CDC-SPTF FINTECH WEBINAR SERIES FOR INVESTORS

Brief 6. Identifying client protection risks and client value in pay-as-you-go models

Many investors want to better understand opportunities in the FinTech space but do not have a roadmap for how to evaluate such investments for their risks and benefits to clients. Industry-wide standards exist for evaluating the consumer protection and social performance management (SPM) practices of traditional financial service providers and can be a starting point for FinTech providers as standards and guidelines are being adapted. In the meantime, investors are seeking answers to the questions: *During due diligence and monitoring of FinTech investments, how do we evaluate client protection risks? How do we assess the value for the end consumer?*

SPTF and CDC Group have designed a webinar series for investors to help answer these critical questions. SPTF is coordinating with experts including the Smart Campaign, MicroSave Consulting, and others to develop content for the series.

This brief presents key lessons from the sixth webinar in this series. During the webinar, Drew Corbyn, Program Manager of Quality and Consumer Protection with GOGLA, and Luca Giacopelli, Senior Risk Account Manager with Mobisol, discussed emerging lessons learned in assessing client protection risks and client value in pay-as-you-go (PAYGo) digital models.

Listen to the full recording here. Click here for additional details regarding agent network risk. To sign up for the webinar mailing list, contact Katie Hoffmann.

Part 1: What are the main client protection risks in pay-as-you-go models?

During the webinar, Drew Corbyn of GOGLA, which is the global association for the off-grid lighting and electrification sector, and Luca Giacopelli of Mobisol, which provides off-grid solar solutions to low-income customers in 15 African countries and is a member of GOGLA, detailed the client protection strengths and weaknesses of the PAYGo off-grid solar industry.

In a recent survey of industry clients, GOGLA found that the industry is performing well in the client protection areas of good product quality and good data privacy. However, the industry still has to improve upon several other areas of client protection risks, including:

- **Lack of transparency.** There is a need for increased transparency in customer contracts and product information, including communicating with clients in ways that allow them to better understand the product and the terms of service. For example, when GOGLA examined a sample of late repayments, it was apparent that some delinquent customers hadn't been told about or did not understand the remote lockout process following late payments. This led to confusion and frustration when they could not access their device.

- **Risks with agent network management.** Many financial service providers use agents to sell and service PAYGo products, which opens providers to the risk that agents will oversell a product or mistreat the customer in some way: "The agent is at the crux of consumer protection," Drew said. "If the agent gets it wrong in the initial marketing or sales, it's easy for these problems to spiral out of control." He noted that the most common cause for dissatisfaction was agent behavior related to overselling.

- **Strategic default.** Due to the growing competitiveness of the industry, there's a growing phenomenon of "strategic default"—where customers willingly default on their loans because it is cheaper to switch providers. This is compounded by the fact that customers' liability is typically limited to the product itself; there is no additional collateral. These increasing strategic defaults could lead to negative credit reports for these customers. It's additionally risky to the customers because they are sometimes switching to inferior products simply for lower cost.

- **Lack of flexibility in repayments**. GOGLA's study noted that PAYGo solar companies are not always flexible in scheduling repayments with customers during financial shocks. Drew told a story of one customer who was two weeks behind on repayment, so he was remotely locked out of his product. The next day, he paid the two weeks of back payments. However, because he had paid the next day, the system showed him one day behind payment so he was still locked out. This happened again the next day. "Due to his frustration, he gave up, and the system was taken away," Drew said. "He was frustrated. That was a case where both company and customer are losing out. There are cases where rescheduling and flexibility can help both."

- **Lack of technical support after warranty.** In its interviews with customers, GOGLA found that technical support and call centers generally produce high levels of satisfaction. However, when a product warranty expires, customers have trouble accessing tech support and replacement parts. This is a risk area for client retention, especially in areas of West Africa.

- **Engineering culture.** Solar companies are traditionally founded by engineers who do not have experience with financial services, particularly with financial services for low-income populations. This type of culture can lead to financial services that are not designed with the customer in mind. “There is still an engineering bias at the base that is setting how the actors are behaving,” Luca said. “There should be a change in the culture of these companies from a pure engineering culture to a broader culture that includes financial services.”

- **Over-Indebtedness.** Many solar companies do not report to credit bureaus, leading to potential over-indebtedness of customers.

Part II: How can investors assess these issues in due diligence or monitoring?

Investors can take several steps during due diligence and monitoring to assess the client risk and value in these models.

First, investors can play a role by **encouraging their partner to assess client risks and client value.** For example, Mobisol started measuring and monitoring its client protection practices after its investor, FMO, asked how it was maintaining positive relations with clients. After that, it used the Smart Campaign’s Client Protection Principles to do a voluntary self-assessment, which helped the company improve core business processes by making itself more client-centric.

Drew and Luca also outlined several specific client-centric issues investors can monitor, including how investees:

- **Report customer data to the credit bureau**. Reporting customer data helps prevent over-indebtedness, could decrease “strategic defaults,” and build clients’ credit history. “Reporting is not just about reporting the bad behavior,” Luca said. “70 percent of our customers have never had a loan before. We’re creating a credit history by reporting their positive repayment. This creates future access to credit.”

- **Prevent over-indebtedness.** Mobisol uses a robust process for evaluating consumer debt capacity. It includes checking the credit reference bureau, collecting customer data via interviews, and creating a credit score model based on machine learning.

- **Use data analytics.** In addition to using algorithms to build a credit scoring model, Mobisol has also used data to better identify if a customer is at risk of defaulting. If they identify a customer is high risk and has some behaviors that represent a late payment is more likely, they are able to make a call to that customer or send an agent to see how to address the issues.

- **Facilitate flexible repayment.** After its client protection assessment showed weakness in this area, Mobisol improved its rescheduling policies for customers experiencing repayment difficulties.

- **Strengthen responsible agent practices**. Investors should ensure partners have procedures for identifying the right agents, training them on responsible best practices, building incentives for these best practices, and monitoring the agents. Technology and machine learning can also help companies better understand customer risk and feedback on agents. Drew noted that it's particularly important to make sure these policies and procedures regarding agent management are in place before companies scale up.

- **Embed a focus on client risks and client value throughout the organization**. Luca emphasized that it is important for a company's board of directors to be aware of and reactive to these issues, given they have the immediate power to steer the company's behavior.

Both Luca and Drew noted that there are some challenges in using existing tools to assess these models. When Mobisol used the Smart Campaign's Client Protection Principles to assess its practices, it noted that not all the Principles – which were written for traditional microfinance service providers – applied to the off-grid solar industry. For example, the off-gird industry:

- Sells physical products, as opposed to purely financial services. This often includes a more complex value chain.
- Has a low-touch underwriting process. There are standards regarding underwriting that need to be applied in microfinance that don't apply to this industry.
- Has no cash loan or collateral.

To better assess the industry, GOGLA has developed its own Consumer Protection Code. While tailored to the off-grid solar industry, the Code draws from many existing responsible finance standards, including the SPTF's Universal Standards for SPM; the Smart Campaign's Client Protection Principles; and GSMA's Mobile Money Certification Principles.

GOGLA is now working to identify indicators and create a self-assessment tool based on the Consumer Protection Code, which should be released later this year. Drew and Luca noted a few continued challenges for assessing client protection practices in the PAYGo solar industry:

- The industry still needs to define what it considers nonperforming loans or portfolio at risk. Drew noted that IFC and CGAP are creating a set of KPIs are this, including an indicator for how to define metrics for late and non-payment.

- The nascency of the industry's institutional development makes it difficult to have a standardized assessment. "The industry is at the very beginning of its journey," Luca said. "This results in a non-standardized business model and diverse range of products."

- There are perceived tradeoffs between a rigorous standards and burdening young companies. Luca noted that it he is not sure the Code will be as rigorous as it could be, given that there is such a diversity of actors in the solar off-grid sector. Drew acknowledged this, but cautioned that GOGLA does not want the Code to overburden burgeoning companies or limit innovation in the industry. “There is room for the Consumer Protection Code to be strengthened while working with research and members to build it up,” he said.