EMERGING PAYMENTS ASSOCIATION

The Impact of New Credit and Lending Services on Payment Service Providers

June 2019

Report from the EPA's Project Futures Workshop

Sponsored by

FICO Decisions

The purpose of Project Futures is to provide members of the Emerging Payments Association with insight and thought leadership on new innovations and technological developments, emerging market trends, and the prospective future regulatory landscape in payments.

The Project Futures workshop in June 2019 focused on the impact of new credit and lending services on payment service providers (PSPs). The focus of the discussion was as follows

- Provide perspective on how innovation and regulation within lending and credit will impact the payments industry and consumers
- How business models will adapt and emerge
- How innovations within lending and credit are impacting global markets and which therefore, have potential to offer tangible benefits at scale over a 3-5-year horizon and beyond
- The barriers that lie ahead.

The half-day workshop was structured around three sessions on:

- The emerging trends and leading organisations driving credit and lending services
- The industry challenges inhibiting innovation within lending and credit
- Developing a roadmap on what success looks like within lending and credit

This report is part of a series of Project Futures reports produced by the Emerging Payments Association. It highlights the content of the discussion, the insights derived and the conclusions drawn. These conclusions highlight the direction of travel for the payments industry as it develops and how the ecosystem will fundamentally change in light of new technologies and innovations.

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Emerging Trends

“Whilst crowdfunding can be utilised as a ‘barometer’ for evaluating whether emerging businesses can attract interest, true success will depend on the accuracy of the prospectus, so investors understand exactly what they are putting their money into.”

Technology

New innovations in payments technology have the potential to open up and integrate a wealth of credit and lending options into a consumer’s lifestyle. Rather than having to explore different channels to determine what credit and lending offerings can be provided, or having to input extensive information about a consumer’s profile, new innovations can allow for credit and lending services to be integrated into existing products.

Open Banking has this capability, through the development of APIs that enable easier integration between parties. It has the potential to change how consumers utilise their financial data and financial profile, and to help them become more pro-active in managing their finances. Consumers have the capability to aggregate and manage their various accounts in one portal, with all their data being readily available. It can allow consumers the opportunity to bypass the manual process of providing physical copies of bank statements when taking out a loan or mortgage, and instead allow banks access to assess their account information.

There has been an increasing trend of mobile money providers launching new and innovative mobile credit products, through the utilisation and analysis of airtime purchase data and habits. This presents an enormous opportunity for mobile money operators to increase customer loyalty and drive mobile money product usage by offering loan products. Allied to this, organisations such as Experian and Cignifi are offering credit scoring services to customers, thereby helping Mobile Network Operaters and Financial Institutions to address the demand for micro loan products, by determining the credit worthiness of customers based on their airtime purchase patterns and emergency airtime advances. An example of this is M-Shwari[1], a micro credit product disbursed via Safaricom’s M-PESA platform, which utilises the customer’s existing M-PESA transaction history to create an initial credit score. These credit scoring services create the solution to a lack of card-based credit information for those who are either unbanked or underbanked, but also resolving the challenges posed by the high cost of customer acquisition.

Artificial intelligence (AI) and machine learning are also driving innovation within credit and lending services, making use of transaction data thanks to Open Banking AISP services. There is an increasing trend towards automated credit assessments, instead of manual underwriting, that increases the pace of the process, and guarantees a greater level of consistency, compliance and accuracy in risk models that quantify the creditworthiness of applicants. Automated assessments provide opportunities and benefits for lenders beyond more manual processes, allowing lenders to approve more low-risk customers and empower lenders to reject the highest risk customers by having a more accurate assessment. However, whilst the excitement around the potential of machine learning amongst lenders is high, the current reality is that the costs of machine learning impede its adoption among smaller lenders.

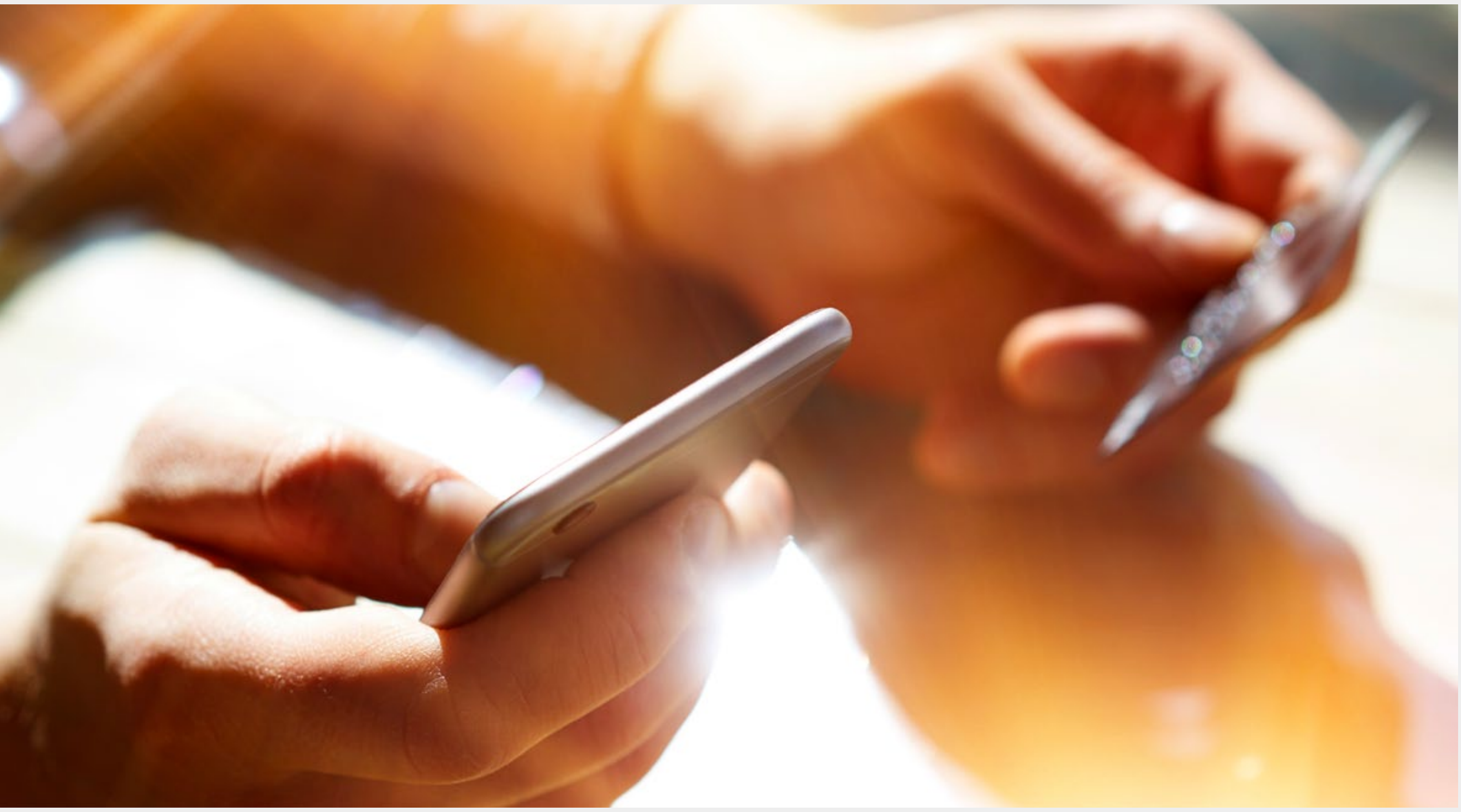
Commercial

Crowdfunding has become a prominent tool for businesses looking to grow in scale and size, but how effective is crowdfunding for generating capital? There have been a number of highly successful crowdfunding examples, such as Monzo[2], but we often forget about the numerous under-the-radar crowdfunding situations. It could also be argued that organisations use it as a PR/Marketing stunt, with a view to announcing a crowdfunding event as a means of onboarding new customers. Whilst crowdfunding can be utilised as a 'barometer' for evaluating whether emerging businesses can attract interest, true success will depend on the accuracy of the prospectus, so investors understand exactly what they are putting their money into.

Organisations are also increasingly embracing the concept of lending at the point of sale. Increasing payment options for consumers buying non-essential items offers the potential for merchants to finance more sales with less risk. Increasingly, payments organisations are looking to incorporate lending and credit services to enhance their existing portfolio. Mastercard's purchase of Vyze[3], a platform which connects retailers with a network of lenders at the point-of-sale and provides merchants with APIs to reroute credit requests to the bank of the payer, allows the card scheme to add a new revenue stream as some consumers forgo credit-card purchases.

"UK consumers are more likely to make a payment via debit card rather than credit – with UK consumers making 1.5 billion debit card transactions compared to 291 million credit card transactions in May 2019."

There is a wealth of opportunity within the buy-now, pay-later market that has not yet wholly been embraced in all territories, although the model has had significant traction across Western and Northern Europe to the point of potential saturation. The opportunity within this niche is currently being exploited by entrepreneurial non-bank FinTechs, such as Splitit, AfterPay and Affirm, who are using the current rails and technologies to provide credit and lending capabilities. The most notable player in this space is Klarna, who have experienced strong growth in the UK market with approximately 5 million consumers utilising the service across 4,000 retailers. A new valuation of $5.5bn puts them



currently as the largest private FinTech in Europe, thanks to new investment[4] to help them crack the US, Australian and New Zealand markets, which may already by saturated by Afterpay, ChilliPay and Laybuy.

Social

The concept of utilising credit is no longer scary to consumers in the UK. Since 1993, credit card spending has been on an increasingly upward trajectory - with a total £16.9 billion spent on credit cards in May 2019 across 291 million transactions[5]. Overall however, UK consumers are more likely to make a payment via debit card rather than credit – with UK consumers making 1.5 billion debit card transactions compared to 291 million credit card transactions in May 2019[6]. However, despite an increasing adoption of credit as a payment method, there still appears to be a disconnect in how consumers interact with their credit profile. Data from Amigo Loans reveals that over half (51%) of UK citizens have never checked their credit file, with 2.5 million (5%) claiming that they are 'too scared to look'. 24% of respondents commented that 'not knowing how' was the reason for not checking their record, with 36% of respondents noting that they 'hadn't thought about doing it.[7]'. There is a clear need to demystify the concept of the credit score and to make consumers aware of what it is and what it means for them. Entities like FICO and Experian are increasingly undertaking outbound marketing campaigns to raise consumer awareness of what a credit score is, what it provides, and to reduce the confusion/complexity behind it. New entrants to the open banking space such as Credit Kudos[8] and ClearScore[9] are helping here.

Similar to credit, lending has also been on a steady upward trajectory with lending levels estimated at £16.63 billion in February 2018[10]. The prevalence in lending has been facilitated by an increasing trend towards peer-to-peer (P2P) lending; with organisations like Zopa and Funding Circle providing access to funds for both consumers and businesses.

From a non-UK perspective, other markets have explored new avenues to create credit assessments and credit profiles in the absence of card data (or a lower prevalence of card data). Outside of the Western world, it has been the merchants and telco providers that have been able to provide credit and lending services due to their intimate relationship with the payer. In the Philippines, Globe Telecom – the country's largest telecommunications provider – utilises its subsidiary Mynt to provide mobile money, micro-loans and technology for the unbanked consumer. In a country with 73% mobile penetration[11] but only 34.5% banking penetration[12], Mynt has been able to effectively utilise the mobile and store networks of its partners and its parent company to provide access to financial services. This innovation has been driven by the 'credit vacuum' in the Philippines in which individuals and SMEs find difficulty in accessing credit from incumbent providers due to stringent credit control, limited access to authentication documents, and a lack of collateral. Instalment payments for purchases

> **"With the rise of various of digital forums for consumers to share their complaints, consumers have increasingly used social media channels to deliver complaints and air the grievances."**

made with credit cards is an increasingly common practice in Brazil with the merchants and retailers providing credit – typically on a 12-month instalment plan, but ranging from 2 to 60 instalments. According to a report by Ebit, 62% of consumers who use credit cards purchase in instalments without interest every month (57.8% of e-commerce payments in the country were made in instalments)[13]. Credit card fees in Brazil are higher than in other markets and consumers are often not able to provide collateral. By paying in instalments, buyers benefit from greater purchasing power and lower impact on their monthly budget. For merchants however, this provides a risk as there is no guarantee of payment. However, it also provides merchants with access to a new cohort of consumers; it is estimated that 80% of all retail sales are made via instalments[14] highlights that 70%[15] of the buyers who financed their purchases with credit card acknowledge that they would not have made the purchase without the capability to pay in instalments. In ensuring that consumers hesitate less before making the purchase, and not burdened by the need to pay the amount in full at the time of the purchase, it allows merchants to attract more clients and foster their loyalty.

One more trend is the move to hyper-personalisation, where products and advertising are highly tailored thanks to the increase in access to data – as noted in the previous Project Futures report, 'Data proliferation and using data to drive payments innovation'. Different demographics are more accepting of this than others, with the younger generation favouring personalisation over privacy, but firms need to be aware of different tastes and not come across as too sinister.

Regulatory

The adoption of RegTech solutions has the potential to solve existing problems within transactions, primarily in the monitoring space. Tools like eKYC have the potential to drive cost savings for merchants and fortify security offerings through automation. An example of this can be seen in India in which the government issued Aadhaar[16], a verifiable 12-digit identification number issued to residents of India for free, has been utilised as a digital identity solution; providing a means of eliminating duplicate or fake identities and authenticating users. In May 2019, the Reserve Bank of India (RBI) provided direction on KYC to enable the use of Aadhaar for account opening with regulated entities, with the consent of the Aadhaar number holder. This will enable consumers and businesses to open instant bank accounts using eKYC based on Aadhaar authentication through the OTP mode.

The Financial Conduct Authority has taken a proactive role in regulating new and emerging P2P lending services, with the industry falling under its jurisdiction in 2014. Since then, the FCA has engaged extensively with firms within this sector and has issued numerous policy papers and requests for industry input. Most recently in June 2019, it introduced revised policy positions, rules and guidance to improve standards in the sector[17]; applying marketing restrictions to P2P platforms with a focus on ensuring that new, or less-experienced investors are protected, insisting that appropriate assessments are made on an investor's knowledge and experience in P2P investments, and setting a standard for the minimum information that P2P platforms need to provide to investors.

Whilst financial services regulators do have a role to play in regulating terms and conditions, the FCA having powers to challenge unfair terms in financial services consumer contracts, they do not have the power to regulate the accessibility of terminology used in terms and conditions.

This may be changing in the credit space as the FCA has recently issued a policy statement[18] on By Now Pay Later offers. As well as making some notable changes such as how interest is calculated and how consumers are notified after an offer period, the FCA continues to reinforce its remit of protecting consumers from harm. It addresses suitable disclosure measures, taking a position on Adequate explanations, Advertising and other communications to ensure that terms and conditions are suitably disclosed and tailored to the consumer, precisely so that these interest and offer periods are understood.

Until this comes into force, it is the market that appears to have taken the increasing trend towards user-friendly messaging in their terms and conditions. Organisations are no longer hiding behind dense legal jargon, but instead are increasingly providing terms and conditions that are clear cut and in simple terms. Challenger banks like Monzo[19] have pioneered this approach and, in doing so, the more established players in the payments industry have followed.

However, it could also be argued that the trend towards user-friendly terms and conditions may also be a tool to reduce or eliminate user complaints. Whilst it could be argued that no-one cares about the fine prints/terms and conditions, when consumers experience pain points with their account provider they become more conscious and considerate of their rights. With the rise of various of digital forums for consumers to share their complaints, consumers have increasingly used social media channels to deliver complaints and air the grievances. With services like Resolver[20] making the complaints and redress process easier, people are more likely to challenge organisations, and thereby leading to those organisations becoming increasingly targetable and ultimately accountable. ■

Footnotes:

1 https://www.safaricom.co.ke/personal/m-pesa/do-more-with-m-pesa/loans-and-savings

2 https://monzo.com/blog/2018/12/05/crowdfunding-closes

3 https://www.finextra.com/newsarticle/33697/mastercard-moves-into-pos-financing-with-vyze-acquisition

4 https://www.finextra.com/newsarticle/34221/klarna-pushes-for-growth-in-us-and-australia-with-460-million-equity-raise

5 UK Finance, Card Spending Update May 2019 (https://www.ukfinance.org.uk/sites/default/files/uploads/Data%20(XLS%20and%20PDF)/Card-Spending-Update-May-2019.pdf)

6 https://www.ukfinance.org.uk/sites/default/files/uploads/Data%20(XLS%20and%20PDF)/Card-Spending-Update-May-2019.pdf

7 https://www.amigoloans.co.uk/press-releases/article/credit-fear-grips-uk

8 https://www.creditkudos.com/

9 https://www.clearscore.com/

10 Aggregate data from Bank of England (https://www.bankofengland.co.uk/statistics/money-and-credit/2019/march-2019#summary)

11 Pew Research Centre, Mobile Connectivity in Emerging Economies 2019 (https://www.pewinternet.org/wp-content/uploads/sites/9/2019/03/PI_2019.03.07_Mobile-Connectivity_FINAL.pdf)

12 World Bank, The Global Findex Database 2017 (https://globalfindex.worldbank.org/)

13 CFA Institute, CFA Institute Research Challenge 2017 (http://cfasociety.org.br/pdf/rc/Insper_Relatorio.pdf)

14 https://www.ft.com/content/29ab1588-58bf-11e2-bd9e-00144feab49a

15 https://www.abecs.org.br/app/webroot/files/media/8/d/d/4f2832c3c205cd447ad706cef2a80.pdf

16 https://uidai.gov.in/

17 https://www.fca.org.uk/publications/policy-statements/ps19-14-loan-based-peer-to-peer-investment-based-crowdfunding-platforms-feedback-final-rules

18 https://www.fca.org.uk/publications/policy-statements/ps19-17-buy-now-pay-later-offers-feedback-cp18-43-and-final-rules

19 https://monzo.com/legal/terms-and-conditions/

20 https://www.resolver.co.uk/

Industry Challenges

Technology

An existing challenge for the payments industry is the concern that bias is unconsciously being incorporated into new solutions that are based on AI and machine learning capabilities. As referenced in the previous Project Futures whitepaper, 'Data proliferation and the use of data to drive payments innovation', the primary composition of developers creating these solutions tends to be skewed towards the white male demographic. This has the potential to lead to solutions that are themselves biased, since the training of their models has not included a wide range of subjects. With this in mind, and considering the cultural and market perceptions towards credit and lending services, this could prove to be a potential challenge for organisations that are adopting a global implementation of solutions that are incidentally incorporating such biases. With AI and machine learning systems being utilised to assist loan underwriters when deciding whether to lend money to customers, biased AI solutions could lead to certain demographics or cohorts being excluded. The industry should, and is (for example the Women in Identity[21] group), doing more to incorporate a wider diversity across AI and ML experts producing these solutions, fostering initiatives across academia to encourage new talent into the industry. Further to this, there is a conscious focus on incorporating and utilising more diverse machine learning models to track and make decisions more reliably.

Commercial

For many organisations, the elephant in the room is GAFA (Google, Amazon, Facebook, and Apple) as a conglomerate that could threaten their consumer base and revenue lines. We have already seen that GAFA have started to make a play into financial services generally; Facebook have launched and retracted P2P payments into their messenger app, Apple allows users to send money to each other using iMessage and have launched Apple Pay and the recent card in conjunction with Goldman Sachs, Amazon have even delved into the SME lending space, and Libra presents a compelling opportunity within the cryptocurrency space. Further to this, GAFA has a distinct advantage when it comes to consumer engagement, generating hyper-personalised engagement and a bespoke user experience, and continuously innovating the ways in which they interact and leverage the data of the users to provide better engagement models. However, recent high-profile data issues have raised concerns regarding the use of data by these organisations – particularly notable by Facebook's recent fine of $5 billion following the Cambridge Analytica data scandal – in which the data of millions of Facebook users was harvested without their consent and used for political advertising purposes. There are questions as to whether such fines and the reputational impact of such incidences will modulate their behaviour and security around consumer data.

In terms of business models, the challenge for organisations is where they should set their strategic direction and what services they should offer. The FinTech uprising stems from entrepreneurs exploiting valuable, niche opportunities that were not being served or serviced well by large incumbent players. This has allowed a vast array of EMIs, PIs, and new challenger banks to emerge at a high valuation and breadth of users, relative to their size and trading history. However, as these have proliferated over time, there is an increasing need to create further unique-selling points to their competitors. This then lends itself to several questions on further growth. Do they continue to remain specialised, and

if so, how do they enhance their current revenue streams, as becoming broader in their focus can increase the pressure on maintaining operational resilience and providing adequate customer support. Do they remain solely consumer-focused or do they make waves into the SME and B2B space? One interesting model is Revolut, who continue to offer an ever-increasing broad product range, the latest being stock trading. Although it can be seen as diverse, there is still a nod to the core offering as it commission free, which echoes Revolut's original proposition of providing fee-free currency transfers.

"The FinTech uprising stems from entrepreneurs exploiting valuable, niche opportunities that were not being served or serviced well by large incumbent players."

Whilst these questions around strategy persist, the larger traditional banks are increasingly adapting by offering services to challenge the newer FinTechs and changing legacy mindsets. Whilst they may still have issues with legacy infrastructure, the reality is that they are becoming increasingly comparable and still retain a larger user base. Further to this, the diversification of the market means that a user's transactional spend is spread across a variety of different account providers. The increasing trend towards non-loyalty from consumers means that financial institutions can't rest on their laurels and must do more to retain their demographics. The question for FinTechs is: How do you get a larger slice of the pie?

"One of the critical challenges for the payments industry is encouraging younger generations to embrace credit. Research shows that credit cards are less popular among millennials than they are among older generations."

Users are pulling towards frictionless payments whilst industry seems to be adding friction into the payments experience, some of which is being enforced through the mandatory adoption of Strong Customer Authentication. Again, legacy infrastructure and a lack of understanding of the customer base is at fault here, as organisations who are relying on SMS OTP are scrambling to find up-to-date mobile numbers for their customers, or look to alternative (non-compliant) methods such as sending knowledge-based challenges to an email address or landline. Digital-first banks such as Monzo lead the way here in terms of a biometric offering and are obviously at an advantage by knowing their customer's phone capabilities via the on-boarding stage. The FCA will surely look to reconcile these different approaches as part of its phased transition for SC[22], and will also be monitoring banks with a more diverse clientele, who must look to support those without access to a mobile phone.

Social

There is an increasing need to provide financial education to the next generation, who make the association with the goods rather than money. This stems from the digital or non-physicality of money which rids it of the emotional attachment that you have with cash or from making a physical transaction. Digital currency is, in essence, just a number on a screen. It could be argued that the modern day 'now' culture is losing an understanding of money as a tangible asset. This was one of the driving forces behind the prepaid card gohenry, according to its founder Louise Hill[23].

One of the critical challenges for the payments industry is encouraging younger generations to embrace credit. Research shows that credit cards are less popular among millennials than they are among older generations[24]. It can be argued that this stems from the cultural experience of money during youth, and their risk appetite for debt. For members of the millennial generation growing up, using debit cards as a means of payment had become a normality and would likely have been

issued a debit card upon opening an account[25]. This is a stark contrast to older generations, who would have grown up with cash and cheques as a primary payment methodology, that experienced the immediate convenience of credit cards as a 'quick-and-easy' payment method that also provides a convenient way of receiving credit. With the speed of transaction ever increasing across digital payment methods, younger generations will likely opt for debit cards as a primary means of payment rather than credit cards. Furthermore, they may also see debit as offering benefits over credit as they are able to avoid the financial risks of debt. Consumer groups such as Moneysavingexpert continue to educate people on the advantages of Section 75[26] and with company insolvencies on the increase[27], consumers more than ever need to be aware of the protections offered by their credit card.

However, avoiding credit presents a number of inherent challenges and can be damaging in the long term. With no credit history, the credit rating of a consumer is likely to be low as there are no proof points of the capability of a consumer to borrow and pay back responsibly. Further to this, avoiding this financial risk does not mean that the younger generation is seeing a reduction in debt. With rising student loan debts and the increasing cost of living, they are likely to have a lower amount of capital available and a reluctance to borrow further. This has led to the rise in younger demographics turning to payday loans to provide a short-term solution, with 51% of millennials (ages 22-37) and 38% of eligible Generation Z (ages 18-21) having considered taking out a payday loan, and with 8% of Gen-Z and 13% of millennials having taken out a payday loan in the last two years[28]. This is a double-edged sword, as payday loans can actually make things worse in the long term as the high APR associated with them makes them harder to pay off than a conventional loan, thereby worsening a consumer's credit score.

In an increasingly digital society, financial services organisations should look towards mobile platforms to provide financial education to consumers. The vast majority of banks, including established players and the challenger/neo-banks, are offering user friendly mobile banking applications. Mobile banking, if harnessed correctly, has the capability to provide financial education to consumers on the value of money and educate consumers on how to use credit and lending services, but without incurring the high cost of educating consumers through more traditional channels (branch advisors, television and radio advertising etc.).

One argument that arose within the workshop focused on the role of financial services regulators in providing consumer education on money management. The remit of the FCA is fundamentally to ensure an appropriate degree of protection for all consumers. General education to consumers on financial management is not truly within the scope of the FCA. However, the FCA does act to ensure firms have their customers at the heart of how they do business, so may have the capability to encourage or set a direction for account providers to issue practical guidance to consumers on credit and lending services.

Regulatory

SCA is being driven primarily by fraud levels. Whilst there is a term for "friendly fraud", ultimately whatever the root cause, the consumer will always pay for fraudulent transactions, the bank passing down costs through fees or adjusting rates (i.e. lower savings or higher lending APRs).

Over the course of the last year, the payments sector has been subject to a number of regulatory changes and organisations have found increasing pressures to keep up with these new compliance and reporting requirements, as evidenced by the need to phase the rollout of SCA rules. As such, if all organisations are focused on adhering and becoming compliant to a raft of regulations, it can impede the capability of an organisation to innovate either around or with the regulation and thereby preventing them from leading the way in the market and ultimately raising the expected standard for PayTechs and FinTechs.

However, technology develops quickly and is typically far in-advance of regulation. Today's best practice is tomorrow's regulation. With that in mind, are regulators moving quickly enough? And if not, how can industry work more collaboratively with the regulator to ensure that developing regulation does not act as an anchor holding back innovation. In the UK, the payments industry and trade associations have been very proactive in engaging with the regulator. However, there is variance in the level of engagement across Europe. Going back to the SCA example, this will cause problems if adoption and enforcement is phased at different times amongst member states, with different competent authorities having their own view.

"Crowdfunding valuations are not policed and so organisations can claim a high valuation with nothing to validate it. Whilst the FCA highlights that you should only invest money you can afford to lose."

It can be postulated that it is easier for organisations to raise capital through crowd funding rather than using traditional routes of seeking venture capital or recruiting angel investors. An emerging theme in the workshop was the role of the regulators in regulating crowdfunding activity. Whilst crowdfunding platforms can provide high returns[29] in comparison to other funding methodologies, there is a greater risk of capital losses. In the UK, the FCA regulate both loan-based crowdfunding ('peer-to-peer lending') and investment-based crowdfunding in which consumers invest directly or indirectly in new or established businesses by buying investments such as shares or debentures. Consumers who invest via loan-based crowdfunding platforms do not have access to the Financial Services Compensation Scheme, and the FCA strictly notes to consumers that their capital will not be repaid and/or dividends will not be paid if the company you invest in defaults or there is a fraud. In the case of the latter, this presents a fundamental challenge to consumers. Crowdfunding valuations are not policed and so organisations can claim a high valuation with nothing to validate it. Whilst the FCA highlights that 'you should only invest money you can afford to lose', it could be argued that there should be some form of regulation to prevent disingenuous portrayals in crowdfunding platforms rather than letting the liability sit solely on the consumer, who are often ill-equipped to interpret a company's balance sheet. Furthermore, the regulator could have a larger role to play in providing guidance and education to consumers on the level of risk across loan-based crowdfunding and investment-based crowdfunding. Similarly, industry bodies and trade associations also have a pivotal role to play in driving consumer education. ■

Footnotes:

21 https://womeninidentity.org/

22 https://www.fca.org.uk/news/press-releases/fca-agrees-plan-phased-implementation-strong-customer-authentication

23 https://www.telegraph.co.uk/connect/small-business/gohenry-family-finances-became-business/

24 Experian, State of Credithttps://www.experian.com/blogs/ask-experian/state-of-credit/

25 UK Finance, UK Card Payments Report 2018 (https://www.ukfinance.org.uk/system/files/UK-Card-Payments-2018-Summary.pdf)

26 https://www.moneysavingexpert.com/shopping/section75-protect-your-purchases/

27 https://www.begbies-traynorgroup.com/news/business-health-statistics/484000-businesses-in-significant-distress-as-consumer-facing-sectors-falter

28 CNBC, CNBC Make It Survey 2018 (https://www.cnbc.com/2018/08/01/1-in-3-college-age-americans-consider-payday-loans.html)

29 https://www.growthbusiness.co.uk/revolut-generates-19x-return-for-crowdfunding-investors-2554741/

Case Studies

A business strategy that is certainly not unique to Fintech is where a firm flourishes by identifying a consumer need that was previously under-served by the traditional providers.

One example is Hello Soda, who add value where existing infrastructure is underserving certain demographics, such as those coming of age or new to a country, who would have a thin credit history and minimal ways of verifying their identity. Hello Soda use (amongst other things) social media presence to enhance customer identity checks and have been successful in uncovering fraud rings, where a customer's identity did not correlate with the corresponding online footprint that they would have expected for a typical customer profile. This is something that a bank with traditional KYC policies would have never spotted.

Another need being exploited is integration into the point of sale and getting in front of the customer, with Klarna a good example of a company growing in an ever-saturated market. Whilst buy-now-pay-later as traditionally been the target of catalogues, white goods and life-essentials, changing habits have meant that this model is now commonplace for mundane, leisure and consumable purchases such as fashion and digital goods. It's also worth noting that with this model, the merchant is paying for the privilege of offering these options, but in return is enjoying increased customer loyalty, basket size and conversion. This is now the acceptable face of credit for the younger generation; we have already mentioned the FCA's policy statements regarding buy now, pay later; it remains to be seen whether affordability is being taken into account with these firms and whether a debt spiral time bomb is ticking. We have identified how it is now possible for firms to draw on spending habits to create more meaningful credit scores; an intelligent and responsible lender could for example, correlate an increase in

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deposits at a gambling company followed by a loan application and act accordingly.

A business strategy that was more up for debate was whether you should acquire, compete or collaborate to increase your product offering. Mastercard are seemingly doing all 3, with the afore-mentioned purchase of Vyze, on top of their own instalment offering[30] and collaboration with various fintechs in the lending sector31.

Another commercial conundrum was the question of specialisation or diversity. Being strong with the underlying core technology increases your potential to provide value-added services. A good example is Ovo who

"Banks are falling behind in the consumer-facing space as TPPs become the interface to the consumer and the bank "simply" providing a core plumbing service; the TPP enhancing the experience using the richer data set."

are another company set to introduce pay later[32] capability, but their core product has grown out of wallet, loyalty, mobile top-up and bill payments. This latest offering will open up a new range of collaboration opportunities with banks, where the partnership trend to drive innovation in lending shows no sign of slowing, thanks in part to PSD2 which apart from fraud reduction, was also focused on driving competition.

Collaboration also plays a part in de-risking reputational damage, for if the project does not work, the failure is not solely reflected on the incumbent's brand. It's also a fast way to enter a new market, as seen with a move made by HSBC[33], who partnered with Avant in the personal loans space as a way of entering the US market. A similar thing is happening in the commercial lending market with Tungsten & C2FO acting as the network and intermediaries, whilst the underlying credit and liquidity is being provided by a traditional bank such as Citi or JP Morgan.

Although we are seeing some of these trends thanks to PSD2, an unintended consequence is the increased disintermediation by the bigger tech firms that are under less regulatory pressure. Banks are falling behind in the consumer-facing space as TPPs become the interface to the consumer and the bank "simply" providing a core plumbing service; the TPP enhancing the experience using the richer data set. Of course, there is nothing to stop the banks doing the same thing, but it is not their traditional speciality. ■

Recommendation Section

The final session of the day involved each group looking at a market situation or customer need in the lending space, then coming up with a commercial opportunity or technical solution to match it. Whilst entire business plans could not be created, the tables provided some valuable insight that could be used as a starting point for innovation based on market trends There were common themes across all tables, with the following ideas key to creating a meaningful commercial proposition:

- Appropriate collaboration between fintechs and incumbents, with each one playing to their strengths. As well as overcoming technical debt, clever use of trusted brands as the customer-facing link to the consumer, whilst the specialist provides the underlying service. There is an opportunity to innovate in the mortgages sector within the UK which still relies heavily on paper-based identity. The fintechs and challenger banks don't necessarily have the financial base to offer the loan but are keener and better placed than the incumbents to offer a better experience.

- Use of rich data, especially to identify seasonal trends. In the energy sector for example, people are in credit during the summer and in debit during the winter. Similarly, in the SME space, plumbers as an example would have a requirement to stock more parts during the colder times of the year so intelligent use of reserves and revolving credit should reflect this. The travel sector also has its own seasonal variations that can be exploited, again using a brand for the consumer front and a specialist for the underlying core service.

- Intelligent customer service and debt recovery, again drawing on seasonal trends or fraud patterns. Chasing for debt associated with fraud can be a waste of resources and understanding the reason for default can be time better spent than recovering the funds. ■

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Notes

About FICO, Benefactor of Project Futures

FICO (NYSE: FICO) is a leading analytics software company, helping businesses in 90+ countries make better decisions that drive higher levels of growth, profitability and customer satisfaction. The company's ground-breaking use of Big Data and mathematical algorithms to predict consumer behaviour has transformed entire industries. FICO provides analytics software and tools used across multiple industries to manage risk, fight fraud, build more profitable customer relationships, optimize operations and meet strict government regulations.

With thanks

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