

The Digital Transformation Journey Continues



BANKING TRANSFORMATION AFRICA

15 - 16 November 2022

**Cape Town International Convention Centre
South Africa**

In partnership with

ITSCREDIT

Vasco Gil

**Managing the Risk of Digital Lending:
Exploring Buy Now Pay Later (BNPL) case**

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Seraph Network

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WHAT IS BNPL

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BNPL IN NUMBERS AND COMPARISON
WITH OTHER CREDIT PRODUCTS

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TRENDS AND CHALLENGES

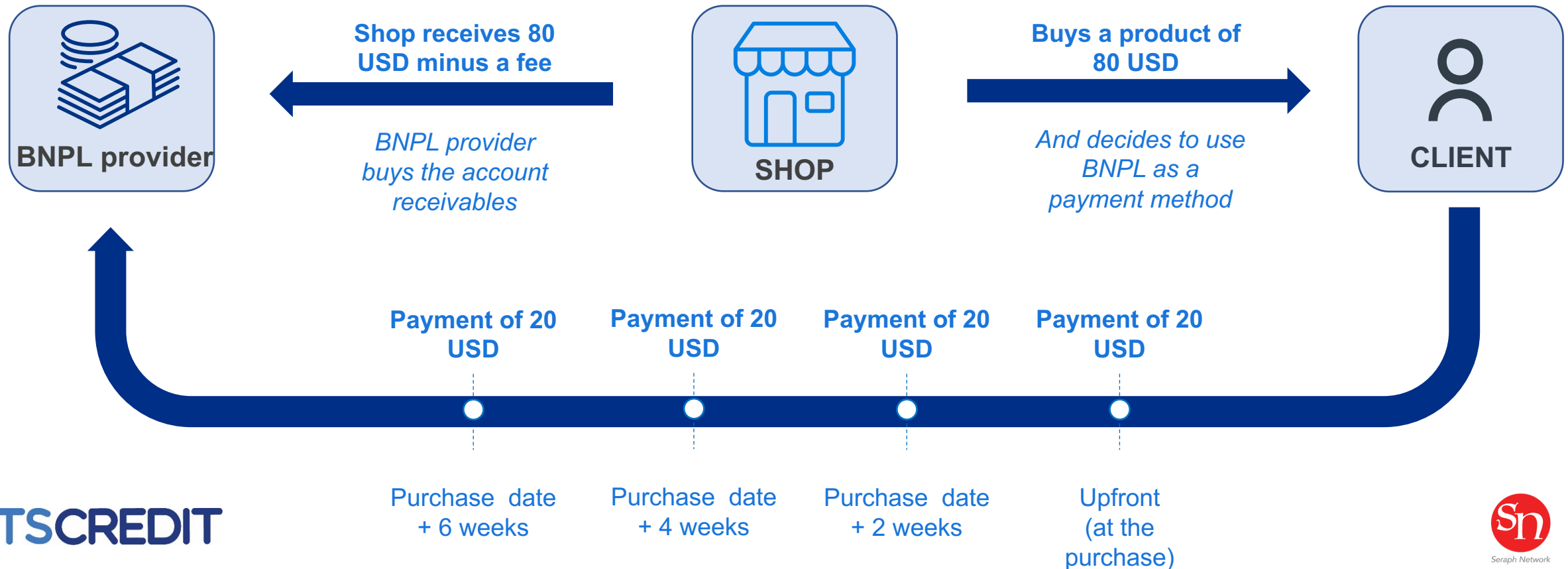
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HOW ITS CREDIT CAN HELP

What is BNPL (1/2)

Buy Now Pay Later (BNPL) is a short-term loan that is granted to clients when they are purchasing a product at point of sale (POS) physical or online merchants (e-commerce). This type of loan allows customers to purchase a product immediately and breaking their payment in equal instalments payments, usually without interest rate.

Illustrative example

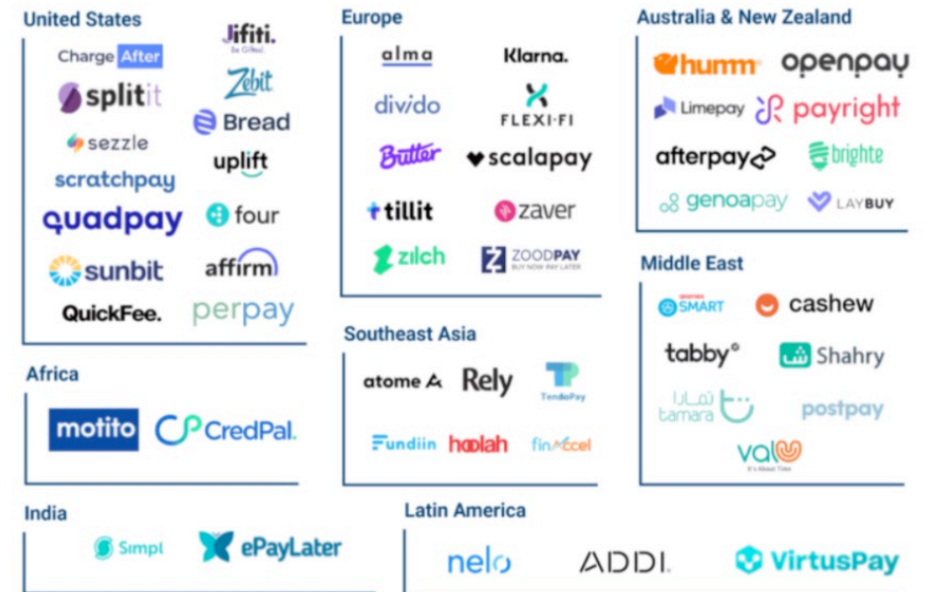


What is BNPL (2/2)

- Usually **no interest** is charged to the final customer. Some companies charge interest on the purchase or interest on failed payments.
- In a first stage the BNPL provider makes money on the “**factor fee**” charged to the merchant to acquire the accounts receivable (ranging from 2% to 8%).
- However, if a client fails payments, **late fees (or interests)** are charged and those could depend and be calculated based on several factors:
 - Fees/interests based on a percentage of initial order
 - Fixed fees per payment
 - Fixed fees structure per payment depending on the loan term
 - Fixed fees structure that are updated as the number of failed payments increase
 - Other structures

With the increase of the BNPL providers **new types of fees** have been created by some companies, namely “Account keeping”, “Establishment”, “Payment processing” fees, among others

Example of BNPL providers



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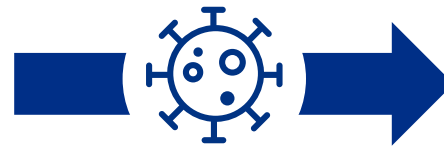
HOW ITS CREDIT CAN HELP

BNPL Popularity (1/2)

The BNPL is not new and it can be **traced many decades ago** known as installment plans, layaway programs, or payment plans as a way for consumers to buy more expensive goods they did not have the funds to buy upfront. In the wake of the 2008 crisis, the BNPL pioneers emerged but their solutions did not successfully pitch the market. Several reasons underlined the fading away of BNPL in those years.

Early BNPL years

- Merchants didn't see any demand for the product
- Consumers did not ask for it as they didn't know about that option
- Costs and resources required by merchants to integrate the BNPL solutions were very high when compared to the perceptive gains
- Higher costs for merchants when compared with other credit products like credit cards



Recent years

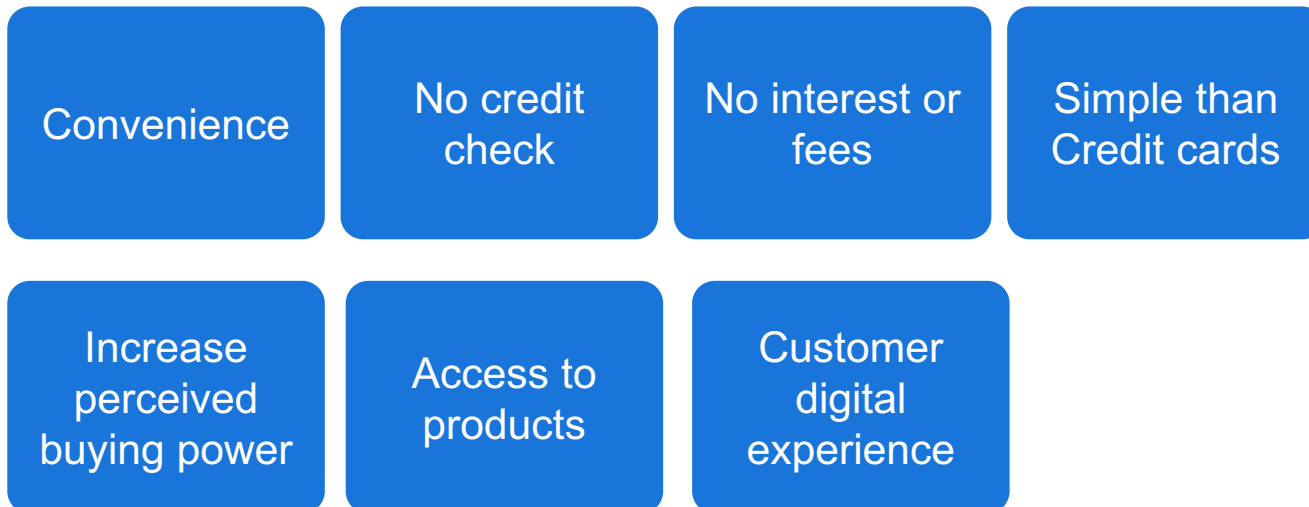
- As coronavirus pandemic evolved, consumers started spending more time in home and merchants had to change their business models to more e-commerce solutions.
- BNPL providers started investing heavily on their product visibility to consumers as well as on awareness campaigns to retailers to sell the advantages for their sales and conversion rates, even if with higher costs.
- Simultaneously, Millennials and Gen Z set the rhythm on the BNPL growth, mainly leveraged on better convenience (online shopping) and lack of alternative credit (no credit checks)

BNPL Popularity (2/2)

Main Advantages for Merchants

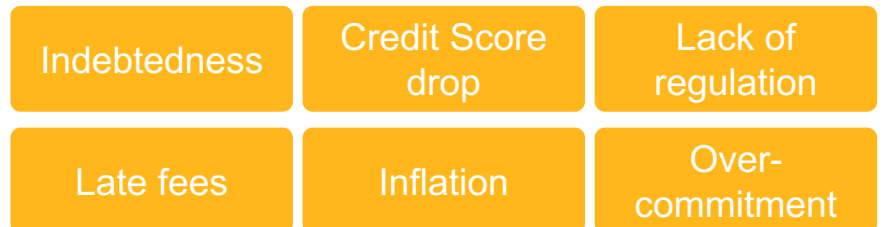


Main Advantages for Customers



Main risks

For Customers



For BNPL providers



BNPL in numbers

50% consumers have used BNPL

39% that never used somewhat likely to used in next 6 months

67% of BNPL users think BNPL could replace their credit cards

36% of BNPL users use it once a month or more

30% of BNPL users trust BNPL providers more than credit card companies when it comes to fair business practices

26% heard about BNPL in social media and 21% in advertisement

47% of BNPL users said that used it to buy electronics

- 43% to buy Clothing and fashion items
- 31% to buy furniture and appliances
- 28% to buy Personal care items or cosmetics
- 27% to buy Household essentials
- 24% to buy groceries

45% of BNPL users said they use it to make purchases that don't fit in their budget.

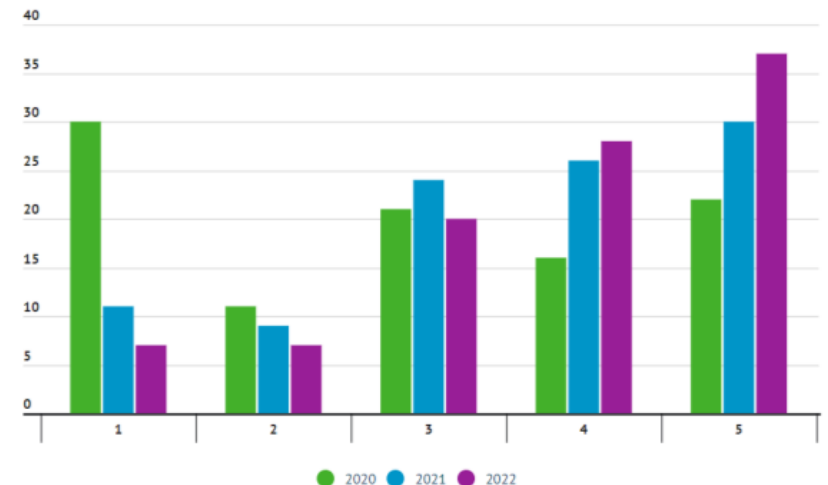
- 37% to avoid payment CC interest
- 21% to borrow money without a credit check
- 14% as can't get approved for CC

33% have made a late payment or incurred a late fee

47% are at least somewhat likely to make a late payment within the next year

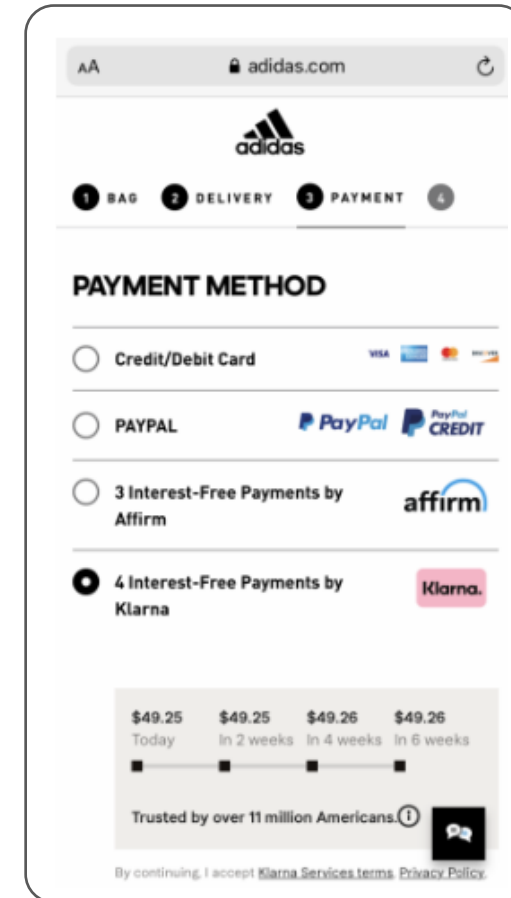
How well do you understand buy now, pay later?

Respondents were asked to rank their understanding of the terms and conditions of buy now, pay later services from 1 (I don't understand the terms and conditions at all) to 5 (I understand the terms and conditions very well).



Comparison

	BNPL	Credit Cards
Interest rate/ Fee	Usually no interest rates applied. No fees for clients not failing the payments, but high fees for late payments.	No interest if paid in full every month. High interest rates if balance is carried for the next month. May have a variety of fees
Credit Checks	Usually no credit check neither good score required	Always requires credit check and good credit score.
Merchant acceptance	Is not available for all purchases	Widely accepted by mostly all retailers. Includes offer rewards and other benefits
Transfer of cost to clients	Retailers cannot pass BNPL cost to costumers	Retailers can charge customers cost for using CC
Regulation	Unregulated product. Lack of oversight, regulation and consumer protection laws	Consumer protection laws & product regulation
Client Score impact/ report to credit bureau	Can't improve the client's credit score but can damage it in case of late. Only late fees are reported to credit bureau.	Can improve/worsen the credit score depending on payment behavior. On-time/late payments reported to Credit bureau.
Payment frequency	Payment usually every 2 weeks. Higher flexibility and longer repayment periods.	Payment once a month. Lower repayment periods.
Simplicity/ complexity	Simplicity and clarity in terms of the value to be paid and the corresponding dates	Complexity of the product. High balances can be difficult to manage.
Market View	Seen as an innovative product but with recent problems partially damaging the reputation	Seen as an "high debt" product, and as an old payment method by new generations.



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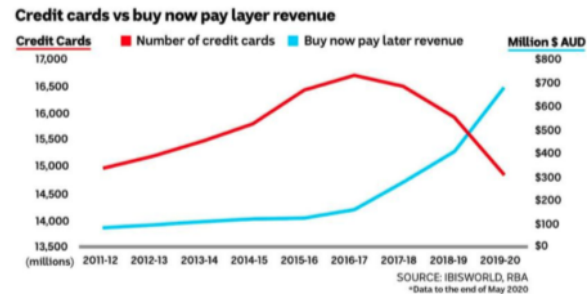
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HOW ITS CREDIT CAN HELP

Recent Trends

Although the rising popularity of BNPL, in the last year/year and a half several BNPL providers have registered high losses due to inability of their customers to repay their purchases. While the worsen of the macroeconomic environment and cost-of-living is playing a part, the BNPL market has been hit stronger than credit cards which have shown more steady and flat default rates (according to Fitch Ratings).

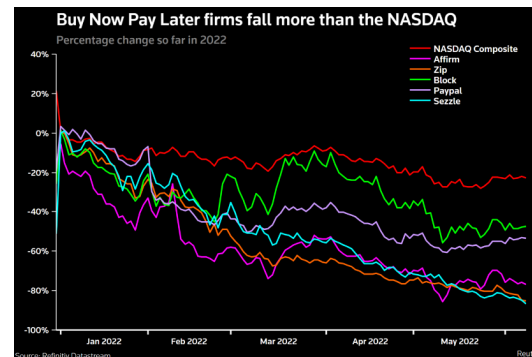
Increase volume



Afterpay vs. Mastercard stock performance in the past year

...but with...

Increase of credit losses & interest rates & Regulation



'Buy now, pay later' stocks slump as U.S. consumer watchdog seeks more regulatory oversight

Higher interest rates threaten the buy now, pay later bubble Sep/22

Klarna seeks to shed more workers Sep/22

Klarna losses quadruple as costs rise Aug/22

PayPal cuts back growth plans, again Apr/22

The Zip share price had another horror month. How much did it fall? Oct/22

Stock Down 93%, Affirm's BNPL Model Suffers As Funding Costs Rise Jun/22

Openpay closes operations in the US market Jul/22
Apr/22

Bad debt blowout fuels massive Afterpay loss

The future of BNPL (1/2)

The recent trends will contribute on the short-term **for significant challenges** that will lead the BNPL industry to undergo major shifts in the upcoming months and years.

REGULATION AND SUPERVISION

Start of more regulatory scrutiny will **increase requirements and costs** and could limit current advantages (CFPB in the US, Consumer credit directive EU and FCA in UK) . Can also be seen as an advantage as it contributes **to reduce reputational risk**.

COST OF FUNDING

The **pandemic, the crisis in Ukraine** as well as the consequences in terms of inflation led to a significant **increase of interest rates** which will increase the cost of funding of these companies. As contrary to Banks, they do **not have deposit structures** neither similar international funding conditions.



INFLATION

BNPL customers tend to be the near **prime and subprime cohorts**, which are the segments most likely to be most impacted by the rise of the cost of living. This will also lead to **changes on the dynamics of the object finance** within the BNPL market, with the increase of use to buy basic essential products (groceries, health, transports, utilities, etc).

CREDIT LOSSES

BNPL have focused on growth and customer acquisition and left open the door for significant increase of default rates due to the inexistence of **credit checks** or client creditworthiness assessments. This will require better assessments and investment on **strong debt collection processes**.

The future of BNPL (2/2)

Simultaneously, from a BNPL **market perspective**, structural challenges will be faced by the current and future competitors:

- **Low barriers to entry** lead to Big ecommerce, retailers or banks (e.g. JP Morgan) to offer their own BNPL solutions.
- Merchants with **more than one BNPL** solution will lead to BNPL providers to have to capture directly the client (new customized products and services, websites transformation, pre-virtual credit cards, etc).
- As losses rise in the first years of growth, not all players will be able to raise money and as all offer roughly the same core product, not all will survive contributing to **consolidation in the market**.
- Competition has intensified as **incumbent credit card** seekers moved to the defense and are now actively seeking to protect their market share.

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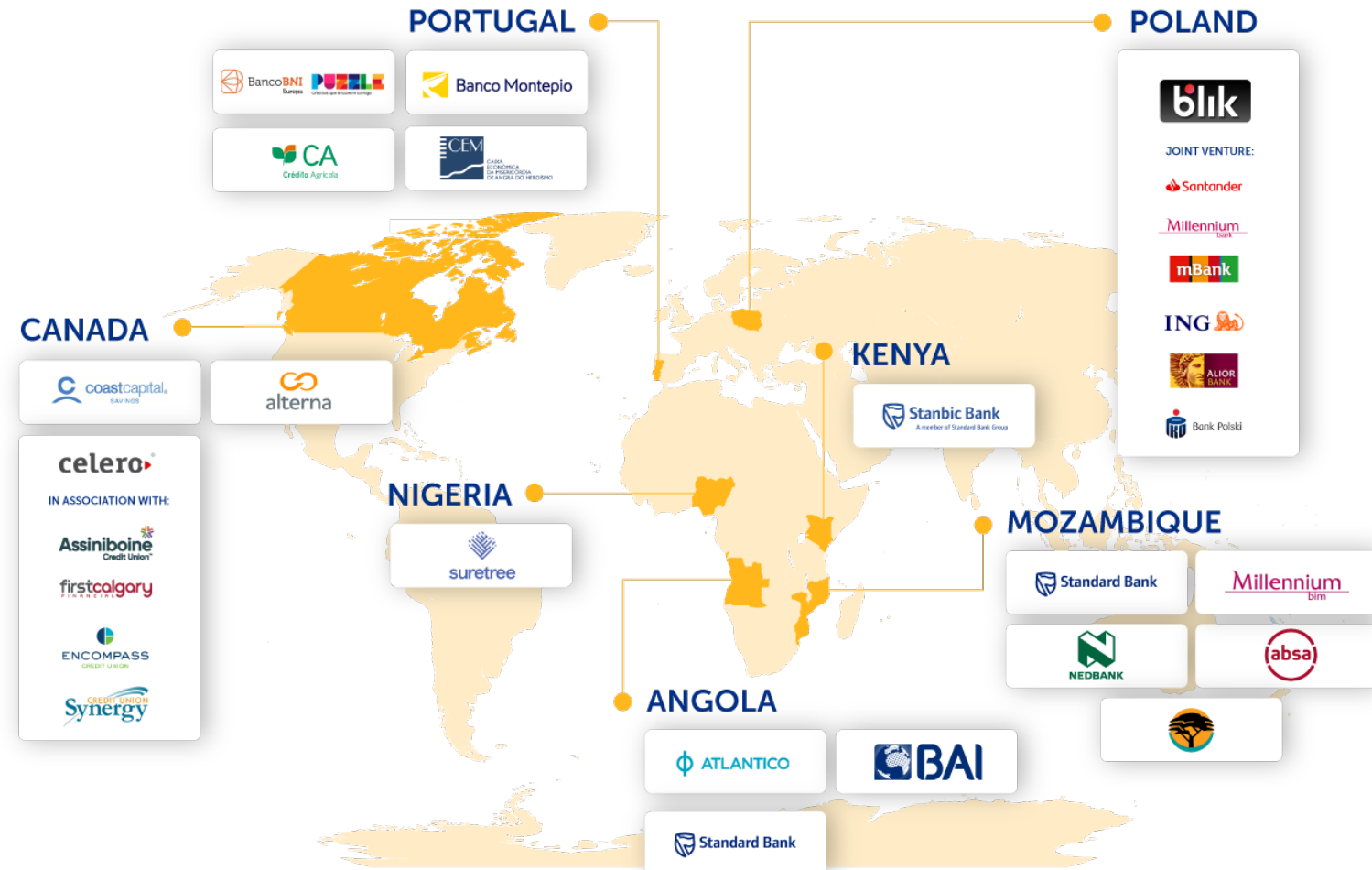
How can ITSCREDIT help



ITSCREDIT delivers an omnichannel platform, focused on the digitalization of credit processes (SMEs, corporate and individuals), high flexibility, fast time-to-market and a 360° view and control of the entire credit lifecycle.

We enable the implementation of an end-to-end credit origination solution, delivering low code interfaces for marketing and product teams to create and manage credit products. ITSCREDIT also delivers state of the art risk and scoring capabilities allowing in-depth risk analysis and reporting, applying artificial intelligence to create challenger models and reduce credit defaults.

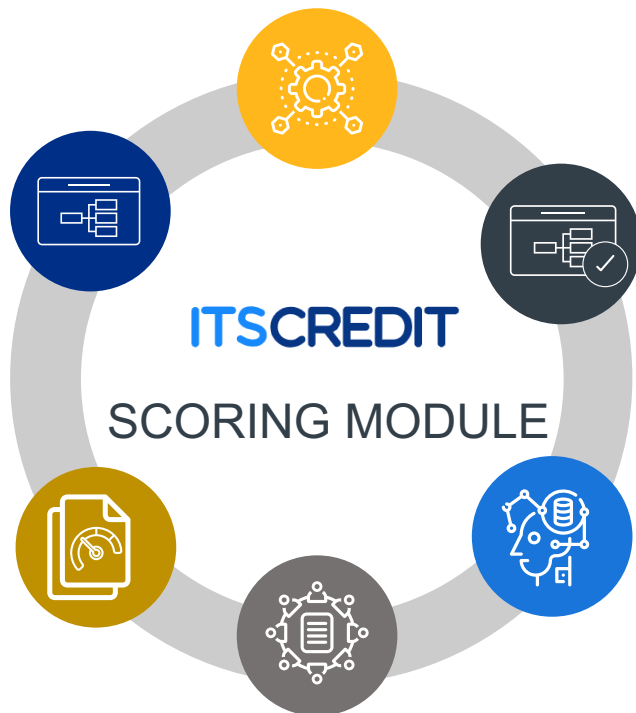
We offer highly customizable software solutions for key credit process challenges, easily adaptable to the regulatory system of each country as demonstrated by successful implementations across the globe.



How can ITSCREDIT help



As default risk increases within the BNPL providers, ITSCREDIT provides all features that will enable any company to separate the expected good clients from the undesirable ones reaching to a credit decision automatically



MODEL CONFIGURATION

Configure the overall scoring model, variables and rules to rate the clients that use BNPL services. Flexibility on changes to reduce the time to market of new models.

MODEL VALIDATION

Predicts how the clients behave, identifies if the variables or rules need to be changed to increase the model quality.

MARKETING LEADS

Enable and streamline the marketing campaigns increasing the potential for cross-selling on those clients that have better credit risk quality.

AUTOMATIZATION ENGINE

Automatic calculation of the scoring grade of a BNPL client by the ITSCREDIT solution verification of all credit decision rules and maximum credit limits.

MACHINE LEARNING

Improve the current scoring model performance, which will support the reduction of default behavior and increase of loan origination and profit.

IMPACT SIMULATION

As BNPL market evolves, the variables that explain client's risk also changes so our solution proactively assess how the risk level of each client will be impacted before the changes are executed