THEME 2 – IDENTIFICATION OF DISTRESS

The conference started with a discussion on preventing distress among vulnerable and low-income borrowers. In the following theme, the conference moved to discuss the identification of distress prevalence among borrowers. Discussions around this theme began with a staging presentation titled "**Using Market Monitoring Tools to Assess Borrower Risks and Outcomes and Listen to Customers**", where Juan Carlos Izaguirre and Laura Brix Newbury presented CGAP's extensive work on credit market monitoring.

The presentation highlighted the importance of the 3Cs principle - customer centricity, capability, and collaboration, in any responsible digital financial ecosystem (RDFE), and how market monitoring is a powerful way RDFEs can uphold this principle. It highlighted how RDFEs can incorporate market monitoring mechanisms at different stages of their operations and how they can gradually build their market monitoring capacities. By starting slow and small, RDFEs can first carry out a scoping exercise to explore the various stages of their process cycle where market monitoring components can be incorporated and then identify the different data points and capacities needed for its effective implementation. Thereon, RDFEs can gradually grow their market monitoring muscle and mature effectively by including market monitoring in their annual plans. This can be operationalised by creating dedicated resources and teams and enhancing in-house data analytics capacity. In any case, RDFEs would need to create a conducive environment for market monitoring by mandating regular monitoring exercises and building an organisational consensus on its importance, ensuring staff and resource adequacy for its implementation, and ensuring the availability of high-quality data for its execution.

The presentation then showcased the work CGAP has done along with its partners in monitoring credit markets in Tanzania (analysis of regulatory reports), India (social media monitoring), and Kenya (early warning systems). This demonstrated the different ways in which credit markets could be monitored: through analysis of regulatory reports, analysis of complaints data, social media monitoring, analysis of consumer contracts, mystery shopping exercises, industry engagement, periodic thematic reviews, randomised phone surveys, etc.

The presentation was followed by a breakout session where the delegates provided valuable insights into the significance of market monitoring for distress identification. Below is a synthesised summary of the discussions that ensued:

1. Collecting and tracking a variety of data sources and indicators

- Many conventional and unconventional indicators can be tracked to identify distress. However, the regular availability and quality of such data could pose a challenge. Some of these indicators and data sources that could be important to collect and track are as follows:

i. Monitoring school dropout rates can help signal when dropout rates increase
ii. Monitoring sales of or expenditure on chronic medication can help signal when the sale of or expenditure on chronic medication reduces
iii. Repayment data of borrowers can help track borrower distress at an individual and a customer-segment level
iv. Application to and demand for NREGA jobs can indicate distress
v. Tracking monsoon and weather forecasts can provide early warning signals for lenders dealing predominantly with agricultural borrowers
vi. Leveraging large nationally representative data sources such as CMIE's Consumer Pyramids Household Survey can be useful to track the broader financial health of the population in different segments and geographies
vii. Reports such as the RBI's Financial Stability Report and MFIN's Micrometer are rich sources of macro-level information.

- Enough data is probably already being collected by different stakeholders in the credit market. They need to be encouraged to track this data themselves and publish it for the entire ecosystem to leverage.
- Such data could aid macro-level assessment of loan concentration and distress.

2. Improving grievance redressal channels

- Grievance redressal mechanisms need to be improved from the ground up, i.e., from the level of loan officers to lenders to SROs to regulators. This can give the credit market a better sense of prevailing customer sentiment and enable the designing of suitable interventions at various levels to address the issues.
- Loan officers can play an essential role in identifying distress as they interact with borrowers regularly. Loan officers could be encouraged to identify and document any genuine distress they observe on the field. However, given the existing workload of a typical loan officer, this vital task might not get its due priority.
- Traditional lenders have some physical touchpoints that can pick up signals of distress and respond appropriately. In the case of digital lending, identifying distress could be even more challenging given the near-to-nil personal interface with customers.
- Customer groups or forums could act as the voice of aggrieved customers and help amplify distress signals to sector stakeholders in a dynamic and timely manner.

- Corporate governance and organisational culture need to place importance on accountability mechanisms for all stakeholders involved in underwriting.

3. Strategies and approaches for market monitoring

- Any market monitoring approach should be flexible, adaptive, and customised based on the geography as well as the demography of the borrowers being monitored. A uniform market monitoring policy at a national level might not effectively capture distress.
- Delinquency is a lagging indicator and a consequence of distress rather than an indicator of it. Tracking multiple data sources and indicators – both qualitative and quantitative –will be useful to observe any emerging common trends and enable regulators and lenders to dig deeper and diagnose problems sooner than later.
- Data sources can only be used to monitor economic indicators. It would be equally important to structure mechanisms for monitoring market practices.
- Grievance-related data could also be a valuable indicator to track. The regulator can take responsibility for collecting and triangulating all grievance data. Such data from multiple stakeholders can help identify trends such as increase in fraud, cases of suicide, etc.
- SROs currently rate districts on parameters like economic situation, number of lenders, loans outstanding, Days Past Due (DPDs), etc., using credit bureau data. The same exercise could be made more granular to detect hotspots. For instance, the Reserve Bank of India (RBI) already has the capacity and willingness to collect and utilise granular data. It collects pin-code level data on macro-prudential indicators to inform monetary policy.
- Credit bureaus could also contribute to monitoring the ecosystem for signs of distress. Tools developed by South African credit bureaus to predict individual distress as well as market health can be something Indian credit agencies can emulate. Such tools can be crafted for the Indian scenario as a public good.
- The prevalent practice among lenders of carrying out due diligence only during the loan disbursement phase is inadequate for identifying distress, as distress usually occurs after the loan has been disbursed. Distress signals must be tracked throughout the loan tenure – through cashflow data, repayment data, periodic surveys, interaction with loan officers, etc. to identify distress effectively.
- Market saturation is a critical indicator that needs collective monitoring. With no forum to monitor over-lending currently, monitoring over-saturation could enable regulators and lenders to remain vigilant and avoid over-heating any market.
- Market monitoring should be conceived as a regular and ongoing exercise, not something resorted to in the aftermath of a crisis. A well-set-up market monitoring mechanism could act as an early-warning system.

4. Challenges in market monitoring for distress identification

- Lack of capacity - Many lenders currently don’t have the capacity to incorporate market monitoring. If regulators were to specify more compliance requirements, lenders would have to build up capacity to adhere to those requirements.
- Lack of consensus – Building consensus among the different enabling stakeholders, such as regulators, funders, etc., about the importance of market monitoring is crucial. This will engender cooperation in framing appropriate rules and allocating resources to successfully implement the various measures discussed.
- Lack of learning from other sectors – Beyond learning from other countries' credit market monitoring practices, there are lessons to be garnered by looking at how other industries conduct market monitoring. The FMCG industry, for instance, has its ears to the ground and does a very good job at market monitoring.