market; • assess whether the features of the STHCCC are suitable and appropriate for a consumer’s needs and financial situation.
<p>Guidance 6</p> <p>Targeted prevention of consumer over-indebtedness</p>	<p>Supervisors’ oversight should evaluate whether:</p> <ul style="list-style-type: none"> • automated creditworthiness assessment models used by providers when providing STHCCC through digital channels take into account consumers’ individual circumstances, are sufficiently resilient and are leading to responsible lending decisions; • the features of STHCCC provided through digital channels do not put disproportionate burdens or risks on consumers; • providers of STHCCC through digital channels have in place adequate systems and mechanisms to monitor the performance of the credit agreement, detect signs of payment difficulties and give support and advice to consumers facing payment difficulties.
<p>Guidance 7</p> <p>Security risks and data privacy</p>	<p>Supervisors should monitor if providers of STHCCC through digital channels have in place adequate internal procedures to monitor operational resilience, mitigate data privacy risks and detect and respond to security incidents in a timely manner.</p> <p>Supervisors should also seek to ensure that providers of STHCCC through digital channels have implemented adequate data privacy</p>

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	policies and follow good practices when collecting, processing and saving consumers' personal data.
Guidance 8 Digital financial literacy	Supervisors should have a pro-active approach to building up consumer knowledge and understanding of the main features and risks of STHCCC provided through digital channels, ensuring that clear, complete and unbiased information is easily accessible in a digital environment and that tools and materials are available to support consumers in the decision-making process.

Responding to this consultation

(1) Purpose of this consultation

Through this Consultation, FinCoNet is seeking feedback from supervisors and other relevant stakeholders on the proposed Guidance and the recommended actions to take. This is to help ensure that what is being proposed is comprehensive, appropriate and likely to be effective in helping supervisors adapt to the risks and challenges that the digitalisation of consumer credit poses to consumers and supervisors alike.

(2) Questions for consultation

Respondents to this consultation are invited to answer the following questions in relation to **each of the proposed Guidance**.

- (1) Do you agree with this Guidance and its actions to take? If you do not agree, please specify the aspects you do not agree with and explain why.
- (2) What challenges and opportunities do you consider relevant for the implementation of this Guidance and its actions to take? We welcome in particular information based on your experience or examples.
- (3) Do you have any other comments related to this Guidance or its actions to take?

(3) Submission of responses

Respondents should fill in the excel file available on the FinCoNet's website ([link](#)) and send their contribution to FinCoNet by email to Sally.DAY-HANOTIAUX@oecd.org.

Please note that the deadline for the submission of comments is **18 January 2019**. Comments submitted after this deadline or submitted via other means may not be processed.

(4) Publication of responses

FinCoNet intends to make submissions available on its website after the deadline for receiving submissions has passed. Please do not include commercially-sensitive material in your submission, unless you consider it essential. If you do include such material, please highlight it clearly so that appropriate steps may be taken to avoid publishing that material. This may involve publishing

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submissions with the sensitive material deleted and indicating those deletions. Unless you identify any commercially-sensitive information, you are making a submission on the basis that you consent to its publication in full.

Guidance to supervisors in the field of digitalisation of STHCCC

Guidance 1: Comprehensive and extensive regulatory framework

Supervisors' oversight should cover all types of STHCCC provided through digital channels and all providers and credit intermediaries (including innovative players), preventing 'regulatory gaps' and 'regulatory shopping'.

Supervisors should also seek to ensure that consumers are adequately protected regardless of the provider or channel they use to avail of credit.

Actions to take to implement Guidance 1

To adequately ensure the implementation of **Guidance 1**, supervisors may, where appropriate, consider the following actions to take:

- Establish minimum regular reporting obligations in order to ensure close monitoring of the provision of STHCCC through digital channels.
- Require that all providers of STHCCC through digital channels are either licensed or registered, in accordance with the requirements applicable to other credit providers in the same jurisdiction and maintain an up-to-date public registration database of market participants.
- Endeavour to get a clear understanding of the specific features of the digitalised STHCCC products and their distribution process, including by making use of innovation hubs and regulatory sandboxes.

Rationale

For additional context, the actions to take listed above are based on the following findings from the Report:

- 1.1. According to the Report⁶, the existence of a comprehensive regulatory framework, applicable to all providers of digitalised STHCCC and the channels used to provide it, constitutes a pre-requisite to the effective oversight of the provision of STHCCC through digital channels.

⁶ FinCoNet's 'Report on the digitalisation of short-term, high-cost consumer credit' (available at <http://www.finconet.org/Digitalisation-Short-term-High-cost-Consumer-Credit.pdf>).

- 1.2. The specific features of digital channels may, however, increase the risks of gaps in the regulatory framework. The Report points out that gaps in the regulatory framework may emerge if regulation does not accompany the evolution of digital financial services.
- 1.3. A first driver of that risk is related to the fact that *'many digital credit products are being offered by new types of providers or as partnerships between traditional financial institutions and other non-traditional companies. These non-traditional providers and business models may fall outside the scope of regulation in some jurisdictions, or may not be subject to the same degree of regulation as traditional lenders'*.
- 1.4. Some regulatory gaps may also arise from the cross-border provision of STHCCC, which is fostered by the use digital channels. As shown by the Report, *'digitalisation may increase the number of firms providing cross-border services, and that differences in regulatory regimes between Member States may result in regulatory arbitrage as some fintech firms may choose Member States where the regulatory regime is perceived to be less burdensome than in their Home State'*.

Guidance 2: Appropriate oversight tools

Supervisors should make use of a set of effective tools to oversee that the provision of STHCCC through digital channels complies with the applicable rules, including not only traditional but also innovative tools specifically designed for the digital environment.

Actions to take to implement Guidance 2

In order to adequately ensure the implementation of **Guidance 2**, supervisors may, where appropriate, consider the following actions to take:

- Follow a comprehensive and risk-based supervisory approach, combining different oversight tools, which may include:
 - monitoring of advertising;
 - social media monitoring (e.g. monitoring of social media platforms, blogs, webpages and forums, use of a 'keyword list' search approach for financial products and providers);
 - on-site and of-site inspections (e.g. remote access to mobile app and digital platforms);
 - complaints handling;
 - analysis of data reported by STHCCC providers to the supervisor;
 - feedback from consumers on their experiences, including consumer testing (e.g. questionnaires, focus groups) and market trend analysis;
 - whistleblowing reporting mechanisms.
- Regularly engage with industry, including technological innovators, and consumer associations, for instance to pre-assess the compliance with regulatory requirements.
- Establish adequate and agile procedures to promote cooperation with supervisors from other jurisdictions in order to ensure an effective oversight of cross-border provision of STHCCC through digital channels.
- Establish cooperation procedures with other authorities responsible for supervising entities involved in the provision of STHCCC through digital channels which may fall outside the supervisor's remit.

Rationale

For additional context, the actions to take listed above are based on the following findings from the Report:

- 2.1. Effective oversight of the provision of STHCCC in a digital environment is essential to ensure that consumers benefit from the same level of protection conferred by the regulatory framework when they are availing of credit provided through traditional channels ('technological neutrality'). The specific features of the digital channels used in the provision of STHCCC may require from the supervisor the use of innovative approaches and tools.
- 2.2. The Report states that one of the most significant challenges for supervisors is to *'ensure an adequate balance between the need to maintain existing standards of consumer protection and mitigate risks to consumers, while also providing the environment for the benefits of technological advancement to be explored in a manner that ensures that the best interests of consumers are protected'*.
- 2.3. To maintain a continuous engagement with other supervisors and industry is, thus, considered of paramount importance to *'enhance knowledge and understanding of the market, the products on offer, and the degree of regulation required to provide the best possible protection for consumers'*. With regard to this, some jurisdictions already have in place formal dialogue mechanisms and coordination processes with industry.
- 2.4. The Report presents the examples of the UK's Financial Conduct Authority (FCA) and the Australian Securities and Investments Commission which *'have established innovation hubs, where they assist and support industry with navigating the regulatory framework, and regulatory sandboxes where providers can test their new products and services in a live environment'*.
- 2.5. On the other hand, the digital environment also presents opportunities to supervisors, who may benefit from technological innovation to conduct more effective supervision (SupTech).

Guidance 3: Consumer access to recourse mechanisms

Supervisors should ensure that consumers of digitalised STHCCC have access to adequate recourse mechanisms through digital channels, including complaints handling and independent alternative dispute resolution mechanisms.

Supervisors should also confirm that providers of digitalised STHCCC convey this information to consumers through digital channels and clearly define responsibilities for complaints handling and dispute resolution.

Actions to take to implement Guidance 3

In order to adequately ensure the implementation of **Guidance 3**, supervisors may, where appropriate, consider the following actions to take:

- Assess whether complaints handling procedures and systems implemented by providers of STHCCC through digital channels allow for an efficient and agile resolution of consumers' complaints and the timely identification of any recurring or systemic issues.
- Require STHCCC providers to adhere to independent out-of-court formal dispute resolution mechanisms, with the capacity to issue decisions in respect of individual cases that are binding on the provider.
- Verify if consumers are provided with clear and up-to-date information on how to submit a complaint or access dispute resolution mechanisms and require that such information is disclosed in the same channel that is being used to provide digital STHCCC.

Rationale

For additional context, the line to take listed above are based on the following findings from the Report:

- 3.1. The Report pinpoints the relevance of the G20 High Level Principle 9⁷, according to which *'Jurisdictions should ensure that consumers have access to adequate complaints handling and redress mechanisms that are accessible, affordable, independent, fair, accountable, timely and efficient'*, in the context of STHCCC provided through digital channels.

⁷ Organisation for Economic Co-operation and Development (OECD), 2011, 'G20 High-level principles on financial consumer protection' (available at <https://www.oecd.org/g20/topics/financial-sector-reform/48892010.pdf>).

- 3.2. Compliance with this principle should take into consideration the specific aspects of the digital environment and seek to mitigate consumers' behavioural biases in this field, for instance by ensuring that consumers of digitalised STHCCC have access to recourse mechanisms through digital channels.
- 3.3. The Report also notes that when multiple parties are involved in the provision of digital credit, consumers may not know where to address their complaints, which reflects how important it is that consumers are aware of the parties involved as well as their roles. The Report indicates that even in cases where consumers know how and to whom to submit a complaint, they often face difficulties in having their complaints resolved, which in turn makes them less likely to report issues in the future.

Guidance 4: Disclosure of information

Supervisors' oversight should seek to ensure that information provided to consumers in relation to digitalised STHCCC, at all stages of the borrowing process, is:

- clear, transparent and complete, does not convey false or misleading information and promotes responsible borrowing;
- disclosed in an easy and timely manner and presented in a way that enhances consumer comprehension and minimises adverse behavioural biases.

Actions to take to implement Guidance 4

In order to adequately ensure the implementation of **Guidance 4**, supervisors may, where appropriate, consider the following actions to take:

In advertising and other commercial communications

- Assess if the information provided to consumers includes, where appropriate, the main characteristics of the STHCCC that is being promoted (e.g. the amount of the credit, the maturity, the reimbursement schedule, the interest rate and other charges, the total cost of credit and the total amount due).
- Require the inclusion of specific warnings, where appropriate, for example, in respect to:
 - the costly nature of the STHCCC;
 - the risks associated with the short maturity of the credit;
 - the risk and consequences of over-indebtedness.
- Prevent or limit the use of:
 - statements or expressions which promote consumers' overvaluation of short-term gains and immediate access to money ('present bias');
 - statements or expressions which induce consumers to take out STHCCC to solve financial problems or to purchase non-essential goods;

- illustrative examples which induce consumers to borrow higher amounts (e.g. using the maximum amount of credit that a consumer can take from the STHCCC as a benchmark);
- techniques that divert consumers' attention from the seriousness of the decision of taking out STHCCC;
- unsolicited marketing (e.g. push models of digital marketing).

Prior to the conclusion of the STHCCC agreement and during its lifetime

- Require that a summary of key information on the specific features (e.g. amount of the credit, total cost of credit, annual percentage rate of charge, repayment schedule) and risks (e.g. consequences of roll-overs, late repayment and arrears) of the STHCCC is presented to consumers in a highlighted and user-friendly manner, including through digital multimedia content (e.g. short explanatory video).
- Require that consumers are provided with information that enables them to clearly identify the firm providing the STHCCC through digital channels, as well as other entities involved in the borrowing process, and understand their specific roles and responsibilities.
- Require that consumers are provided with information on their main rights under the credit agreement, in particular the right to:
 - obtain further information and explanations from the provider of the STHCCC so as to place consumers in a position that allows them to assess if the proposed STHCCC is suitable to their interests, objectives and characteristics (e.g. specific FAQ's, chatbots, call centres);
 - cancel the credit agreement during a certain period of time after its conclusion ('cooling-off period') or to benefit from a period of time to carefully consider the conditions of the credit agreement before its conclusion ('reflection period');
 - access to recourse mechanisms in case of dispute with the provider of the STHCCC (e.g. how to submit a complaint and the alternative dispute resolution mechanisms made available to consumers).
- Establish technological requirements that allow a thorough analysis of the information by consumers, limiting the risk of impulsive or ill-considered credit decisions, including through:

- restrictions that prevent consumers from moving forward in the borrowing process without checking the relevant information on the STHCCC;
- measures that aim to ensure that consumers go over all relevant information on the STHCCC (e.g. minimum reading time, compulsory scroll down, questionnaire on the main features of the STHCCC);
- restrictions on the use of default options.
- Require that consumers can maintain access to the terms and conditions of the STHCCC during its lifetime (e.g. through access to a customer's reserved area, download or email).
- Require that consumers are provided with regular information, where appropriate, during the lifetime of the STHCCC, including:
 - information on the performance of the loan (e.g. amounts paid and the amounts owed);
 - reminders on when and how repayments should be made;
 - warnings on the importance of timely repayment of the credit and the risks arising from missing payments.

Rationale

For additional context, the actions to take listed above are based on the following findings from the Report:

- 4.1. Several studies highlight that communication can help improve consumers' choice and decision-making and that, to be effective, communication in a digital environment should employ different techniques than those used in traditional channels, taking into consideration, among other factors, insights from behavioural economics.
- 4.2. The risk of insufficient disclosure of information and the lack of transparency when STHCCC is provided through digital channels is identified in the Report as a key issue to be considered. The Report refers to the conclusion presented in the 2016 FinCoNet 'Report on Online and Mobile Payments' that there is a need for a technology-neutral consumer protection framework that ensures consumers receive a high level of protection regardless of the platform they avail of, including the issues related to disclosure of information.

- 4.3. The Report gives particular attention to one consequence of not having appropriate disclosure of information, namely that it *'could also result in consumers not being fully aware of all costs associated with their product, which in turn could contribute to repeat borrowing and over-indebtedness'*. The Report further states that *'this is of particular concern when dealing with high-cost products, especially where the consumer may be in a hurry to secure funding, as can often be the case for STHCCC'*.
- 4.4. As for the advertisement of STHCCC, the Report notes that these products are often aggressively advertised using messages that undermine the seriousness of entering into a credit agreement and distract consumers from its high cost, for instance focusing on the ease and speed of obtaining credit.
- 4.5. Moreover, it is noted that digital channels make it cheaper and simpler for lenders to market directly to consumers in a wide range of contexts (e.g. in conjunction with sites where they may be considering a purchase) which can potentially increase the risk of consumers purchasing credit that does not fit their needs, thus further contributing to over-indebtedness.

Guidance 5: Assessment of the consumer's interests

Supervisors' oversight should ensure that providers of STHCCC through digital channels:

- take into consideration the interests, objectives and characteristics of the target market when products are being designed and brought to market;
- assess whether the features of the STHCCC are suitable and appropriate for a consumer's needs and financial situation.

Actions to implement Guidance 5

In order to adequately ensure the implementation of **Guidance 5**, supervisors may, where appropriate, consider the following actions to take:

- Require providers to implement adequate internal procedures to certify that the features of the STHCCC are suitable for the defined target market.
- Evaluate whether providers of STHCCC have set a borrowing process and implemented mechanisms to:
 - gather sufficient and appropriate information to assess the consumer's interests, objectives and characteristics;
 - prevent and reduce the risk of a consumer providing false or outdated information;
 - allow providers to detect inconsistencies in the information provided by the consumer.
- Verify whether providers have implemented systems and put in place procedures to identify specific risks arising from the provision of STHCCC through digital channels (e.g. based on the number of complaints or the number of consumers in arrears).

Rationale

For additional context, the actions to take listed above are based on the following findings from the Report:

- 5.1. Ascertaining whether a specific credit product suits consumers' interests is widely accepted as a key element to be taken into consideration by credit providers when designing and distributing financial products and services. In a digital environment, where there may be no human intermediary in the provision of banking products and services, new challenges arise with respect to suitability assessment.

- 5.2. According to the Report, the lack of human intermediation to explain the features and costs of the product to the consumer and, to a certain degree, to evaluate the consumer's comprehension of his/her obligations, makes it more difficult to assess suitability, as the credit provider may not be as well informed of the consumer's position when making the decision to provide the credit.
- 5.3. The Report contains ample evidence that supervisors should endeavour to ensure that the borrowing process, and the digital tools used to provide the STHCCC, are set in a way that allows the credit provider to adequately assess if the features of the STHCCC are suitable to the consumer's interests, objectives and characteristics.

Guidance 6: Targeted prevention of consumer over-indebtedness

Supervisors' oversight should evaluate whether:

- automated creditworthiness assessment models used by providers when providing STHCCC through digital channels take into account consumers' individual circumstances, are sufficiently resilient and are leading to responsible lending decisions;
- the features of STHCCC provided through digital channels do not put disproportionate burdens or risks on consumers;
- providers of STHCCC through digital channels have in place adequate systems and mechanisms to monitor the performance of the credit agreement, detect signs of payment difficulties and give support and advice to consumers facing payment difficulties.

Actions to take to implement Guidance 6

In order to adequately ensure the implementation of **Guidance 6**, supervisors may, where appropriate, consider the following actions to take:

- Require that automated models used by providers of STHCCC through digital channels to assess consumers' creditworthiness adequately take into account, where appropriate:
 - information on the consumer's individual circumstances (e.g. income, expenses related to servicing obligations and other general living obligations);
 - information available on credit register databases and other agencies that collect credit ratings and/or credit history.
- Evaluate whether automated creditworthiness assessment based on big data and artificial intelligence are leading to responsible lending decisions and comply with data privacy requirements.
- Ensure that, when creditworthiness assessment is exclusively done through automated processing (e.g. profiling), consumers have the possibility of requesting human intervention to step in and contest the automated outcome.
- Require that the application form used to provide STHCCC through digital channels does not contain suggestions that may induce a consumer to manipulate the eligibility criteria for the

credit (e.g. by immediately stating that the income indicated by the consumer, or her/his employment situation, precludes the provision of the credit).

- Establish limits on:
 - the regular costs that can be charged or the total cost of the credit/APR;
 - the maximum amount that can be borrowed;
 - the number of outstanding STHCCC which a consumer may have;
 - the possibility of a consumer taking consecutive STHCCC (e.g. defining a period of time after the reimbursement of STHCCC during which a consumer is not entitled to enter into new STHCCC agreements);
 - the number of roll-overs or extensions of STHCCC;
 - the fees and other conditions that may be agreed in relation to the early credit repayment of STHCCC;
 - the costs that may be charged in the event of arrears.
- Introduce mandatory reflection or cooling-off periods that allow the consumer to adequately evaluate the features, costs and risks of STHCCC and to compare different credit offers, and ensure that consumers may exercise those rights through digital channels.
- Require that providers of STHCCC through digital channels have automated systems that allow prompt detection of signs of deterioration of consumers' financial capacity and dedicated units and contact channels to provide support and advice to consumers with payment difficulties.

Rationale

For additional context, the actions to take listed above are based on the following findings from the Report:

- 6.1. It is widely accepted that an adequate creditworthiness assessment, performed prior to the conclusion of the credit agreement, is a powerful tool in preventing over-indebtedness. The Report drives attention to the benefits of digitalisation in this context, pointing out that digitalisation is pushing forward technologies for creditworthiness assessment and increasing the availability of consumer data, in particular non-traditional data like social media data or

mobile phone activity data. These two vectors combined may result in more accurate and sophisticated credit scoring and in an improvement in overall credit risk management.

- 6.2. According to the Report, the convenience brought by the use of digital channels also emphasises the need to consider consumers' behavioural biases in the oversight of STHCCC provided through digital channels. 'Present bias' is of particular relevance in this context, given that the consumer enjoys the benefit from accessing the funds in the present bearing the costs only in the future, which may result in impulsive borrowing and an increase in over-indebtedness risk. In addition, the Report finds that borrowing in a digital environment may feel less serious to some consumers, which may be heightened by aggressive advertising.
- 6.3. Responses to the Survey revealed that several jurisdictions have implemented specific requirements for STHCCC aimed at mitigating the inherent risks of the product, specifically the risk of over-indebtedness. For instance, some jurisdictions have in place requirements targeting the high cost nature of the product, imposing limits on interest rates, limits on the amount that can be borrowed or limits on the additional fees that can be charged, for example, in case the consumer needs to extend the term of the loan or in case of arrears or default. Also, with the objective of reducing the likeliness of roll-overs, other jurisdictions implemented limits on the possibility of rolling over or refinancing the loan. To ensure a moderate use of STHCCC, some jurisdictions considered the introduction of restrictions on the possibility of a consumer having multiple loans at the same time or within an appropriate span of time.

Guidance 7: Security risks and data privacy

Supervisors should monitor if providers of STHCCC through digital channels have in place adequate internal procedures to monitor operational resilience, mitigate data privacy risks and detect and respond to security incidents in a timely manner.

Supervisors should also seek to ensure that providers of STHCCC through digital channels have implemented adequate data privacy policies and follow good practices when collecting, processing and saving consumers' personal data.

Actions to take to implement Guidance 7

In order to adequately ensure the implementation of **Guidance 7**, supervisors may, where appropriate, consider the following actions to take:

Security risks

- Implement and require providers of STHCCC to introduce and maintain tools and procedures to monitor online and other digital activity, allowing for prompt identification of security risks arising for consumers from such activity.
- Establish effective communication channels for providers to report identified security risks or incidents (e.g. by giving immediate notice of security threats or completing periodic surveys).
- Promote a close engagement with the industry and carry out other initiatives in order to strengthen internal knowledge and expertise on technological tools and solutions.
- Disclose prompt information to raise consumers' awareness about security risks or fraud schemes in the digital environment, including by issuing public warnings.

Data privacy

- Require providers of STHCCC through digital channels to disclose clear and transparent information in good time to consumers on their privacy policies and practices.
- Assess if the information collected and the information management practices implemented by providers of STHCCC through digital channels is compliant with data privacy principles and rules.
- Monitor whether data privacy policies implemented by providers of STHCCC:

- allow consumers to exercise control over their personal information (e.g. establishing the need for the consumer's express written consent for collection and when providers intend to share or transfer personal data);
- require consumers to be informed of the personal data that will be collected and its collection purposes;
- restrict the collection of unnecessary, disproportionate or irrelevant personal data;
- ensure that personal data is only retained as long as it is necessary or, if the provider wishes to maintain it in their records, that it is kept anonymised.

Rationale

For additional context, the actions to take listed above are based on the following findings from the Report:

- 7.1. The proliferation of digital innovation may raise security concerns and expose consumers to increased risk of fraud (e.g. new fraud schemes may take advantage of consumers' lack of digital and financial literacy) and misuse of personal data (e.g. consumers may adopt risky behaviours involving their personal data).
- 7.2. FinCoNet has extensive work on the matter of security risks in online and mobile payments and continues to carry out research in this field. The 2016 'Report on Online and Mobile Payments' found that the most significant security concern among supervisors was the prevention of fraud, as schemes become gradually more sophisticated as a result of technology evolution. Data protection and privacy were also identified as areas where potential consumer detriment could arise.
- 7.3. The Report recognizes that there is a need for credit providers to use all data available about the consumer, including non-traditional data like social media and mobile phone data, but that this must be clearly communicated to the consumer and that safeguard measures must be in place to prevent the improper usage of the data.

Guidance 8: Digital financial literacy

Supervisors should have a pro-active approach to building up consumer knowledge and understanding of the main features and risks of STHCCC provided through digital channels, ensuring that clear, complete and unbiased information is easily accessible in a digital environment and that tools and materials are available to support consumers in the decision-making process.

Actions to take to implement Guidance 8

In order to adequately ensure the implementation of **Guidance 8**, supervisors may, where appropriate, consider the following actions to take:

- Develop and make available digital content, for example, on:
 - consumers' rights and duties in relation to STHCCC provided through digital channels;
 - the features and stages of the borrowing process of STHCCC provided through digital channels;
 - the risks for consumers of taking out STHCCC and the specific risks related to the provision of credit through digital channels;
 - the interest rates, fees and other costs of STHCCC available through digital channels;
 - warnings about unlicensed/unregistered entities, fraudulent schemes or security risks;
 - consumer complaints and examples of supervisory findings and enforcement actions related to the provision of STHCCC through digital channels.
- Make available or encourage other parties to provide tools and materials to facilitate comparison of characteristics or alternative credit products (e.g. price comparison websites) and to assist the consumer in assessing her/his debt situation and financial capacity (e.g. budgeting simulators and debt-to-income calculators).

Rationale

For additional context, the actions to take listed above are based on the following findings from the Report:

- 8.1. The lack of consumer digital financial literacy is identified in the Report as one of the main drivers of risks associated with the digitalisation of STHCCC. The specific features of the digital channels used to provide STHCCC is considered to boost the risks associated to impulsive or

uninformed decisions, which may lead to over-indebtedness and, more generally, to consumers' detriment.

- 8.2. To illustrate these risks, the Report refers to the results of the survey conducted by the Financial Consumer Agency of Canada (FCAC), which highlighted that a large number of payday loans users were not aware that a payday loan is more expensive than other available alternatives on the market. On 'Payday Loans: Market Trends (October 25, 2016)'⁸, FCAC identified the importance of adapting its existing consumer education materials and developing new materials to foster consumer understanding of the costs of payday loans relative to existing alternatives and reducing dependence on payday loans (specifically by paying down debts and ending recurrent debt cycles).
- 8.3. The importance of improving financial information and literacy in a growing digital environment is also acknowledged by international organisations. For instance, in the G20/OECD INFE Report on 'Ensuring financial education and consumer protection for all in the digital age', it is stated that *'several countries participating in the survey underline that financial literacy and knowledge of products/services represent the most important policy priorities or concerns in their jurisdictions'*.

⁸ Financial Consumer Agency of Canada, 2016, Payday Loans: Market Trends (available at <https://www.canada.ca/content/dam/fcac-acfc/documents/programs/research-surveys-studies-reports/payday-loans-market-trends.pdf>).

Annex: Report on the digitalisation of short-term, high-cost consumer credit



Report on the Digitalisation of Short-term, High-Cost Consumer Credit

November 2017

Acknowledgements

FinCoNet would like to acknowledge the work of Standing Committee 2 in developing and getting this project to finalisation. Standing Committee 2 consists of representatives from Australia, Brazil, Canada, China, Germany, Indonesia, Ireland, Portugal and the United Kingdom and had the assistance of staff from the OECD Secretariat. In particular, we would like to thank Colm Kincaid as Chair of the Committee and Filipa Alves, Matthias Aust, Sinéad Cawley, Matheus Rauber Coradin, David Mendes da Costa, Diogo José da Silva, Pedro Dias, Leonardo Nogueira Ferreira, Antônio Marcos Fonte Guimarães, Hudiyanto, Jefferson Rangel Bueno Muniz, Aldi Firmansyah Rubini, João Santos, Yoni Simhon, Melanie Spong, Sam Stoakes, Rudi Saleh Susetyo, Anthony Thompson, Steve Trites, Jennifer Wong and Agus Fajri Zam for their work in writing and producing the survey and report.

The **International Financial Consumer Protection Organisation (FinCoNet)** was established in 2003 as a network of financial consumer protection regulators and supervisors to discuss consumer protection issues of common interest. It is recognised by the Financial Stability Board (FSB) and Group of 20 (G20).

In November 2013, FinCoNet was formalised as a new international organisation of financial consumer protection supervisory authorities.

The goal of FinCoNet is to promote sound market conduct and enhance consumer protection through efficient and effective financial market conduct supervision, with a focus on retail banking and consumer credit.

Members see FinCoNet as a valuable forum for sharing information on supervisory tools and best practices for consumer protection regulators in financial services.

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EXECUTIVE SUMMARY

This Report by FinCoNet on the Digitalisation of Short-Term, High-Cost Consumer Credit (“STHCCC”) represents the output of a detailed survey of regulators in 25 jurisdictions, as well as a review of international literature published on this topic to date. It forms part of FinCoNet’s continuing work on responsible lending and on digitalisation, building on FinCoNet’s previous published reports on those topics.

The Report finds that, used properly, digitalisation has the capacity to transform the availability and provision of credit for the better. However, in the context of STHCCC, it may also introduce new risks and aggravate the risks already associated with these types of loans. The Report also points out specific behavioural risks arising from the convenience of digitalised STHCCC and its removal of the need for human interaction.

The Report finds a wide variation in the nature of the products available digitally in different jurisdictions and a variety of consumer protection issues encountered as a result. This points to the emerging nature of this phenomenon. It also highlights the benefit of international collaboration amongst Supervisors on this topic. This is all the more so given the evidence in the Report that most regulatory frameworks do not distinguish between credit provided through digital channels or traditional channels. This seems appropriate to ensure uniformity of protection for consumers. However, it may also be a symptom of the risks arising specifically from digitalised STHCCC not having been fully considered.

As an international organisation of consumer protection Supervisors, FinCoNet offers a unique forum for collaboration amongst Supervisors on this topic. Based on these findings, FinCoNet will continue its work towards the development of Guidance for Supervisors on the setting of Standards in the field of digitalised STHCCC. This work will draw on the findings of this Report, focusing on the topics identified (collated on page 6 and 7 of this Report). These include the avoidance of gaps emerging in the consumer protection framework (including in the context of cross-border services), approaches to authorisation and oversight, the role of disclosure, consumer access to recourse mechanisms, the mitigation of the risk of over-indebtedness (including risks arising from behavioural biases) and the mitigation of security risks.

Through this work, FinCoNet seeks to provide a platform for Supervisors to exchange views through the auspices of FinCoNet regarding effective approaches to addressing issues arising from the digitalisation of STHCCC and its impact on responsible lending practices. This FinCoNet Report represents therefore an important contribution to the development of consumer protection globally in this emerging field of financial services.

TOPICS FOR GUIDANCE TO SUPERVISORS

The 2014 FinCoNet Report on Responsible Lending¹ identified a number of good practice observations to promote responsible lending. The good practice observations highlight useful or common practices among jurisdictions that are consistent with international developments and standards, or reflect regulatory policy insight into, and experience of, established or emerging good practice.

Based on the findings of this Report, FinCoNet has identified a number of topics that are particularly relevant for Supervisors to consider in their design of a responsible lending regime in relation to the digitalisation of short-term, high-cost consumer credit (“STHCCC”), based on the 2014 Good Practice Observations. These will inform the development by FinCoNet of guidance to Supervisors on the setting of standards in the field of digitalisation and STHCCC, with a view to further promoting sound market conduct and strong consumer protection through the efficient and effective conduct supervision of the digital STHCCC market.

The areas identified throughout this Report on which FinCoNet plans to develop guidance are listed in the table below for ease of reference:

Topics for Guidance to Supervisors		
1	Comprehensive Regulatory Scope (based on 2014 Good Practice Observation 3)	<p>A. The manner and extent to which a Supervisor should have oversight over all providers of digital credit, including new players who may fall outside of scope of the traditional regulatory framework.</p> <p>B. The manner and extent to which a Supervisor should seek to mitigate the risk of regulatory gaps arising (including in the context of cross-border services) and ensure that consumers are adequately protected regardless of the provider or channel they use to avail of credit.</p>
2	Appropriate Oversight Tools (based on 2014 Good Practice Observation 4)	The oversight tools a Supervisor should use to effectively identify and mitigate the risks associated with digital STHCCC.
3	Appropriate Disclosure of Key Information (based on 2014 Good Practice Observations 7 and 8)	<p>The role and effectiveness of disclosure of key information when STHCCC is provided through a digital channel, including:</p> <ul style="list-style-type: none"> (i) the manner and extent to which a Supervisor can foster an imperative on firms to avail of digitalisation to improve the way information is disclosed to consumers, in order to enhance consumer comprehension; and (ii) the manner and extent to which a Supervisor should consider whether additional disclosure obligations or guidance on existing obligations are required for STHCCC provided through digital channels.

¹ FinCoNet, 2014, Report on Responsible Lending

4	Consumer Access to Recourse Mechanisms (based on 2014 Good Practice Observation 23)	The manner and extent to which a Supervisor should ensure that firms availing of digital channels to provide STHCCC clearly define responsibilities for complaints handling and dispute resolution and appropriately convey this information to the consumer, including where there are multiple parties involved in delivery of the service.
5	Targeted Prevention of Consumer Over-indebtedness (based on 2014 Good Practice Observation 15)	The manner and extent to which a Supervisor should have regard to the potential for digitalisation to make it even easier for consumers to access STHCCC and thus further increase the risk of over-indebtedness already associated with STHCCC.
6	Making Use of Behavioural Studies (based on 2014 Good Practice Observations 4 and 21)	The manner and extent to which a Supervisor can use lessons learned from behavioural studies to inform their approach to regulating and supervising the digitalisation of STHCCC.
7	Reasonable Assessment of the Interests of a Consumer (based on 2014 Good Practice Observations 12, 13 and 14)	The manner and extent to which a Supervisor should have regard to ensuring products and services are suitable and appropriate for a consumer's needs and financial situation regardless of the channel through which the STHCCC is provided. This includes consideration of the extent to which automated creditworthiness assessments can fully encompass a consumer's particular circumstances or provide the necessary facility to gauge those circumstances beyond what is provided by written documentation (e.g. to gauge the consumer's true understanding or the veracity of information provided).
8	Requirement for Human Interaction (based on 2014 Good Practice Observations 7, 8, 9, 12, 13 and 14)	The manner and extent to which a Supervisor should consider if and when human interaction should be required when a consumer is availing of STHCCC on a digital channel, for the purposes of ensuring adequate and appropriate disclosure, consumer comprehension and suitability of the product or service.
9	Mitigation of Security Risks (based on 2014 Good Practice Observation 3)	The manner and extent to which a Supervisor should ensure that the proliferation of new technologies accompanying the digitalisation of STHCCC does not introduce unwarranted security risks for consumers.
10	Authorisation Requirements (based on 2014 Good Practice Observation 17)	The manner and extent to which a Supervisor should ensure that the digitalisation of STHCCC and its specific innovative features do not have an adverse impact on the standards required in order to be authorised to provide STHCCC or result in a net decrease in the level of consumer protection.
11	Collaboration with Supervisors and Industry (based on 2014 Good Practice Observations 4 and 21)	The manner and extent to which a Supervisor should seek to collaborate with other Supervisors, as well as engage with industry and technological innovators, in order to acquire information on new and emerging risks, and on best practice for regulating digital STHCCC.

CHAPTER 1: INTRODUCTION

Background

Responsible lending initiatives

As part of global discussions held in the context of the recent global financial crisis, particular attention is being paid to consumer protection and regulatory and supervisory deficiencies relating to consumer credit, i.e., credit provided for personal, household or domestic purposes. In particular, responsible lending – in terms of both business conduct and product suitability – has been identified as a response to these concerns.

FinCoNet is uniquely positioned to canvas the issue of responsible lending across the full range of consumer credit products provided by a range of credit providers and credit intermediaries, from both a consumer protection and market conduct perspective.

In 2013, therefore, FinCoNet set up a Standing Committee on Responsible Lending to focus on identifying regulatory and supervisory tools for supporting appropriate consumer lending practices. The aim of the Standing Committee on Responsible Lending's work is to help jurisdictions share information about current developments in supervisory tools and responsible lending practices, thus enabling jurisdictions to review the adequacy of their responsible lending arrangements. The intended outcome of this work is to see a strengthening in the development and use of supervisory tools aimed at deterring unsuitable or irresponsible lending by helping jurisdictions identify current gaps and weaknesses in their regulatory regimes, including their supervisory and enforcement capabilities.

Following its 2016 Annual General Meeting, FinCoNet agreed that this Standing Committee would focus its work on the main supervisory challenges associated with the digitalisation of STHCCC. This follows on from FinCoNet's previous work in the field of responsible lending, including the publication of the 2014 'FinCoNet Report on Responsible Lending' and the 2016 'Report on Sales Incentives and Responsible Lending'². Following a public consultation, FinCoNet also published in 2016 'Guidance to Supervisors on the setting of Standards in the field of Sales Incentives and Responsible Lending'³.

FinCoNet's work on digitalisation and responsible lending in the field of STHCCC is part of its wider focus on emerging technology and its implications for financial consumer protection. FinCoNet began addressing these issues focusing on online and mobile payments⁴, and is currently expanding its area of analysis to cover more widely risk-based supervision in the digital age.

² FinCoNet, 2016, Report on Sales Incentives and Responsible Lending

³ FinCoNet, 2016, Guidance to Supervisors on the Setting of Standards in the field of Sales Incentives and Responsible Lending

⁴ FinCoNet published a 'Report on Online and Mobile Payments : Supervisory Challenges to Mitigate Security Risks' in 2016, and is continuing work in this field to identify effective and potentially innovative supervisory approaches regarding the mitigation of security risks in the digital ecosystem.

Overview of the Survey

In 2017, FinCoNet developed the 'FinCoNet Survey on Digitalisation of short-term high-cost lending: supervisory challenges to promote responsible lending'. The Survey collected information from different jurisdictions on the marketing and selling of STHCCC products through digital channels. It also collected information on the relevant practices, tools and mechanisms to promote the principles of responsible lending and mitigate the emerging risks associated with the digitalisation of STHCCC.

Survey features

The Survey aimed to identify the following:

- a. The types and specific features of STHCCC in each jurisdiction;
- b. The risks associated with digitalisation of STHCCC;
- c. The regulatory and supervisory framework for STHCCC provided through digital channels.

The Survey also gathered case studies that identified the supervisory challenges posed by digitalisation of STHCCC, and any best practices in this field.

Survey Responses

The Survey was issued to a large number of jurisdictions and representative bodies, including FinCoNet members, associates and observers. A total of 25 responses were received from different jurisdictions (see Appendix One for a list of respondent authorities). All figures must be read in the context of the explanation of the Survey above and the caveats therein. In this Report, 'jurisdiction' refers to one of the jurisdictions that responded to the Survey.

Literature Review

The Report is also informed by a range of literature on the topics of STHCCC, and digitalisation more generally. A large amount of research and writing has been and is currently being undertaken by a number of entities in these fields. Only a selection of this wide range of available literature has been referenced in the Report, where the contents were considered most pertinent.

G20 High level Principles on Financial Consumer Protection

The G20 High Level Principles on Financial Consumer Protection⁵ are applicable across all financial markets (banking, credit, insurance, securities and pensions) and are designed to assist G20 countries and other interested economies with enhancing financial consumer protection frameworks in their own jurisdictions. As part of its research in the development of this Report, FinCoNet considered the risks arising from the digitalisation of STHCCC in the context of the G20 High Level Principles and carried out a preliminary mapping exercise to reflect this (see Appendix Two).

Why Study the Digitalisation of Short-term, High-cost Consumer Credit?

FinCoNet recognises that the STHCCC market can present particular challenges for Supervisors as there is a significant risk that poor lending practices could push borrowers into unsustainable levels of debt. The impact of digitalisation on this market, and the subsequent ease of access to credit, has resulted in new challenges for Supervisors around the world. While innovation comes with many benefits, it can also present new risks to financial consumers. It can expose them, inter alia, to poor lending practices, inadequate disclosure and confusing dispute resolution processes.

Purpose of the Report

In preparing and publishing this Report, FinCoNet seeks to assist Supervisors with identifying current weaknesses in their regulatory regimes in relation to the provision of STHCCC through digital channels. The Report also aims to provide Supervisors with examples of regulatory approaches to draw on to strengthen domestic supervisory tools aimed at deterring unsuitable or irresponsible lending, as well as highlighting areas where further work is merited. Accordingly, while acknowledging the benefits of digitalisation (used properly), FinCoNet's focus in this Report is on understanding the regulatory risks and challenges from the perspective of financial consumer protection.

In addition to the Survey responses, this Report is informed by a range of existing work related to the digitalisation of STHCCC, including the work of international standard-setting bodies⁶, Supervisors in different jurisdictions, consumer bodies, and scholarly literature.

The Report does not seek to provide an exhaustive policy framework for the regulation of STHCCC provided through digital channels. Rather, it seeks to draw attention to the range of current and emerging regulatory practices across jurisdictions intended to promote responsible lending in this field. This

⁵ G20/OECD, 2011, G20 High-level Principles on Financial Consumer Protection

⁶ For example, the Financial Stability Board (FSB) and the Organisation for Economic Co-operation and Development (OECD)

Report will feed into and influence FinCoNet's future work in the areas of responsible lending and digitalisation of financial services, including providing a platform for Supervisors' discussion of these matters under FinCoNet's auspices. It will also support the future work of FinCoNet and the G20/OECD Task Force on Financial Consumer Protection, and the OECD International Network on Financial Education (INFE), with whom FinCoNet works closely on these matters.

Structure of the Report

The Report sets out the key results from the Survey (including case studies identified by the Survey) as well as international developments and experience to date. It seeks to increase awareness and understanding of the risks associated with the digitalisation of STHCCC, and to identify practices to promote responsible lending in this field.

A number of case studies have been chosen to illustrate particular points in the Report. The inclusion of a case study does not indicate that the respondent referred to in the specific case study used is the sole respondent to have identified a particular issue or corrective measure.

The Report includes references to a number of credit providers and products. These references should not be construed as an endorsement by FinCoNet. Nor do they imply any conclusion about the status of any product or service described, but instead are offered as illustrative of new business models and emerging technologies currently being contemplated, proposed or offered.

Contextual matters

Not all of the tools and mechanisms that supervisors, regulators and relevant policy makers may use to promote responsible lending in relation to digital STHCCC will be useful or relevant to a particular country or jurisdiction.

Contextual matters that will influence whether a measure or approach is useful or relevant to a particular country or jurisdiction depend on a number of policy factors, including:

- The shape and sophistication of the market – for example, if STHCCC is a growing market;
- The legal framework of a jurisdiction;
- Economic conditions, such as the availability of credit, interest rate conditions, productivity and growth agendas, and financial stability concerns;
- The general literacy, numeracy and financial literacy of the population – for example, disclosure may be less useful where the general literacy of the relevant consumer population is limited; and
- The desire to promote financial inclusion overall, or among certain groups of consumers.

This Report does not seek to analyse the policy settings or effectiveness of a particular measure or proposal. However, it may identify the contextual background in which certain mechanisms were introduced or may be considered useful, as well as respects in which their utility may be limited.

CHAPTER 2: BASIS AND SCOPE OF THIS REPORT

Key Points

Short-term, High-cost Consumer Credit (STHCCC) may be referred to under different names in different jurisdictions, such as payday loans, small amount credit contracts or moneylending agreements.

The Survey found that, while some jurisdictions' legislation defines specific forms of STHCCC, most jurisdictions do not have a specific legal definition of, or specific classification for, STHCCC per se.

However, based on the Survey responses, STHCCC commonly refers to the practice of lending to consumers:

- (i) amounts of money that are small relative to other forms of credit in the market,
- (ii) for short periods of time, most commonly under 12 months,
- (iii) at a rate that is considered to be high compared to other products in the market.

Responsible Lending: An Overview

The 2014 FinCoNet Report noted that, while consumer credit is an integral part of the global economy, plays a central role in most economies, and the case for regulatory involvement is strong, the international focus on responsible lending for consumer credit is a relatively new phenomenon. International responsible lending initiatives have tended to develop in response to specific concerns or in the context of the development of broader consumer protection issues (as opposed to responsible lending specifically). While consumers, credit providers and credit intermediaries all play a central role in ensuring that the decision to lend or enter into a credit contract or agreement is made responsibly, there is also an important role for regulatory involvement to promote and enforce responsible lending. Insights from literature, research, recent events and international developments suggest that there are three broad grounds on which to justify regulatory involvement to encourage responsible lending which significantly interact, overlap and complement each other:

- promoting economic efficiency – to address market failures such as 'information asymmetry' between credit providers and consumers;
- consumer protection – taking into account principles of equity and fairness, particularly to overcome any imbalance of power between a credit provider and a consumer that results in abusive or predatory practices; and
- financial stability (prudential) concerns – to prevent systemic risk in the market⁷.

⁷ See for example, quote from BCBS's 'Guidance on the application of the Core Principles for Effective Banking Supervision to the regulation and supervision of institutions relevant to financial inclusion' which states that the "proliferation of formal, informal, regulated and unregulated microlenders with varying business models raises further concerns regarding debt stress and potential systemic consequences of overindebtedness in some jurisdictions" (p. 23)

What is Consumer Credit?

This Report uses the definition of 'consumer credit' employed in the 2014 and 2016 FinCoNet Reports:

Consumer credit means “credit provided to individuals for personal, domestic or household purposes, and not business purposes”.

This includes both secured credit (such as mortgage loans and personal loans) and unsecured credit (such as lines of credit, credit cards, overdraft facilities, payday lending and micro-finance).⁸

However, please note that, given the specific object of this report (short-term, high-cost consumer credit), future reference to consumer credit will generally apply only to unsecured consumer credit, as consumer credit products that may be classified as STHCCC are, typically, unsecured credit.

What is Short-term, High-cost Consumer Credit (STHCCC)?

The Survey asked respondents to identify and describe the main features of STHCCC available in their respective jurisdictions. The findings of the Survey in relation to the characteristics of this type of credit as it is defined in various respondent jurisdictions can be found throughout the Report, with some further detail provided in Appendix Three. The intention of this Report is not to map out all types of STHCCC, or to come to a common definition for the term. In any event, the findings of the Survey showed a wide variation in the technical detail of what is considered STHCCC in different jurisdictions. Rather, the aim of this Report is to give a flavour of the different approaches and definitions in jurisdictions as to what is treated as being 'short-term, high-cost' credit, the regulatory risks arising, and the approaches taken to regulation, in order to assist Supervisors with regulating the digital provision of this type of credit in their own jurisdiction.

In general, STHCCC refers to the practice of lending to consumers:

- amounts of money that are small relative to other forms of credit in the market,
- for short periods of time (according to the Survey, these loans were most commonly for durations of under 12 months),
- at a rate that is considered to be high compared to other products in the market.

STHCCC may be referred to under different names such as payday loans, small amount credit contracts or moneylending agreements, depending on the jurisdiction. The Survey found that, in some jurisdictions, specific forms of

⁸ FinCoNet, 2016, Report on Sales Incentives and Responsible Lending, p. 16-17

STHCCC are defined in legislation, while other jurisdictions do not have any legal definitions of, or specific classifications for, STHCCC.

Respondents noted a range of different types of STHCCC products that are commonly provided in their jurisdictions. For example, in some jurisdictions revolving credit products such as credit cards or overdraft facilities were considered by respondents to be STHCCC products. In Ireland, it was taken to refer to a specific statutory category of high cost 'moneylending agreement', where the credit will usually take the form of a cash loan but may also involve the provision of goods on credit from a retailer or the purchase of goods from a catalogue.

CHAPTER 3: DIGITALISATION

Key Points

The phenomenon of digitalisation of financial services has had an impact on the STHCCC market.

Digital STHCCC differs from STHCCC provided through traditional channels in three key ways: it is fast, automated, and remote.

Digitalised consumer credit can be broadly categorised for STHCCC purposes into standard, peer-to-peer (P2P) and retail loan models, amongst others.

As in other financial services, partnering between fintechs and traditional credit providers is to be found in STHCCC.

Done properly, the digitalisation of STHCCC has the potential to offer benefits to consumers. These can include increased access to regulated financial services, improved creditworthiness assessments, enhanced convenience and cost savings.

The Digitalisation Phenomenon

In recent years the world has faced a significant digitalisation of daily human activities, influencing the way people communicate and interact with each other through social, commercial and financial relations. These advancements in digital technology are driving considerable changes in the global economy and in society as a whole⁹. They are also changing the way financial services are delivered, with an overall global upward trend in the uptake of digital financial services. It is expected that this uptake of digital financial services will continue to grow in coming years, acting as a catalyst for further development and innovation¹⁰. According to the Group Speciale Mobile Association (GSMA)¹¹, a trade body that represents the interests of mobile operators worldwide, digital financial services are now widely available to over 60% of the world's population. This digitalisation has allowed large numbers of previously unbanked consumers to access financial services, particularly via mobile channels. These channels are growing in popularity, including in emerging markets and developing economies. In 2016, GSMA reported that mobile money accounts outnumbered bank accounts in several emerging markets and developing countries¹².

⁹ OECD, 2015, Digital Economy Outlook

¹⁰ OECD, 2017, G20/OECD INFE Report on ensuring financial education and consumer protection for all in the digital age

¹¹ GSMA, 2017, State of the Industry Report on Mobile Money 2016

¹² GSMA, 2016, State of the Industry Report on Mobile Money 2015

What are 'Digital Financial Services'?

According to the OECD/INFE, digital financial services (DFS) can be defined as “*financial transactions using digital technology, including electronic money, mobile financial services, online financial services, I-teller and branchless banking, whether through bank or non-bank institutions. DFS can encompass various monetary transactions such as depositing, withdrawing, sending and receiving money, as well as other financial products and services including payment, credit, saving, pensions and insurance. DFS can also include non-transactional services, such as viewing personal financial information through digital devices*”¹³. There are many diverse players involved in the delivery of digital financial services. The OECD/INFE Report noted that banks are the biggest players providing digital financial services, followed closely by telecommunication companies. Other players identified in the report include credit providers, government authorities, insurance or pension companies, post offices, banking agents, mutual societies, fintech companies, e-money institutions, investment banks and stockbroking companies, amongst others.

The Digitalisation of STHCCC

This digitalisation of financial services has also had an impact on the STHCCC market. More and more providers are offering their services through digital channels, as consumer demand for digital credit continues to increase. Online and mobile businesses are attractive for both credit providers and consumers: they require few overheads in comparison to traditional lending institutions and allow fast and convenient access to credit. The online STHCCC market in Australia for example has experienced significant growth in recent years, with one major shop-front lender of small amount credit contracts (SACCs) reporting in 2017 that its online lending volumes had exceeded in-store lending for the first time¹⁴. This acceleration in growth of digital credit is also evident in emerging markets, where mobile-based credit services such as M-Shwari in Kenya have undergone rapid expansion in a short period of time¹⁵.

¹³ OECD, 2017, G20/OECD INFE Report on ensuring financial education and consumer protection for all in the digital age, p.14

¹⁴ Cash Converters, 2017, Half-Year Financial Results for the period ending 31 December 2016

¹⁵ CGAP, 2016, The Proliferation of Digital Credit Deployments

Products and Channels

Respondents to the Survey indicated that some or all of the STHCCC products offered in their jurisdictions are available via digital channels, with web-based channels being the most prevalent. In some cases, providers may use digital channels for part of the loan process but still require an in-person communication at some stage. In other cases, everything from loan application, to approval, to disbursement and repayment is done via a digital channel, with no human intermediation. In Indonesia, providers may use digital channels to assist with credit scoring. In Ireland, licensed moneylenders have used online applications to log complaints and ‘catalogue firm’ moneylenders provide the facility to borrow online at the same time as purchasing a product from their catalogue. The Competition and Markets Authority’s examination of the STHCCC market in the UK¹⁶ found that around 40% of payday loan customers taking out loans with online lenders applied via the website of a lead generator. Lead generators are companies that contract with payday lenders to provide potential customer applications (or ‘leads’) in return for a fee for each lead provided. Online customers who do not apply via a lead generator may access lenders’ websites directly, or by other means including using a search engine, via the websites of associated marketing companies, and, to a lesser extent historically, by using price comparison websites.

In their review of digital credit products¹⁷, the Evans School Policy Analysis and Research (EPAR) identified 68 products on offer digitally in India, Kenya, Nigeria, Tanzania and Uganda. Although their study was not limited to STHCCC specifically, many of the products identified were short-term (30 days or less) and could be considered high-cost as they had relatively high interest rates and multiple fees. Most of the products identified were established between 2012 and 2015 (36 products) and a further 16 were less than a year old or still in the planning stages of development. The majority of products were offered in one country only – of the 68 products identified, only two are offered in multiple countries: L-Pesa in Kenya, Tanzania and Uganda, and Mkopo Rahisi (Tala) in Kenya and Tanzania. The EPAR noted that this geographic concentration may be due to partnerships or identity verification requirements.

The most common digital channel identified was the internet, which is used by 37 of the products, while 27 products operate from mobile applications (some of these products also have an internet platform). However, smartphones are not as widely used in low income countries due to their cost, and as a result a number of products (18) are available on feature phones which do not have access to mobile internet services, operating instead via SMS, SIM card toolkit, or unstructured supplementary service data (USSD). None of the respondents to the FinCoNet Survey reported feature phones as a commonly used digital channel to access STHCCC in their jurisdiction.

¹⁶ Competition and Markets Authority, 2015, Payday lending market investigation: Final Report

¹⁷ Evans School Policy Analysis and Research, 2017, Review of Digital Credit Products in India, Kenya, Nigeria, Tanzania, and Uganda.

Business Models

Digital STHCCC can be said to differ from STHCCC provided through traditional channels in three key ways¹⁸:

1. **Fast:** the use of digital channels allows loans to be approved and disbursed very quickly, often in less than 24 hours and in some cases almost instantaneously.
2. **Automated:** decisions on creditworthiness and loan approval are determined by automated processes which allow services to move more quickly.
3. **Remote:** transactions are made remotely, rather than in person, removing the need to visit the physical location of a financial institution in order to access financial services.

The EPAR identified three primary categories of business models used for the sale of digital credit products¹⁹. These are as follows:

1. Standard Model

Products following this model may vary by platform, loan terms and target market but share three key features:

- a. Loans are disbursed as electronic cash (to either a bank account or mobile money wallet);
- b. Loans are unsecured; and
- c. Loans are provided by banks, mobile network operators or other big lenders (not by individuals).

2. Retail Loan Model

This model allows consumers to apply for a loan in order to purchase retail products. Some digital credit products using this model allow consumers to purchase their retail partners' products directly through their website. Consumers apply for the loan while browsing and can be approved instantly. The digital credit provider then coordinates delivery of the item and manages the loan repayment. Other credit products allow customers to apply for a loan and then use that loan to purchase retail products on their partners' websites. For example, the EPAR identified one credit provider's product partnered with a large online retailer. The retailer provides the retail shopping experience while the credit provider manages the approval, disbursement and repayment of the loan.

¹⁸ Chen and Mazer, 2016, Instant, Automated, Remote: The Key Attributes of Digital Credit

¹⁹ These are of course variations that do not fit clearly into the other models identified. For example, Okoa Stima (Kenya) is a product offered by the communications company Safaricom in partnership with Kenya Power that allows consumers to pay their electricity bills using credit. For two other products, the customer's employer must have signed up for the service which then enables loans to be repaid in the form of a payroll deduction. These products may also use data provided by the employer to assess creditworthiness. Another product (Mjajiri in Kenya) requires customers to pay an upfront fee to use but allows them to earn small amounts for customer referrals.

CASE STUDY A - Ireland

In Ireland, 'licensed moneylenders' (a statutory category of STHCCC) operating as 'catalogue firms' provide goods on credit using the retail loan model. This credit is in the form of a running account, which operates similar to a credit card account. The consumer receives a statement which sets out the sum borrowed and outstanding (including any accrued interest) and the minimum amount that they must repay that month. The remainder of the balance continues to accrue interest and some or all of the outstanding amount can be repaid at any time.

Repayments can be made through a range of different options including postal order, bill pay, bank, cheque, online, or using a credit or debit card. There are currently two catalogue firms operating in Ireland as licensed moneylenders. The most recent data from the Central Bank of Ireland suggests that consumers availing of credit provided by these companies account for approximately 43% of consumers in the overall licensed moneylending market in Ireland.

Catalogue firms give rise to a different set of concerns than those of standard home collection STHCCC firms. Such concerns include, but are not limited to, the ease of access to credit. There is even the possibility that a consumer may apply for high cost credit inadvertently (given its proximity to the purchase and pay features of the website), or at least without having envisaged doing so at the start of the transaction or having given it as much thought as might perhaps be the case where credit is arranged elsewhere.

3. Peer-to-Peer (P2P) Lending Model

According to the International Organisation of Securities Commissions (IOSCO)²⁰, crowdfunding is *"an umbrella term describing the use of small amounts of money, obtained from a large number of individuals or organisations, to fund a project, a business or personal loan, and other needs through an online web-based platform"*. IOSCO lists four subcategories of crowdfunding: donation, reward, peer-to-peer (P2P) lending and equity crowdfunding. In relation to crowdfunding, this Report will focus on the P2P lending model.

In general terms, P2P lending can be defined as the use of an electronic platform that matches lenders/investors with borrowers/issuers in order to provide unsecured loans, including consumer and business lending, as well as lending against real estate. These services are usually provided by new market entrants known for the heavy digitalisation of their processes, including technological support for credit analysis, payments settlements and, in some instances, investment management.

²⁰ OICV-IOSCO, 2014, Crowd-funding: An Infant Industry Growing Fast, p. 4

In this model, the product provides a platform where borrowers are matched with the individual lenders who provide the funding. For the majority of products reviewed by the EPAR, the risk of default lies with the individual lender. One product identified in the EPAR's review (Faircent in India) requires a loan to be funded by multiple lenders in order to reduce the level of risk for any single lender. The time taken for loan disbursement depends on the interactions between the lender and the borrower, who must both agree on the loan terms and conditions.

The P2P lending model poses both benefits and risks to consumers. CGAP considered the major benefits of this model to consumers to be convenience, efficiencies, and the potential to improve access to credit by excluded and underserved groups²¹. The FSB has noted²² that P2P platforms may be more vulnerable than banks to some operational risks, such as cyber-risk, due to their reliance on relatively new digital processes. As with any digital provider, the extent of the exposure to such risks is likely to depend on the level of sophistication of the platform, the mechanisms employed to store clients' data and the robustness of their cyber-security regimes. It may also depend on the level of reliance on third-party providers to whom services are outsourced, and the quality of those providers. CGAP also identified the risk that consumers may be afforded less protection when using P2P platforms which may fall outside of the scope of the traditional regulatory framework²³.

Fintechs partnering with regulated financial institutions

In emerging markets, there are several examples of fintechs²⁴ partnering with traditional financial institutions to offer digital credit products. In some instances, this may be done to avail of the existing authorisation of the traditional financial institution. The EPAR found, for example, that almost half of the digital credit products included in their review operate in partnership with, or are provided by mobile money companies run by, Mobile Network Operators (MNOs). Many of these digital credit products could be considered high-cost as they have relatively high interest rates and charge multiple fees. A small number of respondents to the Survey (12%) indicated that fintechs are required to partner with traditional institutions in their jurisdictions.

²¹ CGAP, 2017, Crowdfunding and Financial Inclusion

²² FSB, 2017, FinTech credit: Market structure, business models and financial stability implications

²³ CGAP, 2017, Crowdfunding and Financial Inclusion

²⁴ The Survey defined 'fintechs' as entities that display innovative technology-based business models and emerging technologies that have the potential to have a transformative effect on the financial service industry.

The Benefits of Digitalising STHCCC

Properly implemented, the digitalisation of credit offers many potential benefits for consumers. New technologies can be a key driver of financial inclusion, with digital channels reaching many more consumers than traditional financial services, including rural and low income populations. Thus digitalisation has the potential to expand the availability of access to credit to consumers who would otherwise be excluded due to circumstances other than creditworthiness (such as their income bracket or geographical location placing them outside the target market of traditional lending). According to the G20/OECD INFE, digital financial services “*open up new opportunities for improving overall levels of financial inclusion by providing a first entry point into the formal financial system for the unbanked, poor, and financially excluded populations*”²⁵. This is particularly prevalent in low income countries and emerging markets, where the expansion of digital channels has enabled entire segments of the population to access credit and other financial services which they previously could not. In some developing countries, the number of adults using mobile money is higher than those with traditional bank accounts²⁶, demonstrating the popularity of these services²⁷. Digital channels can also increase access in developed economies, where they displace old channels and offer more convenient access to credit.

CASE STUDY B – M-Shwari

M-Shwari is a mobile credit and savings product that was launched in Kenya in 2012 through a partnership between the Commercial Bank of Africa (CBA) and Safaricom (a Kenyan communications company). M-Shwari offers unsecured loans to consumers via Safaricom’s M-Pesa platform, a mobile phone based money transfer, financing and microfinancing service. The growth of M-Shwari has been remarkable and has offered access to credit to a large number of consumers who may have been previously excluded by traditional financial services. As of 2015, 1 in 5 Kenyan adults are active M-Shwari customers and the CBA disburses on average 50,000 loans every day²⁸.

Opening an M-Shwari account is quick and easy with minimal barriers to access. The customer only needs to have a feature phone and a registered M-Pesa account. Once they have opened their M-Shwari account, they can access credit immediately, even without having any previous banking history. In fact, over half of M-Shwari accounts are held by customers without any other type of bank account (Cook and McKay 2015). Creditworthiness assessments are carried out using an algorithm based on the customer’s usage of Safaricom services (including M-Pesa).

²⁵ OECD, 2017, G20/OECD INFE Report on ensuring financial education and consumer protection for all in the digital age, p.19

²⁶ European Parliament, 2015, Consumer protection aspects of mobile payments

²⁷ While financial inclusion is evidently a key benefit of the digitalisation of credit, it should be noted that the particular focus of this Report is on consumer protection concerns for Supervisors in the context of STHCCC specifically, rather than financial inclusion.

²⁸ Cook and McKay, 2015, Top 10 Things to Know About M-Shwari

If approved for a loan, funds are instantly and remotely disbursed, allowing the consumer to access credit at any time or location.

In order to qualify for a loan, consumers must be active M-Pesa users for at least 6 months, save regularly on their M-Shwari account and continuously use other Safaricom services²⁹. The amount the consumer can borrow depends on their usage of certain Safaricom services and their previous loan repayment behaviour. Loans are charged a 7.5% facilitation fee and are payable within 30 days. If a consumer pays the loan in less than 30 days, their loan limit qualification will increase. If a consumer has not paid the loan within 30 days, the repayment period is extended for an additional 30 days and another 7.5% facilitation fee is charged on the outstanding loan balance. If the loan has not been repaid by Day 62, the CBA is entitled to hold any funds in the consumer's M-Shwari Deposit Account as collateral and security for any loan amounts outstanding. A final reminder that the consumer will be reported to the credit bureau if non-repayment continues is sent on Day 90 and the consumer is reported to the credit bureau 30 days after this final reminder is sent³⁰.

Digitalisation is also changing technologies for assessing creditworthiness, as lenders have access to more consumer data than ever before. In their review of digital credit products, the EPAR found that common data used for credit scoring included previous digital credit loans, mobile money transactions and balance information, social media data, and mobile phone activity. The use of non-traditional data such as social media data and phone activity adds another dimension to creditworthiness assessments, and enables consumers who may be excluded under traditional assessments to access credit. The use of these new technologies and alternative data can also allow for more accurate and sophisticated credit scoring, and improve overall credit risk management. The digital credit provider Branch (Kenya) argued that even subtle behaviour like deciding to add last names into one's phone contact list can indicate an increased likelihood of loan repayment³¹. In another example, EFL Global uses an artificial intelligence system to provide an internationally available alternative scoring mechanism for people who have previously been outside the banking system, focused on small businesses.

For consumers who are already served by a diverse range of traditional financial services, digitalisation still offers many benefits such as easier and quicker access to credit. Consumers can take out a loan whenever and wherever they want and manage repayments in a more convenient manner. The EPAR noted several products that automatically extended the repayment period when a payment was missed, giving consumers another chance to make an on-time payment and removing the need to contact or visit their financial institution. Digital channels also enable consumers to access cross-border services more easily and readily than through traditional channels.

²⁹ Safaricom, M-Shwari FAQs <https://www.safaricom.co.ke/faqs/faq/273>

³⁰ Cook and McKay, 2015, How M-Shwari Works: The Story So Far

³¹ Dwoskin, 2015, Lending Startups Look at Borrowers' Phone Usage to Assess Creditworthiness

Digitalisation can improve competition through reduced costs and expanded options for shopping around. Availing of online or mobile channels allows firms to save costs on business overheads, while automation may lead to a reduction in required staff. In principle, these cost savings could be passed on to consumers in the form of reduced fees and charges, at least in the context of a sufficiently competitive market. It can also be easier for consumers to shop around and compare products online, which can result in further cost savings. The emergence of P2P lending platforms, properly operated, can for example be seen to offer a facility for consumers to access credit in sectors that are underfunded or where the cost of traditional funding methods is too high. In these aspects, credit intermediated by these platforms can provide an alternative market to higher cost loans provided by traditional banks through digitalised channels. According to IOSCO, P2P lending has “*developed as a vehicle for borrowers to obtain a loan at a lower interest rate than through using traditional avenues of credit provision such as banks*”³². The IOSCO report also notes the ability of online P2P lending platforms to operate at a relatively low infrastructure cost, making them more cost efficient than traditional lenders who require a physical presence and manpower.

Clearly, of course, all these matters (be it automatic extension or cross-border business) require to be done in consumers’ best interests, with the risk being that facilities of this nature could lead to consumer detriment (e.g. where automatic extensions mask an underlying inability to repay that needs to be resolved between the parties).

³² OICV-IOSCO, 2014, Crowd-funding: An Infant Industry Growing Fast, p. 14

CHAPTER 4: REGULATORY FRAMEWORKS

Key Points

The Survey found that, in general, digital STHCCC is subject to the same rules and requirements as STHCCC provided through traditional channels.

Regulatory requirements on STHCCC include rules common to consumer credit generally, such as authorisation requirements and responsible lending obligations such as disclosure, transparency, suitability and creditworthiness assessments.

However, regulatory requirements on STHCCC also include instances of more specific interventions on high cost (including rate caps), restrictions on default charges, restrictions on repeat borrowing/rollovers, prohibitions on some types of STHCCC, and requirements for warning statements.

While initiatives on digitalisation generally were noted, none of the respondents to the Survey reported any oversight tools used exclusively for the supervision of digital STHCCC. Rather, Supervisors utilise the same tools in their supervision of these lenders as for any lenders of consumer credit.

The majority of respondents to the Survey did not consider it likely that crowdfunding is, or will become, a source of STHCCC. However, several of the respondents have taken steps to regulate crowdfunding specifically or are exploring the topic of crowdfunding and regulation.

The Survey found that, in general, jurisdictions do not distinguish in their regulatory frameworks between STHCCC and other types of consumer credit. Neither do jurisdictions distinguish between consumer credit delivered via digital channels and non-digital channels. Rather, the rules that apply to the provision of STHCCC through traditional channels apply also to the provision of STHCCC digitally.

Regulatory Requirements

General requirements for consumer credit

Respondents to the Survey noted that, in general terms, STHCCC is subject to the same rules and requirements in their jurisdiction as other types of consumer credit. Such rules include authorisation requirements and responsible lending obligations such as disclosure, transparency, suitability and creditworthiness assessments. Most respondents (64%) also have in place rules regarding periods of reflection (cooling-off) before a consumer credit agreement is concluded, or periods of withdrawal after the conclusion of the credit agreement. In some jurisdictions, credit provided through digital channels may also be subject to distance marketing legislation.

Specific requirements for STHCCC

Some jurisdictions have regulatory rules and requirements in place that are specific to STHCCC. These rules and requirements are designed to mitigate the risks arising from particular characteristics of STHCCC that have the potential to cause consumer detriment. The following are some examples of the characteristics that pose a risk to consumers as evidenced by the Survey, and a sample of regulatory requirements in place in respondent jurisdictions to address these risks:

1. High Cost
2. Extensions and Rollovers
3. Multiple Loans
4. Cross-selling
5. Other Risks

The Survey findings indicated that these requirements apply to STHCCC regardless of whether it is provided digitally or through more traditional means.

1. High Cost

These types of loans are expensive for consumers and are generally associated with high interest rates. STHCCC may be beneficial for consumers if it is used as an emergency or occasional source of funding for extraordinary or non-recurring expenses. While the cost of these loans is high relative to alternate sources of finance, in an emergency or extraordinary situation, the benefits of having access to credit can outweigh the relatively high cost. However, studies in both the UK³³ and Canada³⁴ have found that large proportions of consumers use these loans to cover ordinary everyday expenses. Research in Ireland found that customers of licensed moneylenders are most likely to borrow for personal items (goods/clothes) and family-related occasions. Using STHCCC to cover recurring everyday expenses is of particular concern, as it may be difficult for the consumer to repay the loan while also being able to afford his or her everyday expenses in the future.

Limits on Interest Rates

Some jurisdictions implement caps on interest rates for consumer credit to address the risks posed by high-cost credit. Table 1 lists some examples. No respondents to the Survey reported a distinction in this regard between consumer credit provided through digital channels and consumer credit provided through traditional channels.

Table 1: Sample of Rate Caps for Consumer Credit in Respondent Jurisdictions

Country	Rate Cap
Armenia	The nominal interest rate cannot exceed twice the Central Bank Reference rate.
Australia	A national maximum cap on costs exists for all credit contracts (excluding those offered by an Authorised Deposit Taking Institution). The cap varies based on the term of a contract and the amount of credit.

³³ Personal Finance Research Centre, University of Bristol, 2013, The impact on business and consumers of a cap on the total cost of credit

³⁴ Momentum, 2014, The Real Cost of Payday Lending

	<p>The cap involves a general 48% APR interest rate cap, including all fees and charges, but with two specific caps for loans of a smaller amount:</p> <ul style="list-style-type: none"> • for loans between AUS\$2,001 and \$5,000 where the term of the loan is between 16 days and two years, the cap is 48% plus a one off fee of \$400; and • for loans of \$2,480 and less where the term is between 16 days and one year the permitted charges are an establishment fee of 20% of the loan amount and a monthly fee of 4% of the loan amount.
Germany	In general, consumer credit contracts can be declared usurious by the courts if the interest rate is greater than double the average interest rate of comparable consumer loans plus a handling fee of currently 2.5%. The same is true if there is a difference in interest rates of 12%.
Korea	Consumer loans may not exceed a maximum interest rate of 27.9% APR.
Latvia	For loans of 30 days or less, the total cost of credit should not be more than 0.55% per day for the 1st to 7th day, not more than 0.25% for the 8th to 14th day, and not more than 0.20% from the 15th day. For loans of more than 30 days, the price cap is 0.25% per day for the entire term, which also applies when short-term loans are rolled over.
Netherlands	The APR for all types of loans is currently capped at 14% ³⁵ .
Portugal	Caps are defined in terms of APR for each type of credit product (personal loans, car loans, revolving credit) and for every quarter, based on the average APR of new consumer credit agreements provided during the previous quarter. The definition of the maximum value of the APR is determined and disclosed every calendar quarter by the Bank of Portugal. For instance, the maximum APR for revolving credit (the most expensive type of consumer credit in Portugal) in the 3 rd quarter of 2017 was 16.4%.
South Africa	Caps are applicable to initiation fees, service fees, interest rates and credit life. The maximum interest rate for unsecured loans is 28% APR and for short-term loans is 5% per month on the first loan and 3% per month on subsequent loans within a calendar year.
Spain	The Spanish Usury Law allows a judge to declare a credit contract void if the interest rate is significantly higher than

³⁵ This cap is based on the 'legal interest rate' (set by the government yearly; set as 2% since 2015) plus a fixed 12%.

	the normal interest rate and clearly disproportionate according to the specific circumstances of the particular case analysed.
UK	<p>The price cap on how much STHCCC lenders can charge consists of three components:</p> <ol style="list-style-type: none"> 1) An initial cost cap of 0.8% of the outstanding principal per day on all interest and fee charges during the agreed loan duration and when refinancing. 2) A cap for those in default of an aggregate total of £15 on fixed charges. Interest can continue to be charged but at no higher rate than the initial cost cap (calculated per day on the outstanding principal and any fixed default charges). 3) A total cost cap of 100% of the amount borrowed applying to all interest, fees and charges. Therefore, the maximum a consumer could ever pay on an individual loan in interest, fees and charges would be 100% of the original principal.

In Ireland, the Consumer Credit Act 1995 requires moneylenders to renew their licences annually, and enables the Central Bank of Ireland to refuse a licence application if it considers the cost of credit to be charged to be excessive. For example, payday lending models have not been authorised in the Irish licensed moneylender market. In Canada, the maximum allowable charge for a payday loan varies across provincial jurisdictions but generally falls within the range of CAD\$15 per \$100 borrowed to \$25 per \$100 borrowed.

The Peruvian regulatory framework does not implement caps on interest rates for consumer credit provided through digital channels or for consumer credit provided through more traditional channels. The main reason for this is that freedom to set interest rates is considered to benefit the poorest population of the country by allowing them to access and use financial services.

Limits on the amount that can be borrowed

Other jurisdictions limit the amount that can be borrowed. For example, in Canada, the maximum amount for a payday loan is CAD\$1,500. Recently, some Canadian provinces have further limited lending to a maximum of 50% of the borrower's pay cheque or net income to be received during the term of the loan. Australian credit law allows for SACCs up to AUS\$2,480 (if the establishment fee and first monthly fee are also financed).

Additional Fees

Several countries noted that consumers may be subject to additional fees if they extend the term of the loan or if they default on a loan, which further contributes to the high-cost nature of these loans and may increase a consumer's debt burden. This is because the amount the consumer has to repay is higher, reducing the consumer's income surplus and increasing the

need for a subsequent loan to meet the consequent shortfall in income³⁶. In studying payday loans in North Dakota in the United States, the Centre for Responsible Lending found that nearly half of all borrowers default on a loan within their first two years of borrowing³⁷. In Australia there have been examples of payday lenders charging numerous default fees such as a dishonour payment fee of AUS\$38.50 (for each default), a missed payment fee of \$38.50 (once-off fee), a default notice/letter of \$10.00 (for each default, applied at 7, 14, 21 and 30 days) and a debt management fee of \$50 (once-off fee). Lenders cannot however, collect more than 200% of the amount loaned, even in circumstances where the consumer defaults under the loan.

The Survey responses showed a number of provisions aimed at tackling this aspect of STHCCC. In Ireland, for example, licensed moneylenders are prohibited by the relevant legislation from applying any additional interest or charges (other than legal costs awarded by a Court) in the event of default or missed payments. As such, a consumer can never be required to pay more than the 'total amount repayable' as stated on the credit agreement, regardless of the amount of time over which the loan is actually repaid (unless charging for legal costs awarded by a Court). Portuguese law sets out limits on the amounts credit institutions may charge their customers as a result of late payment. In arrears situations, credit institutions may only claim the payment of:

- Late payment interest resulting from the application of a maximum annual surcharge of 3%, which adds to the conventional interest.
- A recovery of arrears fee, which may be charged only once for each overdue instalment, and may not exceed 4% of the instalment's amount, with a minimum value of €12 and a maximum of €150.
- The costs that the credit institution might have supported with third parties, on behalf of the customer after the overdue date, depending on the presentation of supporting documents.

In the Canadian province of British Columbia, payday lenders may charge a default fee up to a maximum of 30% interest and a one-time fee of CAD\$20 for a dishonoured cheque or pre-authorized debit.

2. Extensions and Rollovers

The Survey found that extensions are possible in many countries and rollovers are common. For example, although the usual duration for a 'short-term' loan in Latvia is 30 days or less, the regular practice is to extend these loans, with credit being rolled over more than three times in some cases.

There may be regulatory provisions in place to reduce the likeliness of rollovers in some countries. For example, in Lithuania rollovers of short-term loans used to be quite frequent before legislative amendments were made to limit the total amount payable by the consumer. In the UK, firms are prohibited from refinancing or rolling over a loan more than twice. Most provinces in Canada prohibit payday lenders from issuing more than one loan to a borrower at the same time or rolling over one loan into another loan with new charges. Additional protections and obligations were introduced in Australia

³⁶ Department of the Treasury, 2015, Review of the small amount credit contract laws – Interim Report

³⁷ Centre for Responsible Lending, 2015, Payday Mayday: Visible and Invisible Payday Lending Defaults

in 2013 to address the risk of recurring loans. These protections include a presumption of unsuitability, which presumes that a SACC will be unsuitable if either the consumer is in default under another SACC or the consumer has had two or more SACCs in the last 90 days³⁸. A prohibition on charging an establishment fee if any of the credit is to refinance another SACC was also introduced.

3. Multiple Loans

When a consumer takes out more than one STHCCC loan at a time, the repayments can consume a greater portion of their income for a longer period and become increasingly unaffordable. With a large portion of income being used to cover repayments, more credit may be needed to cover living expenses (or even to meet repayments on existing loans), limiting the consumer's capacity to improve their financial situation over time.

A report by the Competition and Markets Authority in the UK found that around 75% of payday loan consumers take out more than one payday loan in a year and that, on average, a payday loan consumer takes out around six payday loans per year³⁹. The report found that repeat borrowing typically accounts for a large proportion of lenders' business: 80% of all STHCCC contracts in 2012 were made to consumers who had previously borrowed from the same lender.

Similarly, in Australia the proportion of consumers with multiple payday loans has increased in recent years. Research by Digital Finance Analytics⁴⁰ showed that the number of payday loan borrowers taking out more than one payday loan in the preceding 12 months had grown from 17.2% in 2005 to 38% in 2015.

Research into the Irish moneylending industry in 2013⁴¹ found that 15% of moneylender customers surveyed were repaying two or more loans with their moneylender, with 1% having four or more loans outstanding. Over 1 in 5 customers (22%) were making repayments to at least two separate moneylenders while 2% reported having one or more loan with at least four different moneylenders.

CASE STUDY C – Russia

In Russia there are specific rules in place that microfinance organisations (MFOs) should follow when interacting with consumers. These rules have been mandatory for all MFOs in Russia since 1 July 2017.

In order to reduce the borrower's aggregate debt burden and prevent the practice of relending, MFOs are prohibited from using a new short-term

³⁸ The Australian government has supported a recommendation from an independent review of the high cost credit laws in 2016 to remove the presumption of unsuitability and instead extend the SACC protected earnings amount requirements to all consumers and lower it to 10% of the consumer's net income. Draft laws are expected to be progressed in 2017.

³⁹ Competition and Markets Authority, 2015, Payday Lending Market Investigation: Final Report

⁴⁰ Digital Finance Analytics, 2015, The Stressed Finance Landscape Data Analysis, p.15

⁴¹ Central Bank of Ireland, 2013, Report on the Licensed Moneylending Industry

(up to 30 days) consumer microloan until the previous one has been repaid in full.

To further limit the debt burden of consumers who take out loans with MFOs, a ban was introduced on providing the borrower with more than ten (this will reduce to nine from 1 January 2019) short-term (up to 30 days) microloans from a single MFO within one year. In addition, the MFO will not be able to renew such contracts more than seven times (this will reduce to six from 1 April 2018 and to five from 1 January 2019) under one contract.

4. Cross-selling

Consumer detriment may also arise where instances of cross-selling occur. Cross selling for this purpose includes where another financial product is sold in conjunction with a STHCCC product, whether the consumer is obliged to accept the other product (tying) or it is an optional extra. According to the Survey responses, the most common type of product that might be cross-sold with STHCCC is insurance. In Peru, life insurance is usually required to access any type of credit, including STHCCC.

Cross-selling may not always be done in the consumer's best interests, particularly where remuneration arrangements are designed based on sales volumes⁴², and could lead to mis-selling. In the Canadian province of British Columbia, tied selling is prohibited for payday loans: a payday lender must not make a payday loan contingent on the supply of other goods or services; a payday loan agreement must not include a term or condition relating to the supply of other goods or services; and a payday loan agreement must include a statement that the supply of goods or services is separate and optional. Tying is also forbidden for credit products in Portugal.

CASE STUDY D – Australia

In Australia, Consumer Credit Insurance (CCI) is the most common financial product sold with SACCs. In 2013, the Australian Securities and Investments Commission (ASIC) took legal action against an arranger of SACCs, and the credit provider for these loans. In this matter, ASIC argued that CCI was sold to customers when it was unlikely that they would be able to claim under the policy. The majority of the customers were on low incomes or in the receipt of social security benefits. Out of more than 182,000 consumer credit insurance policies sold, there were only 43 customers who received a pay-out.

The court upheld ASIC's view and awarded record penalties totalling AUS\$18.975 million against the arranger of the SACCs and the credit provider.

⁴² See findings of 2016 FinCoNet Report on Sales Incentives and Responsible Lending

5. Other topics

The Survey also identified other provisions in place to regulate STHCCC. In Ireland, licensed moneylenders are also subject to specific regulatory requirements contained in the 'Consumer Protection Code for Licensed Moneylenders', which includes rules in relation to provision of information, disclosure, unsolicited contact, errors and complaints handling, record keeping, debt collection, and arrears handling. In the Canadian province of British Columbia, if a lender gives a borrower three loans in a 62-day period, the loan repayment is to be spread out over a minimum of three pay periods. Some provinces have also adopted consumer protection measures for payday lenders, such as ensuring full and accurate disclosure of contract terms, letting borrowers cancel new loans penalty-free within one business day, requiring an independent complaints resolution mechanism, and adopting acceptable debt collection practices.

In addition to the price cap and limit on rollovers mentioned above, the UK Financial Conduct Authority (FCA) introduced the rules specifically for STHCCC in 2014, including the following:

- Requiring advertisements for STHCCC to carry a risk warning;
- Requiring firms to provide STHCCC borrowers with an information sheet with details of free debt advice, when refinancing or rolling over a loan; and
- Prohibiting firms from making more than two unsuccessful attempts to seek payment using a continuous payment authority and from using a continuous payment authority to collect part payments.

STHCCC providers in the UK are also subject to some additional specific reporting requirements over and above those that apply to other lenders. In addition to the requirement for advertisements for STHCCC to carry a risk warning, in 2015 the Advertising Standards Authority (ASA) and the Committee of Advertising Practice (CAP) published Guidance to prevent trivialisation in the advertising of STHCCC⁴³. The Guidance stems from a review of ads for payday loan products and aims to ensure ads for STHCCC are socially responsible and do not trivialise the seriousness of taking out a loan of this type.

The Guidance provides clear warning that advertisements risk breaching the rule whereby ads must be responsible to the audience and society if they:

- Suggest loans are a suitable means of addressing ongoing financial concerns;
- Condone non-essential or frivolous spending; or
- Unacceptably distort the serious nature of payday loan products⁴⁴.

⁴³ CAP, 2015, Trivialisation in high-cost short-term credit ads: Advertising Guidance (non-broadcast and broadcast)

⁴⁴ CAP, 2015, New Guidance for payday loan ads

CASE STUDY E - Australia

Australia has extensive regulatory rules and requirements specific to SACC lenders. No interest may be charged on a SACC and the maximum fees that can be charged are:

- A once-off establishment fee of 20% of the amount loaned; and
- A monthly account keeping fee of 4% of the amount loaned.

Consumers who default under a SACC must not be charged in total more than twice the amount of the loan. Enforcement expenses can also be charged. Australian credit law also prohibits short-term credit contracts. These are defined as a credit that:

- a) is not a continuing credit contract and is unsecured;
- b) is not provided by an authorised deposit-taking institution;
- c) has a credit limit of AUS\$2,000 or less; and
- d) has a term of 15 days or less.

Australian legislation also requires SACC lenders to disclose a warning statement advising consumers of the alternatives to a SACC. This warning statement must be given regardless of how the consumer contacts the lender, be it via internet, telephone or shopfront. In taking reasonable steps to verify the financial situation of the consumer, SACC lenders are also required to obtain and consider 90 days of bank statements for account(s) into which the consumer's income is paid.

There is a presumption of unsuitability in relation to SACCs, which presumes that a SACC will be unsuitable if either:

- a) the consumer is in default under another SACC (the default presumption); or
- b) the consumer has had two or more other SACCs in the last 90 days (the multiple loan presumption).

This presumption of unsuitability is not a prohibition. However, SACC lenders entering into a loan with a consumer who triggers the presumption must be in a position to rebut the presumption and show that the loan is suitable. SACC lenders must also comply with a protected earnings amount that applies to consumers who receive at least 50% of their income through government social security payments – for these consumers SACC repayments are capped at 20% of a consumer's gross income⁴⁵.

⁴⁵ The Australian government has supported recommendations from an independent review of the high cost credit laws in 2016 that include the SACC protected earnings amount requirements be extended to all consumers and lowered to 10% of the consumer's net income. Draft laws are expected to be progressed in 2017.

Specific requirements for digital credit

Many jurisdictions will have more general regulatory rules and requirements in place that cover digital financial services, including digital credit. For example, Brazil noted in its response to the Survey the introduction of a specific provision to mitigate the security risks posed by the use of digital channels. Financial institutions offering digital financial services must ensure the legitimacy and conformity of their products and services and must inform consumers of the risks they may encounter when using these products.

On credit more specifically, Indonesia noted that the 2016 IT-based Lending Services regulation, which applies to fintech P2P lending services and providers but not to traditional lenders, contains a consumer protection aspect. Providers must uphold 5 principles of consumer protection: Transparency; Impartial Treatment; Reliability; Secrecy and Security of Consumer data and / or Information; and Simple, Quick Handling of Consumer Complaints and Resolution of Their Disputes at Affordable Costs. P2P lending providers must give clear and honest information about the services, avoid the use of words which could create misleading information, and pay attention to the needs and abilities of users in order to ensure services offered are suitable. Providers must support the implementation of education activities which aim to increase financial literacy and inclusion. They are also obliged to report users' complaints and their handling progress to the Financial Services Authority (OJK) monthly.

In the UK, payday lenders are required to publish details of all their payday products sold online on at least one FCA-authorized price comparison website, and they must link to that website from their own.

Specific requirements for 'fintechs'

The Survey defined 'fintechs' as "*entities that display innovative technology-based business models and emerging technologies that have the potential to have a transformative effect on the financial service industry*".

Overall, the Survey indicated that there is no distinction made between fintechs and other credit providers in the regulatory frameworks of respondent jurisdictions, with fintechs being subject to the same rules as any other lender.

Most respondents (76%) reported that they have not observed, or do not know of, any fintechs providing STHCCC in their jurisdiction.

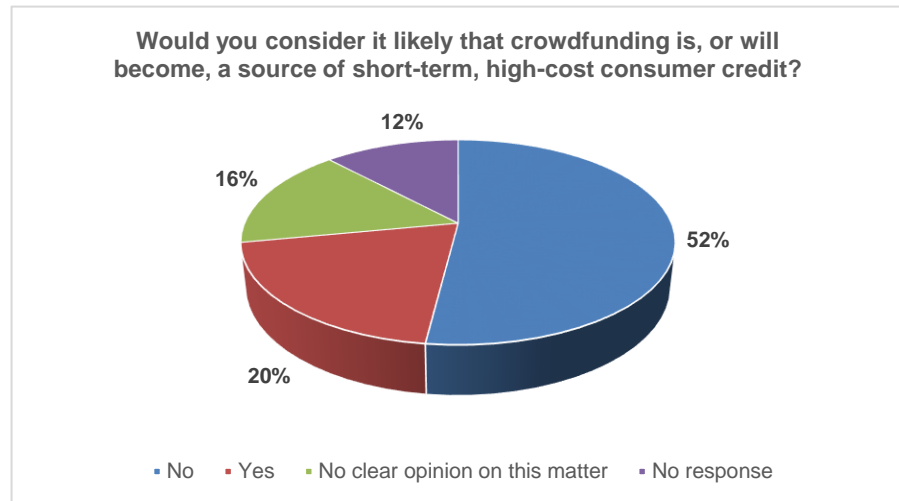
Specific requirements for P2P lending

Most respondents (52%) to the Survey did not consider it likely that crowdfunding is, or will become, a source of STHCCC (see Figure 1). In particular, the rationale most commonly cited for this (30% of those respondents who did not consider it likely that crowdfunding is, or will become, a source of STHCCC) was a view that loan-based crowdfunding platforms are more likely to make available longer term credit operations. In some instances, respondents were of the opinion that these platforms are more likely to present consumers with lower than usual costs if they wish to pose as viable alternatives to traditional retail banking. Meanwhile, some

respondents (12% of total respondents) noted that these platforms will have to present consumers with low-cost credit operations in their jurisdictions due to legal constraints (including caps on price or amount that can be loaned by individual users).

Figure 1 - Crowdfunding as a potential source of short-term, high-cost consumer credit

(This graph reflects the responses received to a request to indicate the jurisdiction's perception on the likelihood of crowdfunding becoming a source of short-term, high-cost consumer credit)



Nevertheless, some jurisdictions in the Survey expressed concerns with regard to the general lack of specific provisions or supervisory tools to deal with issues arising from poor conduct of crowdfunding platforms. In Peru for example, where crowdfunding is not yet regulated, a major challenge facing the regulator is to establish adequate requirements that ensure a secure environment for transactions without significantly increasing related costs. Meanwhile, Latvia, Ireland, Russia and Mauritius stated that they are currently examining crowdfunding as a topic, which implies monitoring the market's trend, and might at some point introduce specific provisions on crowdfunding, depending on the conclusions ultimately drawn in their jurisdiction. In Brazil, there is an ongoing public consultation on P2P lending platforms, in order to help the regulatory authority enact specific provisions on this particular subject, including simplified authorisation processes and proportional risk mitigation requirements.

According to a recent study developed by the FSB⁴⁶, some authorities have acted within existing generic frameworks to deal with issues arising from P2P platforms' conduct-of-business, while others have approved specific rules to discipline those platforms. In some instances, additional public sector policies (e.g. tax policies) have been laid down in order to promote P2P lending.

The FSB study noted that in Germany, the Netherlands, Hong Kong and Singapore, P2P platforms are subject to the same set of rules on investor protection, risk management and capital and/or liquidity requirements as

⁴⁶ FSB, 2017, FinTech credit: Market structure, business models and financial stability implications

other financial services intermediaries. The study noted that, in Germany, platforms have to apply for a banking license in order to engage in credit activity. It also noted that, in the Netherlands, platforms that provide credit products to consumers require a regular licence for the provision of credit, while platforms that provide credit products to small and medium enterprises (SME) are exempt from that obligation. According to the European Banking Authority's (EBA) discussion paper on the EBA's approach to Fintech⁴⁷, eight EU member states have authorisation regimes in place for online platforms to enable lending-based crowdfunding/P2P transfers.

In the United Kingdom, the FCA has subjected P2P lending platforms to several provisions that other types of financial intermediaries were already subjected to, including rules in relation to minimum capital standards and money laundering⁴⁸. One respondent to the Survey (Indonesia) noted specific rules for fintech P2P lending services and providers, as contained in the IT-based Lending Services Regulation introduced in 2016.

Topic for Guidance to Supervisors 1: Comprehensive Regulatory Scope

A. The manner and extent to which a Supervisor should have oversight over all providers of digital credit, including new players who may fall outside of scope of the traditional regulatory framework.

B. The manner and extent to which a Supervisor should seek to mitigate the risk of regulatory gaps arising (including in the context of cross-border services) and ensure that consumers are adequately protected regardless of the provider or channel they use to avail of credit.

Oversight Tools

None of the respondents to the Survey reported any oversight tools used exclusively for the supervision of digital STHCCC. Rather, Supervisors utilise the same tools in their supervision of these lenders as for any lenders of consumer credit. Some examples of oversight tools used by respondents are as follows:

- Assessment of applications for authorisation
- Inspections – both on-site and off-site
- Sectoral or thematic assessments
- Analysis of published information such as annual reports and financial statements
- Analysis of regulatory reporting
- Monitoring of advertising
- Analysis of consumer complaints
- Consumer research and monitoring trends
- Social media monitoring

⁴⁷ EBA, 2017, Discussion Paper on the EBA's Approach to financial technology (FinTech)

⁴⁸ Oxera, 2016, The economics of peer-to-peer lending

CASE STUDY F – Ireland

The Central Bank of Ireland uses social media monitoring to help inform its consumer protection work. Social media monitoring provides the Central Bank with a powerful tool to understand consumers' experiences and concerns around financial services and products in real-time. This informs the Central Bank's risk analysis and policy formulation, while also supporting its supervision of individual firms.

Publicly available social media platforms, blogs and online content such as webpages and forums are monitored in real-time using specific software against a list of key words and a mention is recorded if the key words are matched. The key word list is updated on a regular basis and includes references to various financial products and services in addition to a list of financial services firms that are active in the Irish market. The resulting information is then used to prepare reports categorised by topic, firm name, product sector and social media channel. The monitoring tool can also be used to identify whether the conversation was an expression of dissatisfaction or a more general discussion.

One example of a supervisory action taken as a direct result of information uncovered using this tool was where social media monitoring revealed a lender that appeared to be operating without authorisation in the Irish market. After further investigation, the Central Bank moved to protect consumers by issuing a warning and publishing the name of the firm. No further activity involving this firm was seen following this action.

Some respondents did note that they have introduced or are developing initiatives to address or mitigate the risks associated with the digitalisation of credit more generally. For example, the French Prudential Supervision and Resolution Authority (ACPR) has issued Guidelines on the use of social media for commercial purposes⁴⁹, which help contribute to the mitigation of the risks associated with digitalisation in general.

CASE STUDY G – Portugal

Portugal has in place a maximum rate regime for consumer credit (i.e. credit agreements regulated by Decree-law no. 133/2009, which does not include mortgage credits and, for instance, credit agreements where the amount is below €200 or above €75,000⁵⁰). In order to assess whether credit institutions comply with this regime, the Bank of Portugal carries out a systematic monitoring of rate caps on consumer credit. For this purpose, all credit institutions must, on a monthly basis, report information to the Bank of Portugal on all new credit agreements concluded in the previous month.

⁴⁹ <https://acpr.banque-france.fr/en/authorisation/fintech-and-innovation/fintech-and-innovation-files/data-and-social-media>

⁵⁰ As in other EU countries, credit agreements that are between €200 and €75,000 are subject to the requirements contained in the Consumer Credit Directive 2008.

One respondent (Indonesia) stated that they are currently drafting regulations, which will include initiatives to mitigate the risks associated with the digitalisation of STHCCC. Other jurisdictions, such as Brazil and Peru, noted that they are in the process of assessing the adequacy of their regulatory frameworks in the context of the digitalisation of financial services, and may introduce initiatives to mitigate the associated risks in the future, while Spain is working on its supervisory approach within the framework of the existing regulatory framework.

CASE STUDY H – Brazil

The Central Bank of Brazil (BCB) maintains 'The Credit Information System' (SCR), which is a database containing a broad range of information provided by financial institutions on a monthly basis concerning rendered credit products, including data about collaterals and credit limits granted, amongst others. The SCR is currently the most prominent oversight tool employed by the BCB to track financial institutions' credit portfolios, enabling the monitoring and overseeing of both prudential and conduct risks inherent to credit portfolios. Moreover, this particular tool enables the assessment of financial institutions' adherence to several regulatory standards currently in place in that jurisdiction. For example, information contained in the SCR regarding credit agreements might be combined with credit portability data, in order to assess financial institutions' compliance with the rules laid down by Resolution nº 4,292/2013, which determines that financial institutions must ensure consumers have the right to switch between credit providers at any given time, by allowing the prepayment of credit operations upon the transfer of funds by another institution. To protect consumers who switch from over-indebtedness, and ensure switching is based on the comparison of interest rates on the two products, the Resolution includes a limitation on the new lender extending the loan term or advancing additional credit.

Another relevant supervisory tool currently in use is the 'Central Bank's Complaint System' (RDR) which is based on consumers' claims and complaints registered by the BCB. This system enabled the implementation of an index, which ranks every financial institution based on valid recorded complaints and on quantity of clients' criteria. It supports supervisory work as it facilitates the implementation of actions to identify regulatory breaches and deficiencies of products and services conceived by financial institutions. This particular ranking is also published on BCB's website on a quarterly basis, which ends up incentivising financial institutions to improve their internal process, including complaints handling mechanisms, for reputation's sake.

Topic for Guidance to Supervisors 2: Appropriate Oversight Tools

The oversight tools a Supervisor should use to effectively identify and mitigate the risks associated with digital STHCCC.

CHAPTER 5: RISKS TO CONSUMERS AND CHALLENGES FOR SUPERVISORS

Key Points

If not done properly, digitalisation can have the effect of compounding the risks recognised in STHCCC provided through traditional channels, such as over-indebtedness, unsuitable selling and insufficient transparency and disclosure.

According to Survey respondents, the key drivers of this effect include lack of information and transparency, lack of consumer financial and digital literacy, new players and technologies and supervisory challenges.

There are also specific behavioural aspects associated with the digitalisation of STHCCC that may further increase the risk of over-indebtedness as digitalisation has the potential to enhance the convenience of, and ease of access to, these types of loans. Consumers may also value the anonymity and impersonal nature of borrowing through digital channels.

The digitalisation of STHCCC presents specific challenges for Supervisors. These challenges include keeping up with new technologies and innovation and ensuring Supervisors have adequate resources and knowledge.

Regulatory gaps or arbitrage may also occur with the cross-border provision of digital credit, due to differences in the legal and regulatory frameworks across jurisdictions.

It is important that Supervisors collaborate with one another, as well as engage with industry and technological innovators, to acquire information on new and emerging risks, and on best practices for regulating digital STHCCC.

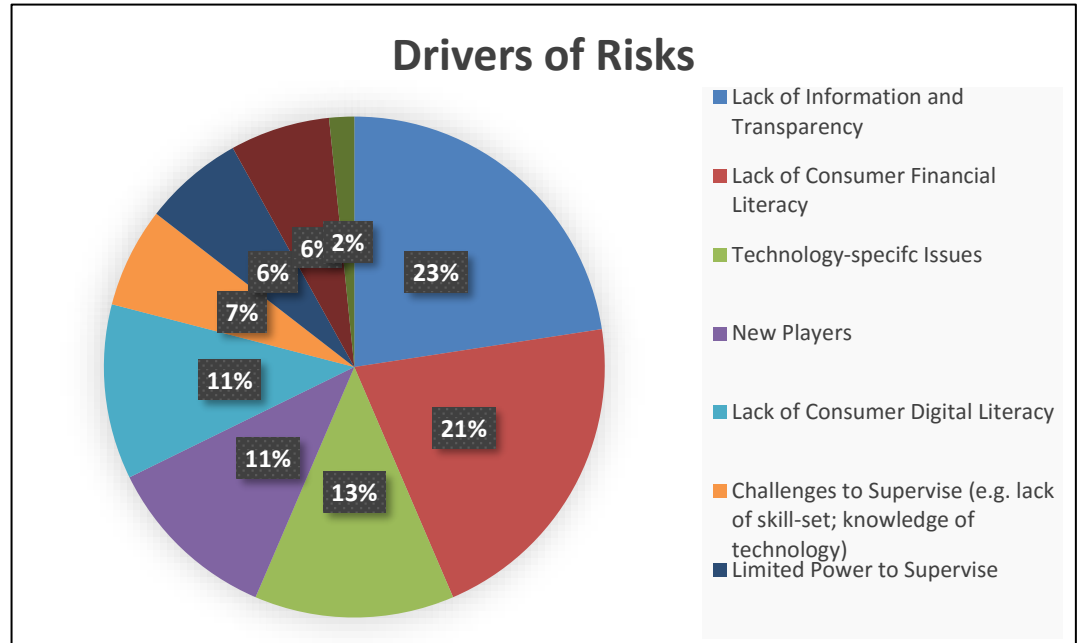
Respondents to the Survey noted a number of risks stemming from the digitalisation of STHCCC. These financial consumer protection concerns were common across jurisdictions, with the main risks identified being over-indebtedness, unsuitable selling, and insufficient transparency and disclosure. Respondents also noted concerns over security risks and advertising.

Drivers of Risks

The Survey also asked respondents to rank in order of importance the main drivers of the risks they identified. Figure 2 below demonstrates the percentage of respondents who ranked each driver in their top three⁵¹.

⁵¹ Note that a small number of respondents ranked more than three drivers in their top three.

Figure 2: Survey ranking of most common drivers of risks associated with the digitalisation of STHCCC



The drivers of risks can be broadly divided into the following categories: Lack of Information and Transparency; Lack of Consumer Financial and Digital Literacy; New Players and Technologies; and Supervisory Challenges.

1. Lack of Information and Transparency

A key issue identified by Survey respondents was the risk of insufficient disclosure of information and a lack of transparency when STHCCC is provided through digital channels. The 2016 FinCoNet Report on Online and Mobile Payments previously highlighted ensuring transparency of charges and disclosure of information as key challenges from a consumer protection perspective where digitally provided services are concerned. It stressed the need for a technology-neutral consumer protection framework that ensures consumers receive a high level of protection regardless of the platform they avail of, including having easy access to all terms and conditions through the disclosure of clear, transparent and complete information.

In particular, the provision of STHCCC through digital channels removes the need for a consumer to engage with a human intermediary during the loan process. Everything from application to approval to disbursement of the loan can be done via the digital channel. The lack of contact with a human intermediary when providing STHCCC in particular can make it more difficult to ensure that the loan is suitable, that it is responsible for the lender to grant it, and that the consumer is fully aware of the high cost nature of the loan and all terms and conditions associated with the product, as well as recourse mechanisms and conflicts of interests.

Supervisors should have particular regard here to G20 High Level Principles 3: Equitable and Fair Treatment of Consumers and 4: Disclosure and

Transparency. These principles state that all financial consumers should be treated equitably, honestly and fairly at all stages of their relationship with financial service providers, and that consumers should be provided with all necessary information on the product or service, with advice being as objective as possible and based on the consumer's individual circumstances, needs and risk appetite.

The Alliance for Financial Inclusion (AFI) has highlighted that the level of disclosure is relatively limited for many of the current digital credit products in the market⁵². For example, with the M-Shwari and M-Pawa products, consumers must exit the data session and access a separate online page on the Commercial Bank of Africa (CBA)'s website in order to view the associated terms and conditions⁵³. If the customer is using a feature phone (i.e. a phone that is unable to access mobile internet) they may not be able to view the terms and conditions on their device. In their focus note '*Doing Digital Finance Right: The Case for Stronger Mitigation of Customer Risks*', the Consultative Group to Assist the Poor (CGAP) also noted that many users do not have access to the internet and thus are immediately excluded from being able to view the terms and conditions. For those who do have access to the internet, having to exit the session and visit a separate page introduces a hassle factor and discourages consumers from seeking out the necessary information. This may be aggravated further if the consumer is not familiar with or comfortable using the technology. As a result, consumers may have limited knowledge of the terms and conditions associated with the product, which could lead to detriment at a later stage.

CASE STUDY I – Ireland

Research carried out by the Central Bank of Ireland into the licensed moneylending industry in 2007⁵⁴ found that 71% of customers did not know the interest rate they were being charged. In order to improve consumer understanding of the high cost of moneylending agreements, a provision was included in the 2009 Consumer Protection Code for Licensed Moneylenders that requires moneylenders to explain all related interest payments, charges and the cost per €100 borrowed to the consumer. Updated research on the moneylending industry in 2013⁵⁵ found that 65% of customers reported knowing the rate of interest they were being charged on their current/most recent loan, indicating that the measures introduced had contributed to an improvement in consumer comprehension.

The issues around disclosure when using a digital channel could also result in consumers not being fully aware of all costs associated with their product, which in turn could contribute to repeat borrowing and over-indebtedness. This is of particular concern when dealing with high-cost products, especially

⁵² AFI, 2015, Digitally Delivered Credit – Policy Guidance Note and Results from Regulators Survey

⁵³ Fiorillo and Mazer, 2013, Digital Credit: Consumer Protection for M-Shwari and M-Pawa Users

⁵⁴ Financial Regulator (now Central Bank of Ireland), 2007, A Report on the Licensed Moneylending Industry

⁵⁵ Central Bank of Ireland, 2013, Report on the Licensed Moneylending Industry

where the consumer may be in a hurry to secure funding, as can often be the case for STHCCC.

Topic for Guidance to Supervisors 3: Appropriate Disclosure of Key Information

The role and effectiveness of disclosure of key information when STHCCC is provided through a digital channel, including:

- (i) the manner and extent to which a Supervisor can foster an imperative on firms to avail of digitalisation to improve the way information is disclosed to consumers, in order to enhance consumer comprehension; and
- (ii) the manner and extent to which a Supervisor should consider whether additional disclosure obligations or guidance on existing obligations are required for STHCCC provided through digital channels.

Recourse mechanisms may also be unclear for digital STHCCC. Of relevance here is G20 High Level Principle 9: Complaints Handling and Redress, which states that consumers should have access to adequate complaints handling and redress mechanisms that are accessible, affordable, independent, fair, accountable, timely and efficient. When multiple parties are involved in the provision of digital credit, consumers may not know where to address their complaints. CGAP reported that even when consumers know how and where to complain, they often encounter difficulties in having their complaints resolved, which in turn makes them less likely to report issues in the future⁵⁶. The AFI recommended that the relationships and responsibilities of those involved in the provision of credit through digital channels should be clearly articulated to all parties, and complaints procedures and recourse mechanisms disclosed to consumers⁵⁷. The EBA also addressed this issue, stating that the allocation of liability among all parties involved in the provision of fintech services should be clear to both the parties involved and to the consumer⁵⁸.

Topic for Guidance to Supervisors 4: Consumer Access to Recourse Mechanisms

The manner and extent to which a Supervisor should ensure that firms availing of digital channels to provide STHCCC clearly define responsibilities for complaints handling and dispute resolution and appropriately convey this information to the consumer, including where there are multiple parties involved in delivery of the service.

⁵⁶ CGAP, 2015, Doing Digital Finance Right: The Case for Stronger Mitigation of Customer Risks

⁵⁷ AFI, 2015, Digitally Delivered Credit – Policy Guidance Note and Results from Regulators Survey

⁵⁸ EBA, 2017, Discussion Paper on the EBA's Approach to financial technology (FinTech)

2. Lack of Consumer Financial and Digital Literacy

By its very definition, STHCCC is an expensive form of borrowing that carries a high risk of over-indebtedness. Consumers may be unaware of the true cost of such credit or whether cheaper alternatives are available. A survey of 1,500 Canadian payday loan users undertaken by the Financial Consumer Agency of Canada found that fewer than half of respondents (43%) understood that a payday loan is more expensive than available alternatives⁵⁹. The EPAR found that the digital credit products reviewed often have relatively high interest rates and charge multiple fees.

If not done properly, the digitalisation of STHCCC can compound this problem, especially where poor financial and digital literacy are combined. If product information is poorly presented in a digital format, the consumer may miss key points or may be discouraged from reading altogether. If there is no human intermediary involved in the credit transaction, it is even more difficult to verify that the consumer has read and understood the terms and conditions and key product information. There may also be no opportunity for a consumer to make further enquiries if they do not fully understand the product, or to seek additional expert advice on their proposed loan.

Behavioural Aspects

Respondents to the Survey noted that there are particular aspects of digitalised STHCCC that may cause a consumer to behave differently in comparison to the conventional borrowing process, and which may increase the risk of over-indebtedness. It is essential for Supervisors to be aware of these behavioural aspects in order to assist them with the mitigation of the risks associated with digitalisation of STHCCC.

Impulsive Decisions

Convenience was identified in the Survey as a key reason why consumers are attracted to STHCCC, which is easier to access and quicker to draw down than many other credit products. Digitalisation has the potential to enhance this convenience even further. In comparison to the traditional borrowing process, which can be long and burdensome, when credit is provided through a digital channel, the entire process can be carried out from the comfort of the consumer's own home or while they are going about the conduct of other business (e.g. on their mobile phone while traveling from one place to another). For many digital credit products, the time taken from application to approval and disbursement of the loan is minimal or, in some cases, may even be instant⁶⁰. For example, Aella Credit in Nigeria has access to data provided by the customer's employer and uses an algorithm to make instant credit decisions. Repayments are then made through payroll deductions.

The convenience provided by digital channels has obvious and significant benefits in terms of consumer experience and quality of service. However, from a regulatory risk perspective, it may result in consumers being incentivised to make more impulsive decisions and not take the time to

⁵⁹ Financial Consumer Agency of Canada, 2016, Payday Loans: Market Trend.

⁶⁰ Evans School Policy Analysis and Research, 2017, Review of Digital Credit Products in India, Kenya, Nigeria, Tanzania, and Uganda

adequately reflect on the suitability of the product for their needs. As noted in the 2014 and 2016 FinCoNet reports on responsible lending, consumer credit is distinct from other financial products as it relates to the ability of the consumer to repay money to a credit provider, rather than the use of the consumer's existing funds to invest into or purchase a financial product. The concept of 'present bias' is relevant here as the consumer feels the benefit of borrowing upfront but bears the cost at a later stage. 'Present bias' causes consumers to act on their urges for immediate gratification and thus value the present over the future, resulting in impulse borrowing and an increased risk of debt problems⁶¹. The digitalisation of credit has the potential to exacerbate consumer tendencies to be biased heavily towards the present, as it becomes even quicker and easier to access credit whenever and wherever the consumer may wish. The immediacy of the opportunity to borrow when using digital channels may make it more difficult for a consumer to resist the temptation to do so excessively.

It has also been noted⁶² that borrowing digitally feels less serious to some users, with a number of M-Shwari borrowers taking out loans despite having no specific purpose for them. CGAP also highlighted this point, reporting that some consumers may choose to avail of unsolicited digital credit offers merely to test out a product, or because they fear they may not readily receive such offers when they require credit in the future⁶³.

Topic for Guidance to Supervisors 5: Targeted Prevention of Consumer Over-indebtedness

The manner and extent to which a Supervisor should have regard to the potential for digitalisation to make it even easier for consumers to access STHCCC and thus further increase the risk of over-indebtedness already associated with STHCCC.

Anonymity

Consumers may also value the anonymity and impersonal nature of borrowing through digital channels⁶⁴. Insights from M-Shwari and M-Pawa users show that consumers perceive that the use of a private, digital channel that does not require the consumer to interact with a human intermediary enables them to avoid harassment, corruption and social pressure⁶⁵. For a consumer who is already in debt, accessing further credit through a digital channel lets them avoid potentially uncomfortable situations that might arise when using traditional channels. This lack of human interaction may lead some consumers to prioritise repayment of traditional loans over digital loans⁶⁶. Using digital channels also allows a consumer to access credit without any intervention, whereas in traditional borrowing situations,

⁶¹ Financial Conduct Authority, 2013, Applying behavioural economics at the Financial Conduct Authority

⁶² Fiorillo and Mazer, 2013, Digital Credit: Consumer Protection for M-Shwari and M-Pawa Users

⁶³ CGAP, 2017, Consumer Protection in Digital Credit

⁶⁴ Personal Finance Research Centre, University of Bristol, 2013, The impact on business and consumers of a cap on the total cost of credit

⁶⁵ Fiorillo and Mazer, 2013, Digital Credit: Consumer Protection for M-Shwari and M-Pawa Users

⁶⁶ MicroSave, 2017, Where Credit is Due – Customer Experience of Digital Credit in Kenya

interaction with a human intermediary may prompt the consumer to consider the impact of their financial decisions more carefully or behave differently.

Topic for Guidance to Supervisors 6: Making Use of Behavioural Studies

The manner and extent to which a Supervisor can use lessons learned from behavioural studies to inform their approach to regulating and supervising the digitalisation of STHCCC.

Suitability

The responses to the Survey raise concerns about how a lack of interaction with a human intermediary during the sales process may affect the suitability of the credit product sold to the consumer, particularly where the consumer's level of digital or financial literacy may already be low. As noted previously, STHCCC products carry a heightened risk of over-indebtedness due to the associated costs and the convenience for consumers. It is essential that consumers are aware of and fully understand the broader financial implications of taking out such loans. However, without a human intermediary to explain the features and costs of the product, and perhaps a better facility to gauge the consumer's comprehension and general disposition towards their repayment obligations, the firm may not be as well informed of the consumer's overall position when making its credit decision. In addition, the consumer may have to undertake more of their own research, which may be misinformed or incomplete, or which they may not be willing to do at all. Digitalisation offers obvious advantages for credit risk assessments when used properly. However, the delivery of the credit itself in a digital manner may restrict the availability of documents for assessing credit risk, and the level and quality of key aspects of creditworthiness assessments that are present in a human interaction (e.g. an experienced advisor assessing how credible the information provided is or how sure the consumer is about their financial position).

CASE STUDY J - Australia

In 2016 ASIC took action against a payday lender following concerns that the firm had failed to make reasonable inquiries into consumers' income and expenses, particularly in situations where the SACC was presumed by the credit legislation to be unsuitable. In addition, ASIC was concerned that the firm did not take reasonable steps to verify consumers' expenses in accordance with its responsible lending obligations. Instead of assessing the actual expenses recorded in consumers' bank statements, the firm applied an internally generated assumed benchmark that had no relationship to the real expenses of the individual consumer.

The firm entered into an enforceable undertaking with ASIC requiring it to pay refunds of AUS\$10.8 million in fees to approximately 55,000 SACC consumers who had applied for a SACC via the firm's website. They also paid penalties totalling \$1.35 million.

There is also potential for digitalisation to be used to groom an application by prompting the consumer to present their information in a particular way or borrow a particular (high) amount. Such malpractices are not unique to digitalisation of course, but it does provide new avenues to prompt this behaviour.

CASE STUDY K - Latvia

In Latvia, instances have been observed of lenders encouraging consumers to disclose a higher income than they may have on digital channels. If the income disclosed by the consumer when applying for credit is considered too low, the system will prompt another question to ask if they have indicated all their income. This nudges consumers to insert a higher income than they have in order to access the credit. A survey carried out in 2015 showed that around 20% of people who had taken out credit considered that credit companies had invited them to show a higher income than they actually had.

Topic for Guidance to Supervisors 7: Reasonable Assessment of the Interests of a Consumer

The manner and extent to which a Supervisor should have regard to ensuring products and services are suitable and appropriate for a consumer's needs and financial situation regardless of the channel through which the STHCCC is provided. This includes consideration of the extent to which automated creditworthiness assessments can fully encompass a consumer's particular circumstances or provide the necessary facility to gauge those circumstances beyond what is provided by written documentation (e.g. to gauge the consumer's true understanding or the veracity of information provided).

Topic for Guidance to Supervisors 8: Requirement for Human Interaction

The manner and extent to which a Supervisor should consider if and when human interaction should be required when a consumer is availing of STHCCC on a digital channel, for the purposes of ensuring adequate and appropriate disclosure, consumer comprehension and suitability of the product or service.

3. New Players and Technologies

A proliferation of new (and perhaps as yet not fully understood) technologies was also cited by respondents to the Survey as a driver of the risks associated with digital STHCCC. This can raise significant security concerns and may expose consumers to an increased risk of fraud or mis-use of personal data. This aligns with the findings of the G20/OECD INFE Report '*Ensuring financial education and consumer protection for all in a digital age*' which stated that digital financial services can expose consumers "to *newer*" threats including, notably, the risk of digital fraud and abuses, misuse of personal

*financial data, lack of transparency and inadequate information on products and related redress mechanisms, data privacy and security vulnerabilities, cybercrime, etc.*⁶⁷.

FinCoNet previously published an extensive report on the security risks posed by online and mobile payments, and continues to carry out research in this area. FinCoNet's 2016 Report on online and mobile payments found that the most significant security concern amongst survey respondents was the prevention of fraud as schemes become gradually more sophisticated as a result of technology. Data protection and privacy were also identified as areas where potential consumer detriment could arise. These risks were also highlighted by CGAP who reported concerns amongst consumers regarding the safety, privacy and use of their data when availing of digital channels⁶⁸. One respondent to the Survey completed for this Report was aware anecdotally of lenders selling consumer data to other lenders if the consumer does not meet their lending criteria (e.g. if Lender A does not lend to social security recipients but Lender B does). There is a need for the use of all data by lenders, including social media data and mobile data, to be clearly communicated to consumers, and protections put in place against the improper usage of this data⁶⁹.

Topic for Guidance to Supervisors 9: Mitigation of Security Risks

The manner and extent to which a Supervisor should ensure that the proliferation of new technologies accompanying the digitalisation of STHCCC does not introduce unwarranted security risks for consumers.

A proliferation of new and innovative players in the market also raises the prospect of STHCCC models that fall outside the scope of the traditional regulatory framework, as well as the risk that Supervisors do not understand the digital aspect of the service sufficiently to identify the risks it poses to consumers and/or its compliance with regulatory requirements. The topics of supervisory knowledge and resources, and regulatory gaps are discussed further below. However, it is apparent that one key supervisory control, and potential learning point for Supervisors, is the assessment of new models at the point at which Supervisors assess applicants for authorisation. This perspective is to be found, for example, in discussions around the use of innovation hubs and regulatory sandboxes, including seeing such initiatives as a means for Supervisors to improve their understanding of the features of digitalised services and the risks they pose.

⁶⁷ OECD, 2017, G20/OECD INFE Report on ensuring financial education and consumer protection for all in the digital age, p.26

⁶⁸ CGAP, 2015, Doing Digital Finance Right: The Case for Stronger Mitigation of Customer Risks

⁶⁹ AFI, 2015, Digitally Delivered Credit – Policy Guidance Note and Results from Regulators Survey

Topic for Guidance to Supervisors 10: Authorisation Requirements

The manner and extent to which a Supervisor should ensure that the digitalisation of STHCCC and its specific innovative features do not have an adverse impact on the standards required in order to be authorised to provide STHCCC or result in a net decrease in the level of consumer protection.

4. Supervisory Challenges

80% of respondents to the Survey also noted specific challenges for Supervisors in the regulation of digital STHCCC. These included limited powers, resources, knowledge, and skills. If a Supervisor does not have the necessary understanding of the new providers, technologies and products on offer, and the ability to identify and mitigate new and emerging risks, then the level of regulation may not be sufficient and consumers could suffer a lower degree of protection as a result. Supervisors should have particular regard to G20 High Level Principle 2: Role of Oversight Bodies, which states that there should be oversight bodies explicitly responsible for financial consumer protection with the necessary power, resources and capabilities to fulfil their mandates, and that international co-operation between oversight bodies should be encouraged, and attention paid to consumer protection issues arising from cross-border transactions.

Knowledge and Resources

In addition to addressing the risks previously outlined, respondents to the Survey noted that the digitalisation of STHCCC presents specific challenges for Supervisors related to their capacity to adjust to the pace of change and keep up with new technologies and innovation. Survey respondents noted the difficulties faced when regulating digital financial services, such as a lack of resources with the required knowledge of new technologies and providers. The digitalisation of financial services is evolving rapidly and it is essential that regulation and regulatory practice is able to keep up with these developments. Supervisors must grapple with how to ensure an adequate balance between the need to maintain existing standards of consumer protection and mitigate risks to consumers, while also providing the environment for the benefits of technological advancement to be explored in a manner that ensures that the best interests of consumers are protected.

Regulatory Gaps

The Survey responses also indicated that if regulation does not keep pace with the evolution of digital financial services, there is a risk that gaps may arise in the regulatory framework of which Supervisors are unaware of or ill-equipped to deal with. Many digital credit products are being offered by new types of providers or as partnerships between traditional financial institutions and other non-traditional companies. These non-traditional providers and business models may fall outside the scope of regulation in some jurisdictions, or may not be subject to the same degree of regulation as traditional lenders. The AFI noted for example that some banking institutions have raised complaints about the difference in treatment between banks and

mobile network operators in terms of Know Your Customer requirements⁷⁰. Such gaps in regulation can expose consumers to increased risks of misconduct or irresponsible lending when availing of STHCCC through digital channels.

Such regulatory gaps might even take the form of technical compliance with a rule framed in a traditional service context lending to a result that, in substance, avoids achieving the objective of the rule in question. An example of this could be the disclosure of terms and conditions or other text required by regulation in the form of lengthy text (as one would find in a traditional pack of documents) where the service is in fact accessed and used on a smartphone (where it may be impractical for a consumer to read or digest such text on their phone in that format).

Cross-border Issues

A number of respondents to the Survey, such as the Netherlands, the UK and Lithuania, cited in their responses experiences of instances of digital STHCCC being offered in their jurisdiction from other jurisdictions. In addition, several respondents noted that it is possible cross-border issues will become more prevalent as digital channels continue to increase in popularity. Digital channels allow STHCCC to be offered to consumers and/or accessed by consumers from one jurisdiction to another more easily and readily than ever before.

However, regulatory gaps may arise with the cross-border provision of digital STHCCC due to differences in the legal and regulatory frameworks across jurisdictions. Regulatory arbitrage may also occur when firms attempt to circumvent rules relating to the provision of STHCCC in one jurisdiction by moving to another jurisdiction but still offering their services via cross-border channels. In the Survey responses, the Netherlands noted this phenomenon where a cap of 14% APR was introduced, causing payday lenders to move their operations to other EU member states where they continue to offer payday loans to Dutch consumers via digital channels. In France, the ACPR has recognised the increased risk of cross-border issues with the provision of credit through digital channels and is currently developing tools to detect such issues as soon as possible. The EBA noted that digitalisation may increase the number of firms providing cross-border services, and that differences in regulatory regimes between Member States may result in regulatory arbitrage as some fintech firms may choose Member States where the regulatory regime is perceived to be less burdensome than in their Home State⁷¹.

⁷⁰ AFI, 2015, Digitally Delivered Credit – Policy Guidance Note and Results from Regulators Survey

⁷¹ EBA, 2017, Discussion Paper on the EBA's Approach to financial technology (FinTech)

Collaboration

The Survey responses show that respondents recognised that there are particular risks posed by the digitalisation of STHCCC that have the potential to cause significant consumer detriment, but that few jurisdictions have in place specific rules and requirements for STHCCC provided through digital channels. In addition, the findings of the Survey and the literature available on the topic indicate that some markets are more advanced than others with regards to the availability of digital STHCCC and that practices and the nature of the consumer protection issues arising can vary from one jurisdiction to another. Finally, it is also clear that digitalisation enables a given STHCCC model to migrate quickly from one market or jurisdiction to another. This all evidences the benefits for Supervisors of sharing their experiences on digitalised STHCCC, so that Supervisors can learn about developments and regulatory experiences in other jurisdictions before the issues present themselves in their own.

Collaboration between Supervisors and industry players in the field of digital credit can also help enhance knowledge and understanding of the market, the products on offer, and the degree of regulation required to provide the best possible protection for consumers. In their guidance, the AFI recommended that Supervisors regularly engage with the providers and innovators of digital credit products and new technologies in order to better understand the product features, distribution models, marketing strategies and other relevant information⁷². This will help improve the ability of Supervisors to identify gaps in their regulatory frameworks (including in the context of cross-border services) and areas that may pose a current or future risk to consumers. Some countries have already put in place formal industry dialogue and coordination processes⁷³. One such example is in Kenya where the Supervisor arranges regular stakeholder forums to discuss current market trends and issues. Another is the initiative *Modelo Perú*, the name given to a partnership between Peru's financial institutions, telecommunications companies, large payers and payees, with close collaboration with regulators, with the shared goal of developing a common mobile payments platform and increasing financial inclusion⁷⁴. Some Supervisors, such as the FCA and ASIC, have established innovation hubs, where they assist and support industry with navigating the regulatory framework, and regulatory sandboxes where providers can test their new products and services in a live environment. The goal of these initiatives is to encourage innovation while also ensuring consumers are adequately and appropriately protected. In the UK, the FCA offers direct support through its innovation hub, which assists regulated and unregulated businesses in bringing innovative ideas, products, or business models into the financial services market, where these are in the interests of consumers. The FCA sandbox allows established businesses and start-ups to test innovative propositions in the marketplace while ensuring appropriate consumer safeguards are in place. The Financial Services Agency of Japan offers a "Fintech Support Desk" service for one-stop consultation and information sharing with fintech companies. Since 2015, the

⁷² AFI, 2015, Digitally Delivered Credit – Policy Guidance Note and Results from Regulators Survey

⁷³ CGAP, 2015, Doing Digital Finance Right: The Case for Stronger Mitigation of Customer Risks

⁷⁴ Bower, 2015, Modelo Perú: A Unique Approach to Financial Inclusion

Netherlands Authority for the Financial Markets (AFM) has had an Innovation and FinTech programme in place that focuses on:

- Creating an overview of innovative and fintech concepts and their impact on the sector and the AFM
- Accommodating innovative players by addressing problems and reducing unnecessary barriers
- Making the legislative framework and legal interpretations appropriate
- Preparing the AFM for the fast-moving market conditions.

As part of this programme, representatives from the AFM visit meetings of industry players who are undertaking innovative initiatives, organise seminars and invite new parties to discuss their business models.

As could be expected, these initiatives are not specific to STHCCC per se, and/or may have been conceived with other types of financial services in mind. Nevertheless, such initiatives represent examples for reflection by Supervisors when considering how to structure engagement with industry on digitalised STHCCC.

As an international organisation, FinCoNet offers a unique opportunity for cooperation and engagement on common issues of concern between Supervisors with a consumer protection mandate. This may be particularly useful with regards to the digitalisation of credit and other financial services where Supervisors can stand to benefit substantially from peer learning and experience sharing of new and emerging risks and best practices.

Topic for Guidance to Supervisors 11: Collaboration with Supervisors and Industry

The manner and extent to which a Supervisor should seek to collaborate with other Supervisors, as well as engage with industry and technological innovators, in order to acquire information on new and emerging risks, and on best practice for regulating STHCCC.

Other Risks

Advertising

Some respondents (20%) noted that the manner in which STHCCC is advertised to consumers could also lead to potential detriment. STHCCC is often aggressively advertised using cute messaging that undermines the seriousness of entering into a credit contract and distracts consumers from the high cost. The focus is on the ease and speed of obtaining credit. The advertisements are often targeted at financially excluded or vulnerable consumers by including lines such as 'We will lend to you when others won't'. Supervisors may have provisions in place to address the specific issues associated with advertising of STHCCC. For example, as previously

mentioned, Guidance was published in the UK in 2015 to prevent trivialisation in the advertising of STHCCC⁷⁵.

CASE STUDY L – Australia

In 2012 ASIC released Regulation Guide 234: *Advertising financial products and services (including credit): Good practice guidance* to help credit providers comply with their legal obligations not to make false or misleading statements or engage in misleading or deceptive conduct. This guidance cautions credit providers from using promotional claims that reflect practices that do not comply with responsible lending obligations.

In 2014, a payday lender paid AUS\$30,600 in penalties after ASIC took action in response to their websites using statements such as "instant decisions" and loan approvals "within minutes".

Digital channels make it cheaper and simpler for lenders to market directly to consumers in a wide range of contexts (e.g. in conjunction with sites where they may be considering a purchase). One respondent to the Survey noted that digitalisation also provides lenders with a greater ability to target and reach specific consumer segments, which obviously can be a good thing or a bad thing for consumers' best interests, depending on how such targeting is used. This ease of targeted advertising through digital channels can potentially increase the risk of consumers purchasing credit that may not be suitable for their needs, and further contribute to over-indebtedness. CGAP noted that marketing digital credit individually to consumers may encourage them to borrow with no real purpose or intentionality⁷⁶.

CASE STUDY M - Portugal

Within its mandate on consumer protection, the Bank of Portugal carries out systematic monitoring of advertising on banking products and services regardless of the channel through which the products or services are provided.

In this way, the Bank of Portugal has a dedicated team to oversee compliance of advertising campaigns on banking products and services with the applicable rules on accuracy, transparency and balance of information.

The main features are as follows:

- (i) *Ex post* supervision mainly;
- (ii) Mixed principle and rules-based regulation;
- (iii) Risk-based approach;
- (iv) All the different means of communication are under scrutiny (TV, outdoor, mail shots, internet, booklets etc.).

⁷⁵ See p. 31 of this Report

⁷⁶ CGAP, 2017, Consumer Protection in Digital Credit

Use of Rewards

Some digital credit products may offer attractive reward programmes that encourage consumers to keep borrowing. The use of rewards as an incentive to encourage consumers to take out high-cost loans may further contribute to unsuitable selling and consumer over-indebtedness. The EPAR identified 32 products that advertise reward programmes that incentivise certain behaviours from consumers. For example, M-Pesa in Kenya rewards customers as they use the product, allowing them to accrue points that can then be used to increase their future loan limits. One respondent (Canada) has observed other types of unregulated digital high cost lending products marketed through promotions that offer borrowers free access to their credit reports and credit scores. These promotions are intended to appeal to borrowers to use the loans to rebuild their credit score.

There is reason to be particularly concerned about the effectiveness of rewards in a digital STHCCC environment. There are distinct consumer behavioural characteristics associated with digital credit, such as the influence of 'present bias'. Also, the consumer may consider digital borrowing to be 'less serious' than traditional means of borrowing. These characteristics could result in the consumer being especially influenced by the immediacy of an opportunity presented by a reward scheme offered with a digital STHCCC product.

Of relevance here is FinCoNet's 2016 'Guidance to Supervisors on the setting of Standards in the field of Sales Incentives and Responsible Lending'. The Guidance includes that Supervisors' oversight should include consideration of the benefit of promotional incentives offered to consumers versus the cost of the credit product. This oversight should consider:

- Whether the benefit is significantly outweighed by the cost of the credit, including having regard to how that cost of credit compares to other equivalent credit products;
- Whether specific disclosures or warnings are required;
- The timing and nature of the presentation of the promotional incentive and how such timing and presentation may influence the consumer's decision; and
- When to restrict or prohibit this practice on the grounds that the apparent benefit of the promotional incentive is in fact illusory.

CHAPTER 6: CONCLUDING REMARKS

Used properly, digitalisation has the capacity to transform the availability and provision of credit for the better. However, in a STHCCC context, it may also introduce new risks and aggravate the risks already associated with these types of loans. As well as the very presence of new players and technologies themselves, the drivers for these risks include lack of information and transparency, as well as lack of consumer financial and digital literacy. There are also specific behavioural risks from how digitalisation enhances the convenience of STHCCC and removes the need for human interaction.

The findings of this Report also show that Supervisors face specific challenges with the digitalisation of STHCCC. Supervisors have to work in their jurisdictions, and with one another, to ensure they know and understand relevant digitalised STHCCC practices and that gaps in the regulatory framework for STHCCC do not arise as a result of digitalisation.

The Report shows the wide variation in what countries consider to be STHCCC and the nature of the products available digitally in their jurisdiction. It also shows the variety of regulatory issues encountered as a result. This highlights that there are very clear benefits to be obtained from collaboration amongst Supervisors on this topic, as well as engagement with industry. FinCoNet offers a unique opportunity for such cooperation and engagement between Supervisors from around the world with a consumer protection mandate. To this end, FinCoNet will continue to progress its work on this topic towards the development of Guidance for Supervisors in the setting of Standards in the field of digitalised STHCCC, with a view to further promoting sound market conduct and strong consumer protection.

Appendix One: Respondent Authorities

JURISDICTION	RESPONDENT AUTHORITY
Armenia	Central Bank of Armenia
Australia	Australia Securities and Investments Commission
Brazil	Central Bank of Brazil
Canada	Financial Consumer Agency of Canada
France	Bank of France
Germany	Federal Financial Supervisory Authority (BaFin)
Indonesia	Financial Services Authority (OJK)
Ireland	Central Bank of Ireland
Italy	Central Bank of Italy
Japan	Financial Services Agency
Korea	Financial Services Commission
Latvia	Financial and Capital Market Commission
Lithuania	Bank of Lithuania
Luxembourg	Financial Sector Surveillance Commission
Mauritius	Bank of Mauritius
Netherlands	Netherlands Authority for the Financial Markets
Norway	Financial Supervisory Authority
Pakistan	State Bank of Pakistan
Peru	Superintendence of Banking, Insurance and Pension Funds Administrators (SBS)
Portugal	Central Bank of Portugal
Russia	The Bank of Russia
Saudi Arabia	Saudi Arabian Monetary Agency
South Africa	Financial Services Board
Spain	Central Bank of Spain
United Kingdom	Financial Conduct Authority

Appendix Two: Mapping of G20 High Level Principles to relevant risks and issues associated with the digitalisation of short-term, high-cost consumer credit

G20 High Level Principles on Financial Consumer Protection	Relevant Risks/Issues of Digitalisation of Short-Term, High-Cost Consumer Credit
1. Legal, Regulatory and Supervisory Framework	<ul style="list-style-type: none"> • New business models for provision of credit through digital channels may not fit neatly into traditional view of regulated activities • Risk of regulatory gaps arising due to lack of understanding of, or slow reaction to, emerging risks/implications for consumer protection created by new players providing credit through new channels • Regulatory framework could create a barrier to entry for new players with innovative ideas who could offer consumer benefit
2. Role of Oversight Bodies	<ul style="list-style-type: none"> • Increased risk of cross-border issues due to ease with which cross-border transactions can be carried out through digital channels. A lack of international cooperation can exacerbate these issues. • Lack of staff with appropriate knowledge/understanding about the implications for consumers for credit provided through digital channels
3. Equitable and Fair Treatment of Consumers	<ul style="list-style-type: none"> • Provision of credit through digital channels is often direct-to-client with no human intermediary. This creates issues with ensuring: <ul style="list-style-type: none"> ➤ Consumers are treated fairly ➤ Products are suitable and appropriate for the consumer's needs ➤ Information is understood by the consumer • Increased risk of exclusion of some groups e.g. the elderly
4. Disclosure and Transparency	<ul style="list-style-type: none"> • Digital platforms may fall outside of scope of existing disclosure requirements • Difficulties with effective presentation of disclosures e.g. on smaller screens etc. • Difficult to ensure consumer has read and understood information • Consumer may not be aware of who is providing the service and what conflicts of interest may exist • Ease of targeted advertising/unsolicited communications through digital channels increase risk of consumers purchasing credit that may not be appropriate for their needs • Consumers may not be made aware of cheaper credit alternatives
5. Financial Education and Awareness	<ul style="list-style-type: none"> • Consumers may purchase credit more impulsively through digital channels • Difficult to determine whether or not consumer understands the product

	<ul style="list-style-type: none"> • Difficult to determine if consumer aware of their rights and responsibilities when purchasing credit • Consumers may not have an understanding of the implications of purchasing short-term, high-cost credit
6. Responsible Business Conduct of Financial Services Providers and Authorised Agents	<ul style="list-style-type: none"> • Lack of human intermediary in provision of credit through digital channels makes it less clear who the responsibility for protecting the best interests of the consumer lies with • Automated assessments of consumer needs present challenges for ensuring products are suitable • Development of digital financial services may be undertaken by/outsourced to non-regulated entities or individuals who may not have relevant financial knowledge and understanding • Conflicts of interest may not be obvious when credit is provided through digital channels
7. Protection of Consumer Assets against Fraud and Misuse	<ul style="list-style-type: none"> • Digital channels create new opportunities for committing fraud • Nature of fraud through digital channels can make it difficult to trace the source • Consumers/regulators may not be aware of emerging methods for carrying out fraud/scams
8. Protection of Consumer Data and Privacy	<ul style="list-style-type: none"> • Risks associated with storage of data on digital platforms • May not be clear to the consumer who has access to their data, what data they have access to, or who it is shared with when using digital financial services • Use of consumer data by financial institutions for decision-making/pricing practices could impact on consumers' access to products/services
9. Complaints Handling and Redress	<ul style="list-style-type: none"> • Consumers may not be aware of complaints handling and redress procedures when using digital channels • Lack of human intermediary may make it more difficult for consumers to access effective mechanisms for addressing their complaints • May not be clear who is responsible for the detriment and redress e.g. if failure of underlying algorithm
10. Competition	<ul style="list-style-type: none"> • Risk that a level playing field may not exist if new players are not subject to regulatory requirements • Risk that regulatory requirements could create a barrier to new entrants or hamper innovative approaches

Appendix Three: Overview of what is considered to be short-term, high-cost consumer credit in a sample of respondent jurisdictions

In some jurisdictions, specific forms of STHCCC are defined in legislation. For example, in Canada, the Federal Criminal Code 1985 defines a payday loan as a short-term, small-dollar loan of up to CAD\$1,500 with a term of 62 days or less. It is made in exchange for a post-dated cheque, a preauthorised debit or future payment of a similar nature. In Australia, a 'small amount credit contract' (SACC, but commonly called a payday loan) is defined in the National Consumer Credit Protection Act 2009 as a contract that:

- a) is not a continuing credit contract and is unsecured;
- b) is not provided by an authorised deposit-taking institution;
- c) has a credit limit of AUS\$2,000 or less; and
- d) has a term between 16 days and one year.

In Ireland a particular licence is required to provide the services of a "moneylender", where the APR is 23% or higher. Moneylending agreements are defined in legislation and are generally short-term (the most common length of term being 9 months).

However, the Survey found that most jurisdictions do not have any legal definitions of, or specific classifications for, STHCCC. Supervisors may have their own criteria for what they consider to be STHCCC. For example, in Indonesia, the OJK defines high cost credit as credit where the rate incurred is higher than the average interest used in the market. Consumer credit under and above the amount of €289 is distinguished in Lithuania for statistical purposes, with loans under this amount generally being more expensive and having a shorter duration.

In the UK, the FCA defines STHCCC as a regulated credit agreement:

- a) which is a borrower-lender agreement or a person-to-person ('P2P') agreement;
- b) in relation to which the APR is equal to or exceeds 100%;
- c) either:
 - a. in relation to which a financial promotion indicates (by express words or otherwise) that the credit is to be provided for any period up to a maximum of 12 months or otherwise indicates (by express words or otherwise) that the credit is to be provided for a short term; or
 - b. under which the credit is due to be repaid or substantially repaid within a maximum of 12 months of the date on which the credit is advanced;
- d) which is not secured by a mortgage, charge or pledge; and
- e) which is not:
 - a. a credit agreement in relation to which the lender is a community finance organisation; or
 - b. a home credit loan agreement, a bill of sale loan agreement or a borrower-lender agreement enabling a borrower to overdraw on

a current account or arising where the holder of a current account overdraws on the account without a pre-arranged overdraft or exceeds a pre-arranged overdraft limit.

Some respondents noted that they have not observed what might usually be considered STHCCC in their jurisdiction. In Italy for example, this is due to having regulatory provisions in place that substantially limit the possibility to lawfully market such products. A cap of 14% APR was introduced in the Netherlands, making it illegal for payday lenders to operate on Dutch territory. However, payday lenders operating from other EU member states are exempt from the Dutch Financial Act and are able to offer credit with an APR above these national limits.

Other respondents reported that they consider revolving credit such as overdrafts and credit cards to be STHCCC in their jurisdiction. In Brazil, the average interest rate for a credit card is 484% APR. In Spain, the average APR of consumer credit granted by financial institutions supervised by the Bank of Spain is below 10%, whereas consumer credit granted through revolving cards can reach APRs higher than 20%. The Bank of Spain notes that it has been observed that some private entities falling outside of its scope for supervision⁷⁷ offer short-term credits (e.g. from 15 days) at a very high annual percentage rate (e.g. above 1000%). Revolving credit products are also reported as the most expensive type of consumer credit sold in Portugal, where the maximum APR for revolving credit in the third quarter of 2017 was 16.4%⁷⁸.

⁷⁷ These private entities are not financial institutions and are thus not regulated by the Bank of Spain.

⁷⁸ In Portugal, caps are defined in terms of APR for each type of product and for every quarter, based on the average APR of new consumer credit agreements provided during the previous quarter.

Glossary

Acronyms	Meaning
ACPR	Autorité de contrôle prudentiel et de resolution (French Prudential Supervision and Resolution Authority)
AFI	Alliance for Financial Inclusion
AFM	Autoriteit Financiële Markten (Netherlands Authority for the Financial Markets)
APR	Annual Percentage Rate
ASA	Advertising Standards Authority
ASIC	Australian Securities and Investments Commission
BCB	Banco Central do Brasil (BCB)
BCBS	Basel Committee on Banking Supervision
CAP	Committee of Advertising Practice
CBA	Commercial Bank of Africa
CCI	Consumer Credit Insurance
CGAP	Consultative Group to Assist the Poor
DFS	Digital Financial Services
EBA	European Banking Authority
EPAR	Evans School Policy Analysis and Research
EU	European Union
FCA	Financial Conduct Authority
FinCoNet	International Financial Consumer Protection Organisation
FSB	Financial Stability Board
G20	Group of 20
GSMA	Group Special Mobile Association
INFE	International Network on Financial Education
IOSCO	International Organisation of Securities Commissions
MFO	Microfinance Organisation
MNO	Mobile Network Operator
OECD	Organisation for Economic Cooperation and Development
OJK	Otoritas Jasa Keuangan (Indonesian Financial Services Authority)
P2P	Peer-to-peer
RDR	Central Bank's Complaint System (Brazil)
SACC	Small Amount Credit Contract
SCR	Credit Information System (Brazil)
SME	Small and Medium Enterprises
STHCCC	Short-term, High-cost Consumer Credit
USSD	Unstructured Supplementary Service Data

List of References

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