INSIGHTS CREDIT MANAGEMENT

Alternative lending market: data is key

Technology-led innovation will have a far-reaching impact within the sector by reshaping day-to-day processes, writes Pedro van Gaalen

Digital technologies such as artificial intelligence (AI), machine learning, robotic process automation, data analytics and blockchain are transforming the global credit management industry.

As adoption accelerates, technology-led innovation will have a far-reaching impact within the sector by reshaping day-to-day processes, offloading onerous compliance and administrative tasks from staff and creating new opportunities to engage with customers and attract and retain new business.

In SA, pockets of fintech innovation have emerged within the broader financial services market, where the alternative-lending sector is a leading developer of data-driven solutions.

"In global terms, SA is fairly advanced in using data in credit risk management," says Thomas Maydon, Head of Credit and Analytics at Principa Decisions.

"Organisations are legally obliged to use data to make prudent credit decisions when determining indebtedness and affordability. The ability to effectively identify consumers through the ID number system has allowed financial services providers to pool external data from credit bureaus with other internal sources to assess their credit risk."

A report on the impact of the fourth industrial revolution on the South African financial services market by the Centre of Excellence in Financial Services also highlights how data analytics has helped to create a thriving alternative lending sector within the local credit market.


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While credit bureau information has traditionally formed the foundation for credit scoring, innovative service providers now use alternative scoring methods that combine established data sets with new and unconventional data sources to assess risk and creditworthiness.

"More recently, other aspects of customer financial behaviour beyond credit performance have been incorporated into scorecards to ascertain factors such as their propensity to pay and establish credit limits and interest rates. All of these factors, including internal customer data analytics, are built into automated algorithms, which help to determine the credit offered to the customer," explains Alfred Ramosedi, CEO of Bayport Financial Services.

Importantly, this alternative credit risk assessment approach creates opportunities to provide lending outside the traditional banking system. This caters to market segments such as SMEs and consumers without formal credit histories or traditional records of income, which have historically been excluded from credit markets based on traditional assessments.

Transaction Capital Business Solutions aggregates credit bureau information and information available on the web to interrogate and understand the businesses it lends to. CEO Darren Abrahams says this, coupled with the firm's analysis of the applicant's financial position, enables prudent decision making.

"We have maintained loss rates at around 1% and recently introduced a risk-scoring model into our business to positively impact default rates."

And digital technology also assists lenders to improve collections and ensure regulatory compliance.

Says Ramosedi: "We use digital technology to improve our communication with customers and have created self-service capabilities via a mobile app and website that allow customers to pay their instalments, access their statements, apply for new loans and view their credit health report at no cost."

Maydon adds that more can be done within collection call centres to leverage data to improve outcomes.

"Building predictive and prescriptive analytics solutions helps providers extract insights from the mountains of historical and telemetry data they're sitting on to determine the best action, such as the best time to call a customer."

To leverage similar capabilities, Transaction Capital Business Solutions develops and tailors bespoke systems to the company's interactions with clients and debtors.

"The key to successful collections is maintaining strong relationships with the appropriate party, and having easily accessible information. There are no off-the-shelf IT platforms that facilitate the complexities of our business model, which is why we develop our platforms based on the feedback we receive from stakeholders," says Abrahams.

There is also significant innovation happening within the contact centre environment to transform customer engagements. For instance, Maydon reveals that call centres are increasingly augmenting AI into the collections and sales and marketing functions to empower agents.

"These solutions deliver insights to the agent as they speak to customers, which can inform their approach, expedite issue resolution times to enhance customer experience, or assist with cross-selling and upselling financial products such as insurance or gap cover."

And the next development emerging in the digital engagement frontier includes virtual assistants and chatbots that enable self-service capabilities. "While consumers, particularly millennials, are more open to using this form of engagement, these solutions are only as good as the data you feed them. Lenders require a good technology platform and data analytics tools to feed these AI-enabled chatbots the information they need to meet consumer expectations around engagement and increase the likelihood that they will yield the desired outcome," says Maydon.

Multilayered approach needed to manage rising fraud threats

Statistics released in 2019 by the Southern African Fraud Prevention Service revealed a rise in identity fraud using both real (99%) and fabricated (48%) identity documents compared to 2018.

The South African Banking Risk Information Centre highlighted a similar trend, with 23,466 banking fraud incidents reported across banking apps, online banking and mobile banking in 2018, which amounted to more than R262m in gross losses, along with an 18.4% rise in credit card fraud and an 17.5% increase in debit card fraud over 2017.

"To mitigate the risks posed from identity theft and credit application fraud and best serve empowered consumers, credit providers are deploying a multilayered approach to managing fraud threats, but there is no 'silver bullet'," says Keith Wardell, director of fraud, ID and acquisition for TransUnion Africa.

New research by Experian and Forrester Consulting affirms that 85% of companies polled in Europe, Middle East and Africa (EMEA) consider identify fraud prevention and detection a top priority.

However, fraudsters are both inventive and relentless, with new opportunities emerging as transactions increasingly shift online.


Mark Naicker ... need to invest.

"Many organisations feel they are locked in a digital arms race with fraudsters and recognise the need to invest in innovation and technology to manage fraud effectively," says Mark Naicker, Global Fraud Consultant at Experian.

Experian's research revealed that 51% of respondents in EMEA are planning to invest in artificial intelligence and machine learning solutions in the next three years, alongside single-access modular platforms (55%) and capabilities to prevent fraud.

Alfred Ramosedi, CEO of Bayport Financial Services, explains that credit providers also employ automation to identify risks. "Our originations processes and systems have built-in fraud triggers and we apply linking software in the background to identify potential identity fraud, document manipulation and employment misrepresentation," he says.

Wardell adds that companies are also using online and offline datasets to create a single 360° view of a consumer's personal and digital identity.

"This entails validating the consumer and the risk associated with the device they use to access digital channels. Sharing insights on fraudsters is also beneficial because collaboration, not competition, is key for credit providers to fight fraud."

Darren Abrahams, CEO at Transaction Capital Business Solutions, elaborates that this process should also include obtaining copies of proof of residence and ID documents and verifying these against the person's identity who signs the requisite documentation.

"To prevent credit application fraud, we research related businesses on the web, and also visit the actual business to ensure it exists. Another key element is the relationships we hold with our clients and their debtors through on-site visits and continuous engagement via our dedicated credit controller team," explains Abrahams.


Darren Abrahams ... relationships.

However, rising consumer expectations around customer experience and fraud prevention requires businesses strike the right balance between fraud prevention and positive, frictionless customer experiences.

Says Naicker: "Security measures that cause friction negatively impact on their experience." As a consequence, he expects the transition from legacy systems to emerging technologies, automation, advanced analytics and biometrics will accelerate to help meet the demands of friction-free fraud prevention across every channel.

Regulations to tackle overindebtedness

In the face of economic uncertainty, nonexistent growth and record unemployment, already overindebted consumers are struggling to meet their debt commitments.

According to TransUnion's Q4 2019 CCI report, which measures consumer credit health, 908,000 of the country's 58-million active consumer accounts are in arrears by three months.

However, the situation could be worse, says Thomas Maydon, Head of Credit and Analytics at Principa Decisions.

"SA has robust legislation in place, such as the National Credit Act, which has ensured that the country's overindebtedness hasn't reached unmanageable levels due to reckless lending. Without these regulations, the economy could be far worse off."


Benay Sager ... restructuring.

In an effort to further reduce overindebtedness, government recently introduced the National Credit Amendment Act, or 'debt relief' bill.

"The bill allows low-income earners to extract themselves from debt through debt restructuring if they earn a gross income of R7,500 or less per month, have unsecured debt of R50,000 or are critically indebted," explains Benay Sager, chief operating officer of DebtBusters and partner for 1Life's Truth About Money Initiative.

"Furthermore, all applicants will receive financial literacy training. It is important to note that these amendments do not automatically write off existing debt, and consumers will also not be able to apply for new credit while under debt intervention," adds Carmen Williams, director of research and consulting for TransUnion South Africa.

While the bill is not yet in effect because its implementation requires regulations that have yet to be formalised, the industry is already responding to its pending introduction.

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REDUCING EXPOSURE

"Lenders already appear to be reducing their exposure to these consumers amid concerns they won't be able to recover their money. These consumers are already finding it more difficult to access credit," adds Sager.

While these "forgiveness" bills are well intentioned, Maydon believes they simply pour cold water on an overheating radiator that inevitably boils over again.

"Lenders understand the risks when lending to this market segment, which they price in with higher lending requirements. This simply makes credit more expensive across the board, which many will incur once they're able to borrow again."

Accordingly, time will tell if these proposed new regulations will have their intended impact on overindebtedness.


Thomas Maydon ... legislation.

INSIGHTS: CREDIT MANAGEMENT

Broader access to SME funding key to economic growth

• *Banks, lenders struggling to serve this crucial segment of the economy*

As the South African government struggles to stimulate economic growth due to various structural challenges, small to medium-sized enterprises (SMEs) will play an increasingly important role in SA's economic development.

Yet micro-enterprises and the SME sector face numerous challenges. According to the World Bank Group's 2018 International Finance Corporation (IFC) report, there are an estimated 5.78-million small businesses in SA, but only 14% are formalised.

Worryingly, the sector only grew by 15% between 2008 and 2017, which reflects the low survival rate and almost stagnant growth. This is largely attributable to the difficulties SMEs experience when attempting to access finance, with 75% of credit applications rejected, while only 2% gain access to bank loans.


Guy Hosking ... digital age.

According to Nick Tuttelberg, Global Consultant at Experian, banks struggle to serve this crucial segment of the economy due to difficulties in assessing SME creditworthiness.

"Demonstrating cash flow remains a challenge for smaller businesses. Many receive small, frequent bank deposits, which makes it difficult for a lender to verify loan 'affordability', and many may not have audited financials to share at the application stage."

"Credit bureau information on local businesses, in particular SMEs, has also been limited," says Guy Hosking, chief financial officer at Retail Capital.

"As such, SMEs remain underserved and offer a significant untapped growth market."

These circumstances have created opportunities for alternative lenders and, increasingly, fintech startups to meet the demand.

"However, problems can arise when new entrants aren't headed by bankers, or those who have experience operating in markets where it can take up to five years to recoup money from defaulters," says Gary Palmer, CEO of Paragon Lending Solutions.

"Where banks focus on serviceability to judge eligibility, some newer and more cavalier lenders take a purely asset-based view. In some cases, even when solid assets back a deal, business owners are charged high interest rates — often in excess of 36% per annum — even where the loan should attract more favourable rates."


Gary Palmer ... be cautious.

Palmer says he has not seen financing deals structured like this since 2008, and warns that there is significant risk in the current lending market. As such, lenders and business owners must be cautious.

Accordingly, the need for comprehensive scoring and vetting processes to assess customer credit risk has never been greater.

/123RF — NUTHAWUT SOMSUK

"Fortunately, the digital age provides various data sources that can help to rate credit risk, with much of this data now available in real time. This empowers alternative lenders to expedite applications and approve loans in hours or days, rather than the weeks typically taken by traditional banks," says Hosking.

With the right solution, Tuttelberg says lenders can also assess payment behaviour for expenses like rent, utilities, transport and salaries, which can boost approval rates.

"Categorisation can offer real-time insights on aspects like other accounts, business interests, foreign income and even fraud."

Providing SMEs with various loan repayment options that match the business's ability to service their loans is also vital to their sustainability, adds Darren Abrahams, CEO at Transaction Capital Business Solutions.

"Providing solutions like invoice discounting and other lending products that cater to their unique funding requirements throughout the working capital life cycle is vital for the country's underbanked SME sector."


Nic Tuttelberg ... footprint.

In this regard, Abrahams says it is paramount to assess SMEs on an individualised basis. "Every business has unique working capital requirements, which is why credit assessment teams must apply innovative structuring and credit risk management to craft bespoke solutions based on the client's specific needs."

Transaction Capital leverages its database of more than 12,000 SMEs when vetting credit applications, which it overlays with aggregated credit bureau data and additional digital channels to obtain relevant financial information.

"We also partner with numerous institutions that provide assistance when lending to qualifying businesses that lack collateral to secure the loan," adds Abrahams.

And introducing new and more appropriate data sources is also helping to broaden access to finance through traditional banks.

"There are many forms of alternative data that could help build a financial footprint," explains Tuttelberg.

This access to richer data sources is driving the open banking trend globally, which paves the way for banks to offer new products and services to consumers and businesses, including SMEs.

"Open banking means that applicants are able to authorise and grant permission to their banks to share their account transaction history with other vendors," says Tuttelberg.

"This can assist entrepreneurs to demonstrate affordability, even if their credit history or data provided does not reflect the criteria desired by the finance provider."

CLEARER PICTURE

It also gives financial institutions a clearer picture of a company's cash flow and its individual cyclical circumstances for a more sophisticated and accurate assessment.

"In this way, open banking data has the potential to fuel not only SME growth, but also enable credit lenders to be more competitive."

Ultimately, if local banks, lenders and commercial institutions prepare early to embrace open banking, and are agile enough to harness open banking data through technology, they will be better positioned to make the right credit decisions and ensure clients never have to shop around for alternate offers," says Tuttelberg.

Arbitration a viable option for trade credit defaults

SA's struggling economy, record unemployment rate and rising living costs continue to dampen consumer spending.

Consequently, businesses are grappling with constrained cash flow. The resultant liquidity shocks increase the risk that businesses will default on loans and trade credit agreements.

"In the trade credit environment, nonpayment of goods sold on credit to customers is on the rise. Even with the best agreements and supporting documents at hand, taking legal action against nonpaying debtors is a long and costly process, with no guarantees of payment," says DebtSource attorney Martina Biecker.

Fortunately, third-party dispute resolution through the courts is not the only recourse for suppliers. Arbitration provides an alternative, private mechanism for dispute resolution outside the courts.

The Arbitration Act 42 of 1965 governs the process in SA. However, for the act to be enforceable, the parties must record their agreement in writing to arbitrate any dispute relating to a matter specified in their contract.

"Therefore, it is imperative that this is included in the credit agreement upfront as part of a credit application form, for example," she says.

Furthermore, parties have the security of an administered system of carefully drafted Rules for Arbitration.

"The process involves submitting a dispute, by agreement from both parties, to one or more arbitrators who will make a binding decision on the dispute," elaborates Biecker.

Arbitration is consensual, confidential and neutral as parties can choose elements like the applicable law, language and venue. The arbitrator's decision is final and can be made an order of the court.

"As such, arbitration can be a more effective and efficient process than litigation. However, arbitration can only succeed if the contracting parties are desirous about resolving their issues, and it is often overlooked or frowned upon as either ineffective or too costly," says Biecker.

Also, in many instances, the relationship between the parties in failed credit transactions has irretrievably broken down, which can create animosity.

To streamline the process and make it more appealing, a small arbitration procedure model was designed for commercial disputes related to values between R20,000 and R495,000.

The small arbitration process has its roots founded in terms of the act and is designed to be as cost effective and accessible as possible to businesses. The simplified small arbitration process requires the claimant to file a statement, which is then served on the respondent.

"The arbitrator's fees are split between the parties. The arbitrator may request a pre-arbitration to limit disputes, or will deliberate the matter based on submissions only. The parties receive the arbitrator's findings 14 days after the hearing. This offers a convenient and expeditious alternative to the delays, risks and costs associated with litigation."

Responsible lending is crucial

According to stats recently released by Experian South Africa, consumer debt totalled R1.75-trillion at the end of 2019.

Secured debt in the form of home loans (R840bn) and vehicle loans (R426bn) accounted for R1.27-trillion (72.6%) of total consumer debt, while unsecured lending — which comprises credit cards, personal loans and retail store credit — amounted to R479bn (27.4%) of total consumer debt exposure. Personal loans in particular have shown strong growth over the past 18 months as consumer demand for cash continues to rise.

"Due to the tougher economic climate and record unemployment, more consumers are accessing personal loans and other available unsecured credit facilities to support day-to-day expenses," says Jaco van Jaarsveldt, Head Innovation, Marketing Services and Consulting at Experian South Africa.

"What is concerning is that more consumers are struggling to repay these loans and facilities, resulting in increased default rates that negatively impact on their futures."


Jaco van Jaarsveldt ... demand.

Some positive news to emerge from Experian's latest report relates to the improving trend in retail store card default rates observed over the past four quarters, which indicates that both consumers and retail lenders have adopted a more conservative approach.

"Retailers implemented pre-festive season tightening in credit lending in 2018, which is now yielding results as overall industry default rates show marked improvements," says Van Jaarsveldt.

"We expect consumers to remain under pressure financially in the coming months, which will result in continued high demand for unsecured lending products.

"However, we expect lenders in the unsecured loans market to review their lending criteria to manage the deteriorating portfolio performance, which could make access to credit more difficult in the coming months."

Alfred Ramosedi, CEO of Bayport Financial Services, affirms that it is prudent for lenders to focus on credit quality, rather than grow their loan books in the current economic conditions.

"Lenders must ensure they offer credit responsibly to creditworthy consumers who can afford it. And in a more competitive marketplace, customer loyalty and consumer engagement will be key to success in this regard."