



Digitalisation of short-term, high-cost consumer credit

Guidance to supervisors

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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.

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

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

³FinCoNet, 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).

⁴FinCoNet 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 that it considers particularly relevant for supervisors to take into consideration when overseeing the provision of STHCCC through digital channels.

Based on these topics and on the views of FinCoNet members, FinCoNet has developed the enclosed Guidance to supervisors in the field of digitalisation of STHCCC.

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

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

For the purposes of this Guidance, 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'.

⁵FinCoNet, 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>).

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.

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 off-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.

Guidance 3: Consumer access to recourse mechanisms

Supervisors should ensure that consumers of digital 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 digital 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.

Guidance 4: Disclosure of information

Supervisors' oversight should seek to ensure that information provided to consumers in relation to digital 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.

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).

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.

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.

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).