



Keeping clients first  
in microfinance

# Prevention of over indebtedness

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[www.smartcampaign.org](http://www.smartcampaign.org)



1. Over-indebtedness: framing the issue
2. Smart Campaign Strategy
3. What's next?

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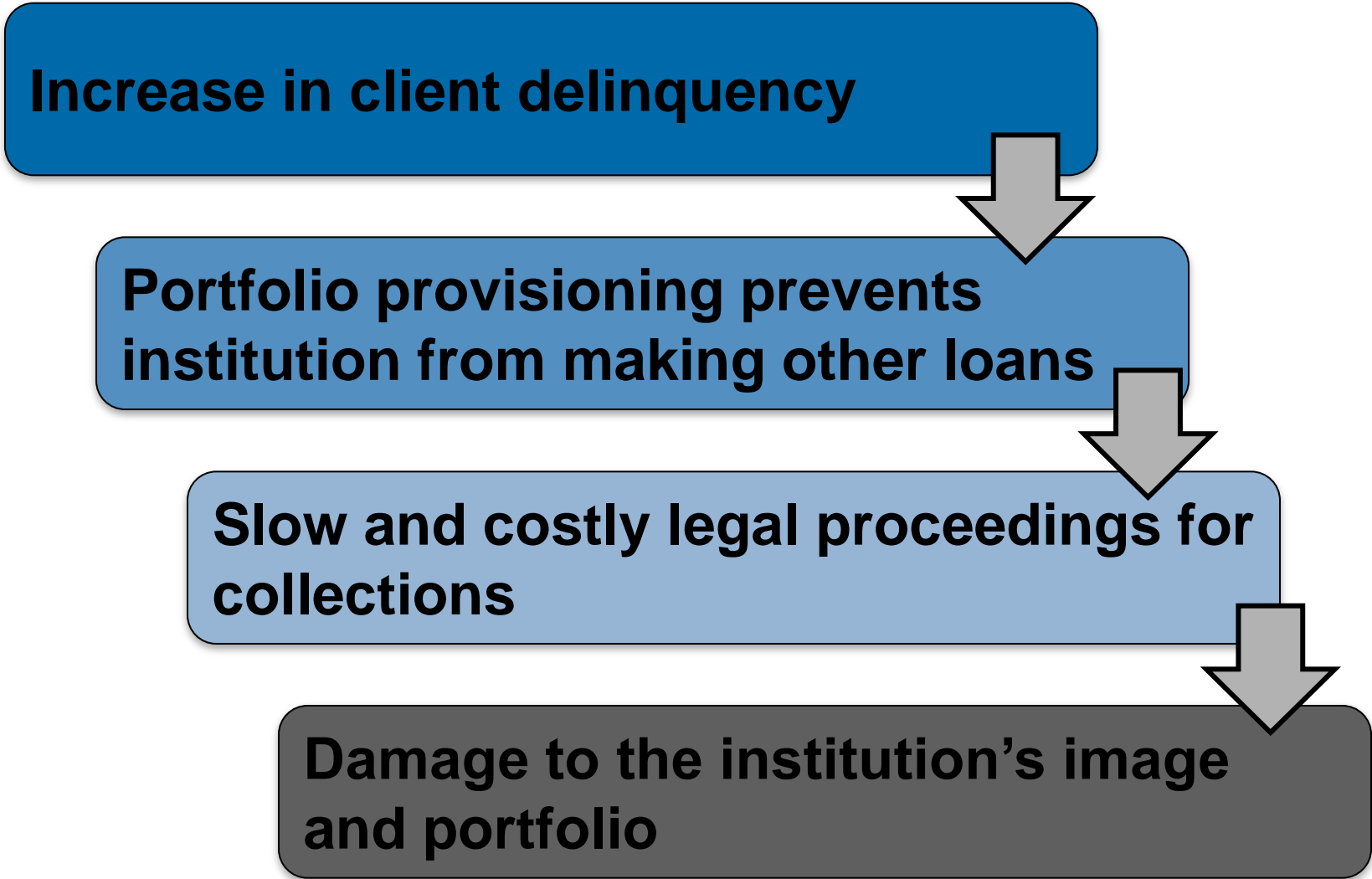
# Principles of client protection

1. Appropriate product design and delivery
- 2. Prevention of over-indebtedness**
3. Transparency
4. Responsible pricing
5. Fair and respectful treatment of clients
6. Privacy of clients data
7. Mechanisms for complaint resolution

# Definition

- Over-indebtedness refers to the risk faced by credit customers of taking on levels of debt that may be greater than they can manage, or that cause undue sacrifices to repay.

# How over-indebted clients affect the MFI



## Clients may ...

- Work longer hours
- Reduce consumption
- Use savings for loan repayment
- Take new loans to pay off current debt
- Sell assets, including productive assets
- Invest less in productive assets and human capital
- Search for help from family, depleting relatives' assets

# Identifying the Causes of Over-indebtedness

## Multiple loans

- Multiple loans are issued to client, by one or more institutions, due to:
  - Lack of information on the client's liabilities
  - Incentives for loan staff to oversell credit products

## Poorly designed repayment schedules

- Repayment schedule does not match the client's business cycles (e.g., agriculture)

## Inadequate capacity analysis

- The institution relies on guarantees as a substitute for adequate capacity analysis

## Unpredictable events

- Accidents, disease, or natural disasters



# Issues around over-indebtedness

- Borrowers have difficulty in realistically assessing their loan repayment capacity.
  - Borrowers prone to predictable cognitive biases that can contribute to over-borrowing.
- Providers have a duty to ensure that they do not take advantage of these tendencies.

# Everyone has a role to play

## 3 pillars



- Client protection regulation and supervision
- Norms and codes of conduct for the industry
- Financial education for clients

## Actors

Regulators (Central Banks, Governments, Client protection agencies) clients)

Codes of conduct, voluntary involvement of financial service providers

Clients (individuals or enterprises) and client protection agencies

**Technical and financial partners**

Inter disciplinary questions

Stability of the financial system, access to financial services, job creation, development of micro, small and medium enterprises, etc.

- ... are responsible for educating themselves on the prices, terms, and conditions of the financial products they consume.
- ... should make a realistic assessment of their capacity to repay a loan before borrowing, and should not borrow anything they do not need or cannot repay.
- ... are responsible to provide full and accurate information about their financial situation, and to inform the provider if they are having difficulty repaying the loan.

# Financial providers

- ... should take adequate care in all phases of their credit processes to determine that clients have the capacity to repay without becoming over-indebted.
- ... should implement and monitor internal systems that support prevention of over-indebtedness and will foster efforts to improve market level credit risk management (such as credit information sharing).

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# Focus on prevention and improve practices

- Client underwriting process
- Loan terms and conditions
- Sales techniques
- Staff incentives
- Monitoring systems
- Market initiatives

# CPP Standards





# Tools available from the Smart Campaign\

## Technical Tools

Getting Started Questionnaire: Self Assessment for MFIs

Avoiding Over-indebtedness: Guidelines for Financial and Non-Financial Evaluation

Smart Lending

Smart Savings

Technical Guide for Investors

## Samples and Case Studies

Client Business Evaluation Toolkit from Microfund for Women

Loan Calculator from Opportunity Bank Serbia

Smart Note: Facing Over-indebtedness at Partner

Loan Officer Training Manual from Banco Solidario

Debt Management Guide from NCR South Africa

## SMART CAMPAIGN CLIENT PROTECTION CERTIFICATION

Issue Date:  
**January 2013**

Issued to:  
**Partner**  
Ulica 15 maj, Trzni Centar  
Sjenjak  
Tuzla  
75000  
Bosnia and Herzegovina

This Certifies that Partner has been evaluated according to the standards of the Client Protection Certification Program and found to take adequate care to implement Client Protection Principles as promoted by the Smart Campaign.

#### Additional Information:

For a complete list of entities that are currently certified against the standards for implementing the Client Protection Principles, see the Smart Campaign Certified Entities Directory at [www.smartcampaign.org](http://www.smartcampaign.org). The standards can also be found on the website.



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TO REPORT COMPLAINTS REGARDING THE HOLDER OF THIS CERTIFICATE OR MISUSE OF THE SMART CAMPAIGN NAME OR LOGO,  
PLEASE CONTACT THE SMART CAMPAIGN CERTIFIER AT [info@microfinanzarating.com](mailto:info@microfinanzarating.com) OR THE SMART CAMPAIGN AT [www.smartcampaign.org](http://www.smartcampaign.org).

UNLESS EARLIER REVOKED BY THE SMART CAMPAIGN OR BY MATERIAL CHANGES THAT AFFECT CERTIFICATION STATUS, THIS  
CERTIFICATE IS VALID FOR TWO (2) YEARS FROM THE DATE OF ISSUANCE.

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# Strengthen credit reporting

- Market-level issues
- Lender-level issues
- Service-provider level issues
- Borrower-level issues

- *Over-indebtedness refers to the risk faced by credit customers of taking on levels of debt that may be greater than they can manage, or that cause undue sacrifices to repay*
- What is an 'undue' sacrifice? (Jessica Schicks study in Ghana)

# Prevent crises

- Funder coordination
- Financial provider awareness
- Client education
- Warning systems (i.e., upcoming MIMOSA)