FinTech Lending in Sub-Saharan Africa

OECD Background Report – Main Findings

Digital Finance in Africa Policy Workshop


FinTech lending in Sub-Saharan Africa

Lessons from African economies

OECD

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Structure of OECD Background Report

- Drawing from OECD countries' experience
  - Marketplace and FinTech lending for SMEs in the COVID-19 crisis (OECD 2022)

Background Report Contents

- Market trends for FinTech lending in Sub-Saharan Africa (SSA)
- Potential benefits and risks of FinTech Lending for SSA economies
- Policy and regulatory trends of FinTech lending in SSA
- Policy considerations for SSA, drawing from the experience of OECD economies.

FinTech Lending in SSA: Market Trends

- Broadly defined as business models in which prospective borrowers can apply for loans via online platforms
  - Usually operated by non-bank financial institutions
- Rapid growth of SSA FinTech lending activity driven by
  - widespread adoption of mobile technology and digital payments, which has paved the way for usage of all digital financial services for innovation (incl. innovation facilitators)
  - increased access to capital due to attention from investors
  - growing demand from largely unbanked population.
- E.g.: Nigeria is home to over 250 FinTech companies[1], half of which provide payment services
  - 15% of Nigerian FinTechs are focused on SME lending[2]
- E.g.: Kenya, digital lending has grown over the past decade such that the Competition Authority of Kenya estimated several hundred lenders operating in Kenya even pre-COVID19
- While P2P lending has the largest market in Kenya and South Africa, and increasingly Nigeria, 90% of online alternative lending comes from companies headquartered outside of SSA[3]
- New crowdfunding models in SSA emerging through partnerships between global crowdfunding platforms and local FinTechs

[12]CGAP (2022), *BNPL in Nigeria: Emerging Fintech Innovations for MSEs | Blog | CGAP*
[3]Pervez, O. (2022), "The Fintech Landscape in India and Africa: A Primer", *ORF Issue Brief No*, Vol. 584

FinTech Lending in SSA: Business Models

Payday lenders

- Short-term, high cost, unsecured loans that are due by the next “payday”
- Popularity extends from their ease of access and short-term commitments
- Due to often exorbitant fees charges by many payday lenders, borrowers often become trapped in cycles of debt

Telecom players and MNOs

- Using extensive existing infrastructure of mobile networks and a broad user base, allowing to reach a large population quickly
- Leverage the ubiquity of mobile phones to deliver financial services directly through mobile platforms
- Leverage data from mobile usage patterns, airtime purchases, and other telecommunication activities for credit scoring and risk assessment
- Possible advantage of debt enforcement over commercial banks due to access to borrower cash flow through existing mobile wallets

Buy Now Pay Later

- Short-term financing in which consumers can pay for goods or services over a period of time
- Extant in the region through informal agreements between wholesalers and retailers or distributors and customers
- Two approaches: one involving modest loans for retailers, one for straightforward credit to SMEs and individuals

FinTech Lending in SSA: Adoption

- **Indicative figures around FinTech lending uptake in SSA:**
- **2 million** adult individuals in Kenya borrowing from **unregulated digital lenders** as of 2019, compared to 200,000 in 2016[1]
- 2% of Kenyan adults use loans from unregulated digital credit providers, compared to 8.6% borrowing from mobile banking-enabled lenders and **16.9% from mobile network operators** (as of 2021)[2]
  - Digital credit utilization is more pronounced among young individuals aged 18 to under 35, as well as among urban dwellers and those with higher levels of education.[3]

- Higher default rates associated with borrowing also indicate the varied success of FinTech lending practices in SSA jurisdictions**:**
  - **50.9% of people who borrowed loans through mobile banking apps** and 46.3% of people who borrowed from digital app loans reported to have **defaulted repayment (**as of 2021)
  - compared to borrowers who had a default rate of 30.8% from microfinance institutions, 22.5% from government credit institutions, 22.1% from banks, 16% from saving and credit cooperatives, and 34.4% from social groups[4]

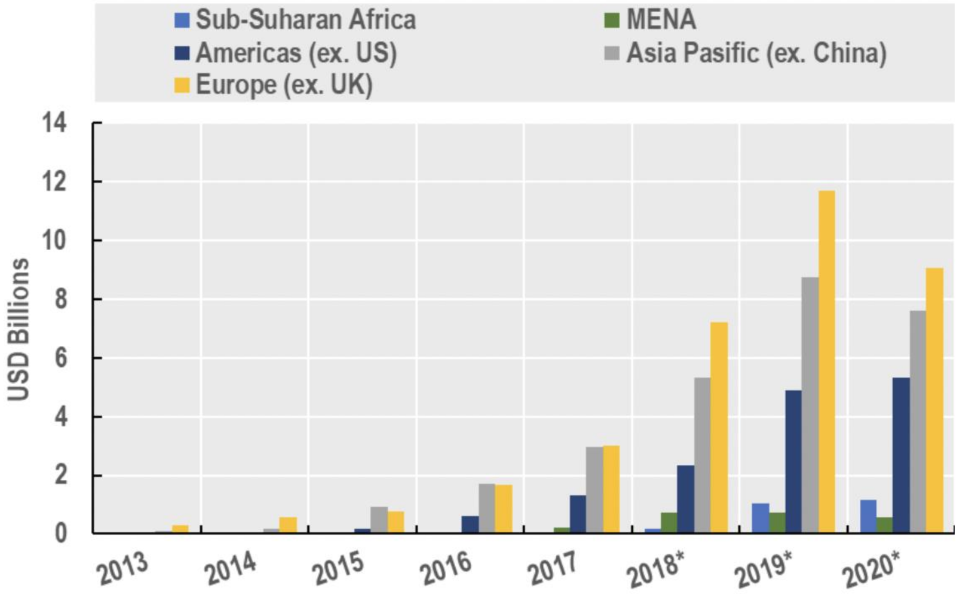
- While digital credit usage has increased over the last decade, **credit penetration overall in SSA remains low**
  - Compared to a global average credit penetration of 19%, it stands at 6% for Kenya and 9% for South Africa.[5]

[123]Central Bank of Kenya (2021), “Bank Supervision Annual Report 2021”

[4]KIPPRA (2023), *Regulation of Digital Credit Providers in Kenya: Policy Issues and Options – KIPPRA*,

[5]McKinsey (2022), *Fintech in Africa: The end of the beginning.*

Yearly FinTech Lending Flows by Region (2013 – 2020)



Source: Cambridge Center for Alternative Finance (2021).

Potential Benefits of FinTech Lending in Sub Saharan Africa

Potential for Improved Efficiency and Productivity Gains

Lower operating costs

Less capital and liquidity requirements

Flexible funding distribution

Faster processing

Potential for Promotion of Financial Inclusion

Credit for segments unserved or underserved by incumbent financial

Broader physical reach

Higher scale due to lower costs with increased automation

Can increase the size of the pie

Opportunities for Alternative Credit Worthiness Assessments

AI-based models and big data

AI for fraud detection

Potential to improve underwriting processes

Opportunities for Supporting the Public Sector

Access for support schemes for SMEs or underbanked individuals

Potential for role in government credit schemes

Further consideration needed given role in fraudulent loan schemes

Potential Risks of FinTech Lending

Systemic risks

- Possible risk of relaxed underwriting standards or use of untested credit scoring methodologies could compromise asset quality or result in higher level of loan defaults
- Potential risk of targeting vulnerable borrowers and underpricing their risk
- Lack of validation of models across a complete credit cycle
- Funding instability and insolvency risks

Risks of Regulatory Arbitrage

- Due to regulatory fragmentation and pace of innovation
- Risk of misaligned interests and moral hazard
- Platforms using their own balance sheet exposed to credit risk due to lack of financial safety mechanisms

Consumer Protection

- In case there is lack of oversight, absence of appropriate disclosure practices, information asymmetry
- Limited online disclosure of terms and conditions and lack of transparency
- Loan defaults possible due to ease of borrowing
- Risk of discrimination through use of alternative data, despite numerous benefits

Policy and Regulatory Trends: OECD Countries

- In most OECD countries, FinTech lending activity is regulated through **existing regulatory frameworks**
  - Depending on the specific type of FinTech lender, certain jurisdictions are also adjusting existing frameworks or introducing new policy measures in response to this activity
  - **85 countries have introduced MPL-specific regulation** compared with 113 that did not, with a majority of this regulation coming from high-income countries[1]

- Empirical findings indicate that, in some cases, **tailored regulatory structures for alternative finance allow for a broader range of permissible activities compared to pre-existing frameworks, while also establishing clearer obligations**
  - Out of a list of 20 types of requirements, respondents of a survey reported the average bespoke framework for P2P lending encompassed 9, compared to 5 requirements in pre-existing frameworks[2]

- To date, most legislative actions have targeted **P2P lending** rather than **balance sheet lending[3]**
  - Due to its resemblance to traditional lending intermediation, balance sheet lending frequently finds itself within the scope of existing regulatory frameworks

- Due to their significant potential in helping improve access to finance for MSMEs, **countries are increasingly seeking to cover crowdfunding platforms in their legal and regulatory frameworks[4]**
  - P2P lending platforms can help connect investors with borrowers or corporates seeking to raise funds
  - Covering both equity or debt financing

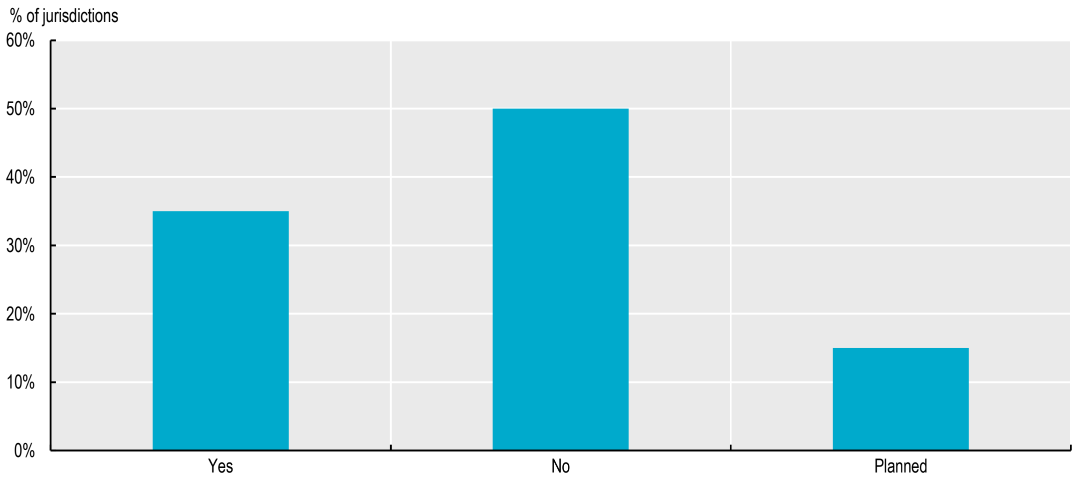
[123]OECD (2022), "Marketplace and FinTech lending for SMEs in the COVID-19 crisis", *OECD Business and Finance Policy Papers*, No. 02,
[4]Feyen, E., H. Natarajan and M. Saal (2023), *Fintech and the Future of Finance Market and Policy Implications.*

Policy and Regulatory Trends: Sub Saharan Africa

- Regulations for digital lending are uneven compared to those for payments
  - E.g. Kenya have launched digital lending-specific regulations
  - Other SSA countries are in the early stages of developing them (AFI)
- Existing legislation may also be considered sufficient for regulating FinTech lending
  - Certain regulators have aimed to introduce ‘light-touch’ regulation for market stimulation
- Other measures also introduced: e.g. **imposing limits on lending volumes and/or confining usage to certain categories of 'sophisticated' or high-net-worth borrowers**
- According to the Cambridge Centre for Alternative Finance, **50% of the sampled jurisdictions in SSA do not have an agency with a mandate to oversee P2P lending activities**[1]
  - Countries that do have such a mandate are likely to locate these within central banks, compared to other regions such as the Asia Pacific, where only 21% of central banks had mandates in such cases[2]
  - Regulation for P2P lending appears to coincide with increased market activity: Enhanced regulatory clarity may help bolster firms’ confidence in developing their propositions (CCAF)
- **Two noteworthy approaches for regulation of digital credit**:
  - (a) formal **regulations specifically tailored to digital loan services** for each type of financial institution (e.g. West African Countries Central Bank (WAEMU), which categorizes any digital credit service as a banking product); and
  - **(b) “test and learn” approach** that formulates decisions based on the outcomes of DFS products that have already been brought to market (e.g. Bank of Tanzania)

[12]CCAF (2021), *FinTech Regulation in Sub-Saharan Africa | Cambridge Centre for Alternative Finance*

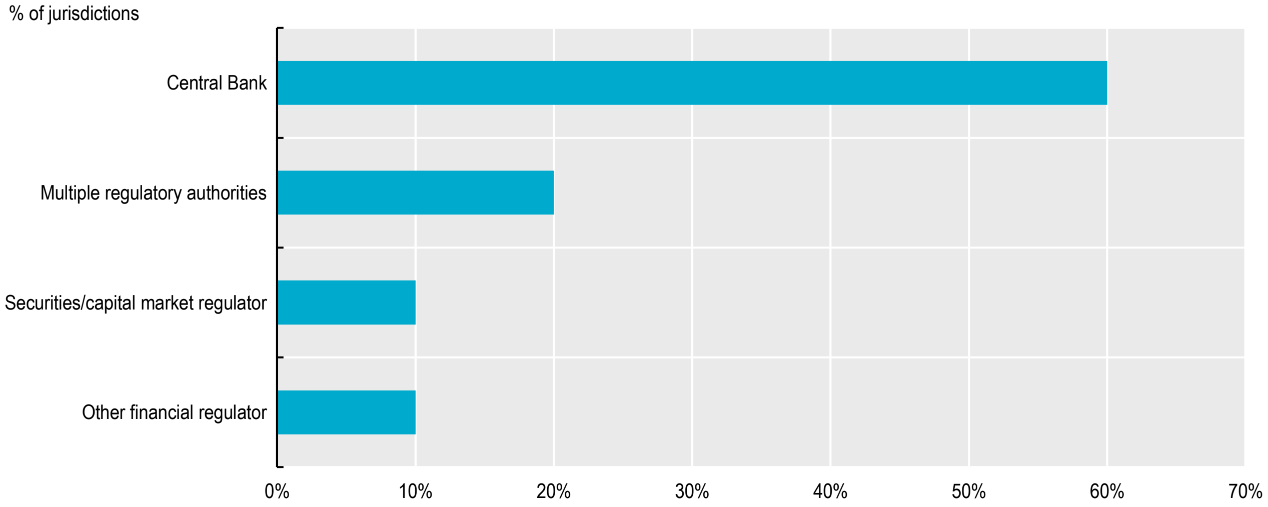
SSA jurisdictions with mandate for P2P lending (n = 20)



Note: N denotes the number of jurisdictions surveyed.

Source: (CCAF, 2021)

SSA regulators with mandate over P2P lending (n = 10)



Note: N denotes the number of jurisdictions surveyed.

Source: (CCAF, 2021)

Policy and Regulatory trends: Examples of Regulatory Frameworks in SSA

Kenya

- Central Bank of Kenya (Digital Credit Providers) Regulations, 2022 require all persons establishing or carrying out digital credit business in Kenya to be licensed by the Bank in accordance with the regulations or to be regulated by any other written law
- Cover the governance of digital credit providers and require providers to disclose both positive and negative credit information of customers to licensed credit reference bureaus
- Limit digital credit providers from inviting/collecting deposit and requires providers to only access and collect customer information as needed

Tanzania

- Bank of Tanzania (BOT) operates a “mandate and monitor” approach towards FinTech. Governance of digital credit is regulated by the same regulatory framework that applies to all financial services providers
- Microfinance (Non-Deposit Taking Microfinance) Regulations 2019 govern the provision of digital credit and regulates interest rates for digital credit. The Microfinance Regulations also emphasise the disclosure of interest rate details in loan agreements.
- Part XI of Tanzania’s Electronic Money Regulations 2015 require mobile money issuers to “display and disclose charges and fees for their services to customers and any changes thereof

South Africa

- Follows an activities-based regulatory model, with its National Credit Act (NCA) often hailed as the 'gold-standard' across SSA due to its strong focus on consumer protection
- The NCA governs all credit providers, including banks, retailers, non-bank financial institutions (NBFIs), and other entities, that extend credit beyond a specified threshold or volume, as well as all consumers.

Nigeria

- Limited Interim Regulatory/Registration Framework and Guidelines require all lenders operating via digital platforms to register with the FCCPC

Preliminary policy considerations

Monitor the market for such products

- Monitor the evolution of the market for such activity
- (incl. for regulatory arbitrage)
- Anticipate and manage **emerging risks**

Market Conduct and Consumer Protection

- **Monitor conduct risks**
- **Consider strengthening of disclosure requirements (**particularly concerning conflicts of interest)
- Consider clear and comprehensive guidance that encourages **consumer protection safeguards**

Support Innovation

- **Balance the need for innovation** with the pace of regulation (where needed)
- Consider **proportionate responses** to potential risks (so as not to stifle innovation)
- Consider supportive policies and measures (e.g. **innovation facilitators),** where appropriate

Alternative Data for Policymaking

- **Harness the power of data** to improve policy developments and regulatory frameworks (incl. SupTech/ RegTech solutions)
- **Invest in data** collection to better **monitor FinTech lending growth**, leverage, and inform policy discussion and potential action.

Thank you!

www.oecd.org/finance