

Implementing the Client Protection Principles

A Technical Guide for Investors

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Since 2008, CGAP has been working with the investor community to address how client protection can be integrated into the process of investing in microfinance. This Technical Guide has been developed based on the generous contributions and knowledge sharing of an informal investor “Client Protection Principles Implementation Working Group” and many other staff members of diverse investment organizations. In particular, CGAP wishes to thank staff from Aavishkaar Goodwell, BlueOrchard, Credit Suisse, Deutsche Bank, Developing World Markets, FMO, Grassroots Capital, Incofin, KfW, Kiva, MicroVest, Oikocredit, Oxfam Novib, responsAbility, Symbiotics, Triodos, Triple Jump, and Unitus Capital for their contributions. Thanks also go to Cara Forster, Robin Ratcliffe, and Beth Rhyne from the Center for Financial Inclusion at ACCION International; Alexia Latortue from CGAP; Deborah Drake from the Council of Microfinance Equity Funds; and Deborah Burand from the International Transactions Clinic of the University of Michigan for their helpful comments.

I. About the Guide

Client protection is a key tenet of microfinance. This is demonstrated by the extraordinarily large number of organizations that are endorsing the Client Protection Principles—a set of global principles aimed at ensuring microfinance clients are treated fairly and responsibly and do not become over-indebted. Although the Client Protection Principles are widely agreed upon, deeper implementation of the principles and ways of monitoring them, both at the microfinance institution (MFI) and funder level, are in the early stages of development. Microfinance providers and their supporters are actively looking for concrete and practical ways to implement the Principles more comprehensively.

This Guide offers simple and straightforward guidance and tools and resources for investors seeking to incorporate the Principles into their investment processes. It was compiled by CGAP, drawing on contributions from across the microfinance investor community. It presents seven recommended action steps, suggested approaches, and sample templates currently being used or being developed by investors and fund managers.

The Guide is a “living” document that will be updated regularly as practice evolves. **Investors are strongly encouraged to provide feedback on how to improve this Guide and to share additional material that could be included.** Comments and material should be sent to Kate McKee (kmckee@cgap.org) and Estelle Lahaye (elahaye@cgap.org).

Microfinance investors are a diverse group, including large development finance institutions, such as KfW; large commercial banks with small microfinance units, such as Deutsche Bank; and small private equity funds, such as Grassroots Capital and Aavishkaar Goodwell, that have different business models, priorities, and institutional capacity. This Guide offers a comprehensive view of how the Principles are being implemented, but it does not propose a “one size fits all” approach. Instead, it shares existing practice, in the spirit of facilitating mutual learning and co-development of practices and standards in this area.

The Guide is organized as follows:

- Section 2 describes the Client Protection Principles.
- Section 3 provides an overview of the origins and status of the Campaign for Client Protection.
- Section 4 offers practical advice on approaches and tools to implement the Principles.
- Section 5 highlights challenges to implementing the Principles.
- Section 6 provides a listing of resources and tools.

II. What Are the Client Protection Principles?

The Client Protection Principles promote ways for microfinance providers to take practical steps to treat clients fairly and respectfully while avoiding practices that might harm them. These Principles are distilled from the path-breaking work of providers, international networks, and national microfinance associations to develop pro-consumer codes of conduct and practices. While the Principles are universal, meaningful and effective implementation requires careful attention to the diversity within the provider community and conditions in different markets and country contexts.

Here are the six Client Protection Principles:

- ***Avoidance of Over-indebtedness.*** Providers will take reasonable steps to ensure that credit will be extended only if borrowers have demonstrated an adequate ability to repay and loans will not put borrowers at significant risk of over-indebtedness. Similarly, providers will take adequate care that noncredit financial products, such as insurance, extended to low-income clients are appropriate.
- ***Transparent Pricing.*** The pricing, terms, and conditions of financial products (including interest charges, insurance premiums, all fees, etc.) will be transparent and will be adequately disclosed in a form understandable to clients.
- ***Appropriate Collections Practices.*** Debt collection practices of providers will not be abusive or coercive.
- ***Ethical Staff Behavior.*** Staff of financial service providers will comply with high ethical standards in their interaction with microfinance clients, and such providers will ensure that adequate safeguards are in place to detect and correct corruption or mistreatment of clients.
- ***Mechanisms for Redress of Grievances.*** Providers will have in place timely and responsive mechanisms for complaints and problem resolution for their clients.
- ***Privacy of Client Data.*** The privacy of individual client data will be respected, and such data cannot be used for other purposes without the express permission of the client (while recognizing that providers of financial services can play an important role in helping clients achieve the benefits of establishing credit histories).

III. The Origins and Status of the Campaign for Client Protection

Client protection in microfinance is not a new issue. Various MFIs and networks have developed pro-consumer policies for their operations during the past three to five years, driven either by social concerns or, in some cases, allegations of unscrupulous lending practices that were hurting the industry.

Early developers of codes of conduct and client protection policies include national associations, such as the Association of Microfinance Institutions in Uganda, Sa-Dhan in India, and ProDesarrollo in Mexico; international networks, such as SEEP, WOCCU, the Microfinance Network, and Opportunity International; and individual MFIs, such as Banex in Nicaragua, Prizma in Bosnia, Mibanco in Peru, and the Procredit group (an owner/operator of microfinance banks in over 20 countries).

In April 2008, Deutsche Bank brought together several dozen microfinance leaders in Pocantico, N.Y., to discuss the future of microfinance. Their findings, the Pocantico Declaration, laid out their agreement on the need for an industry-wide code of ethics for microfinance and an active assertion of the microfinance brand as a double bottom line industry. This meeting helped inspire the Campaign for Client Protection in Microfinance.

[The Campaign for Client Protection](#) brings together practitioners, networks, donors, investors, fund managers, and policy makers to make a joint and concerted effort to further advance client protection. Launched in March 2009,¹ the Campaign is an ambitious three-year initiative that aims to ensure that providers of financial services to low-income populations take concrete steps to protect their clients from potentially harmful financial products and ensure that they are treated fairly.

The Campaign serves as an umbrella for all industry-wide efforts on client protection, with the Center for Financial Inclusion at ACCION International serving as the secretariat. ACCION International and CGAP synthesized existing codes from a number of microfinance networks and associations' work, distilling the main points into six Client Protection Principles.

The Center for Financial Inclusion was charged with coalition building and outreach to encompass individual MFIs, networks, associations, and professionals working in the field, because of the work with MFIs already initiated by the Center in its Beyond Codes collaborative action research project. Beyond Codes is examining how microfinance providers can best implement the Principles within their operations (see [Box 1](#)). It has recently published [Self-Assessment Guide on Client Protection for MFIs](#), which provides a detailed set of indicators MFIs can use to assess how they are doing in implementing the Principles (see Section 4 for details of how this is relevant to investors).

¹ The campaign officially began in March 2009, with the steering committee meeting, but the public launch will take place in September 2009.

CGAP was charged with reaching out to investors and donors, in light of CGAP's extensive work with social investors, microfinance investment vehicles (MIVs), and donors, urging them to join together to integrate the six principles into their internal systems and processes. This Guide is a product of a fruitful collaboration with many investors.

Box 1: Beyond Codes—How Are MFIs Implementing the Client Protection Principles?

In an effort to move from principles into practice on consumer protection, the Center for Financial Inclusion created the Beyond Codes project, which has since become the informal research arm of the Campaign for Client Protection. Beyond Codes was designed to establish a body of knowledge, developed in conjunction with participating MFIs, about how the Client Protection Principles are implemented. Collaboration and information dissemination are key tenets of the project.

Structure

- Twelve MFIs in four countries representing different geographic regions (Kenya, Bosnia, the Philippines, and Mexico) are participating in the project.
- Institutions of different sizes, with different legal structures, including banks, nonbank financial institutions, nongovernmental organizations, and credit unions, are participating.
- Timeline and process:
 - September 2008—advisory group meets to discuss design of research protocol
 - November 2008—develop questionnaire indicators
 - November 2008 to October 2009—field test methodology through guided self-assessment of MFIs using list of indicators and agreement on pilot projects to improve operations
 - January to October 2009—monitor pilot projects and document business case and lessons learned
 - November 2009—advisory group meets
 - 2010—investigate development of client protection certification process based on short list of indicators

Goals

- Develop a methodology to assess the state of consumer protection in an MFI by evaluating current practice against the implementation of the Principles.
- Document and share model practices in participating MFIs, creating case studies that can promote the implementation of better practices in other MFIs.
- Recommend and track pilot projects in participating MFIs to collect data on the business case for better client protection practices.
- Develop capacity in national network personnel on the Beyond Codes methodology.
- Facilitate information sharing among practitioner peers.

Explanation on Indicators

The indicators that make up the questionnaire were developed from discussions among several stakeholders and from the project's growing experience in the field. The original list was designed to be quite inclusive so as to examine as broad an array of topics as possible. Through the field-testing process and the discussions at the second advisory group meeting, the project team will narrow the list of indicators significantly, identifying a much shorter list of indicators that are the most universal, predictive, and objective of those currently being tested.

IV. Implementing the Principles

This section provides tools to help investors incorporate the Principles into their investment processes. It draws heavily on current investor practice and references that organizations have developed so as to encourage mutual knowledge sharing and learning.

We start by defining a minimum set of actions for investors serious about incorporating the Principles into their investor processes. Specific examples of investor practice for each of these actions follow.

Recommended Actions for Investors

1. Incorporate the Principles into investment policies.
2. Endorse the Principles publicly.
3. Encourage current and prospective investees to discuss and endorse the Principles.
4. Develop, test, and refine criteria and procedures to assess investee implementation of the Principles during screening and due diligence processes.
5. Integrate the Principles into financing or shareholder agreements, as appropriate.
6. Monitor implementation of the Principles by investees through mandatory reporting and regular monitoring and evaluation.
7. Report on progress to investors and other stakeholders.

Most funders are at the early stages of developing policies and procedures related to all these actions. One of the most advanced is KfW, which has taken a systematic and organization-wide approach to implementing the Principles. [Box 2](#) details its approach and corresponding actions.

Box 2: KfW's Approach to Implementing the Client Protection Principles

For KfW, the focus on client protection started in 2007, with news of an increasing problem with responsible finance practices, particularly in Eastern Europe and Latin America. Partner MFIs were complaining that competitors were adopting aggressive and nontransparent lending practices. They feared a race to the bottom. Yet they lacked tools to combat the problem.

KfW realized the need to develop a concept of *how* to promote responsible finance and tools to tackle the problems, even before the Campaign for Client Protection started. Here are the steps it took:

- Published a **position paper** on responsible finance in February 2008 that was discussed and endorsed by a senior management committee: "[Responsible Finance: a Leitmotif for KfW financial sector promotion.](#)" Management and staff needed time to gain consensus on how to best address these issues. **Action 1: Incorporate the Principles into policies.**
- Joined the Campaign for Client Protection in Microfinance and **endorsed** the Client Protection Principles. **Action 2: Endorse the Principles publicly.**
- Entered into a **dialogue** with microfinance providers and other financial sector stakeholders about the need for the Principles. KfW's approach is to build inclusive financial systems; hence this dialogue is held not only with MFIs, but also with ministries of finance, central banks, and commercial banks. To facilitate this dialogue, KfW has organized, together with the respective central banks, workshops on responsible finance in countries such as Azerbaijan and Kosovo. **Action 3: Encourage current and prospective investees to discuss and endorse the Principles.**
- Promoted internal awareness and debate with staff from the six regional financial sector teams. This led to the drafting of a **checklist** on responsible finance and template Terms of Reference as to how to integrate responsible finance issues into due diligence. **Action 4: Develop, test, and refine criteria and procedures to assess investee implementation of the Principles during screening and due diligence processes.**
- Integrated responsible finance issues, including the Principles, into the **due diligence process**. This took time; a balance had to be struck between providing information on the Principles' implementation to financiers and investors and managing the related transaction costs. This underscores the importance of a continual dialogue on these topics and highlighting their importance for business and developing responsible financial markets. **Action 4: Develop, test, and refine criteria and procedures to assess investee implementation of the Principles during screening and due diligence processes.**
- Drafted and integrated a clause on responsible finance into KfW's template **loan agreement**. **Action 5: Consider integrating the Principles into financing agreements.**
- Promoted internal workshops and **training**. Internal awareness building and debate among staff is a key step to KfW's approach to implement the Principles within a responsible finance framework. KfW holds regular staff training events, including on responsible finance issues, and gets input from investment officers on all tools.

Next steps include the following:

- **Implement and mainstream.** Implementation is in process.
- **Monitor and evaluate.** In 2010, KfW will review the experience of implementing the checklist. In one year, it will evaluate its experience and adjust its approach as necessary. To facilitate this process, KfW has set up a cross-regional team of six internal focal points for responsible finance issues, representing its regional financial sector teams. The task of the focal points is to stimulate debate in their respective region and implement good practices and standards. The team will meet regularly to exchange experiences and discuss problems to get a better sense of how to initiate and maintain an effective dialogue with partner institutions on responsible finance issues. **Action 6: Monitor implementation of Principles by investees.**
- **Report.** The team will prepare a report to the board of managing directors to ensure high-level attention. **Action 7: Report on progress to investors and other stakeholders.**

1. Incorporate the Client Protection Principles into investment policies.

Recognizing the need for client protection is a critical first step to adopting and incorporating such standards into investor practices. Senior managers may need to be convinced of the need for client protection so that they will be committed to client protection and responsible lending.

The subprime mortgage crisis in the United States highlighted the importance of client protection by showing the devastating impact on people's lives when financial institutions extend overly high amounts of credit. Over 2 million Americans lost their homes, both because they had taken on more debt than they could reasonably repay and/or because their loans lacked transparency and the loan terms were more onerous than they realized. The crisis highlighted the importance of "traditional banking," which is based on really knowing the customer, working with them in a responsible manner, and building long-term value for both lender and customer.

The subprime crisis provides a cautionary tale for microfinance. It revealed the reputational risk to our sector: Failure to follow responsible practices could jeopardize the work and social impact of MFIs in general. This has helped galvanize efforts to promote responsible finance and ensure client protection and fair treatment. Many investors have since underlined their commitment to ensure that the MFIs they fund are offering products and services that benefit their clients (i.e., not just products that can be profitably sold) and make a contribution to pro-poor economic development.

KfW, for example, started focusing on these issues in 2007, before the subprime crisis, and adopted new policies and practices related to responsible finance (see [Box 2](#)). **MicroVest** developed an internal working paper on predatory lending in 2008 to raise awareness within the organization. It incorporated related changes into due diligence policies and procedures, with guiding questions on what is triggering predatory lending.

In addition to integrating the Principles into investment policies, investors should communicate and discuss these issues and policies with their staff. Raising awareness from within can make staff supportive of the changes and facilitate the implementation of the Principles. **Oikocredit**, for example, has communicated with its regional offices on the Principles to raise awareness among project officers and country managers.

2. Endorse the Client Protection Principles publicly.

A key step in demonstrating your organization's commitment to the Principles is to publicly endorse the Principles. Endorsement demonstrates to MFIs, investors, and other stakeholders that you consider client protection issues part of doing good business. It also provides an entry point to start a dialogue with partner MFIs. In addition, endorsing the Principles helps build the momentum and shared norms across the microfinance industry.

Joining the Campaign for Client Protection is a simple and effective way of demonstrating your institution's public support for the Client Protection Principles. By joining the Campaign, investors are committing to implementing the Principles into their own processes and roles (such as due diligence, investment, monitoring, and governance). Investors can join the Campaign by going to the Campaign for Client Protection [Web site](#) and signing up. As of July 31, 2009, over 80 investors and 110 MFIs had endorsed the principles. A complete list is available on the [Web site](#).

Joining the Campaign is important because it is part of mobilizing awareness and commitment throughout the microfinance industry around the Client Protection Principles and ensuring client protection becomes an integral part of all financial systems. The Campaign will also provide participants with tools, updates, and knowledge sharing on the implementation of the Principles.

However, to translate such an endorsement into meaningful action, the following steps also need to be taken.

3. Encourage current and prospective investees to discuss and endorse the Principles.

The next step is to inform your investee MFIs of your commitment to the Principles. CGAP has drafted a template letter that can be modified and used by investors to communicate with MFIs (see [Annex 1](#)). Encouraging your investees to become endorsers of and leaders in the Campaign is important. Their active participation will help accelerate progress on the most important priority—identifying specific improvements in policies and practices at the retail level that are both meaningful for clients and workable for the diverse array of microfinance providers and contexts.

Many investors have already communicated their endorsement of the Principles to investees. **Developing World Markets**, for example, used the letter template, but modified it to better fit its needs (see [Annex 1](#)). Representatives of **Oikocredit** in South East Asia discussed the Principles and its endorsement at a recent meeting with MFI partners in Cambodia.

Investors are typically not making it mandatory for current or prospective investees to join the Campaign and endorse the Principles. Rather, most see the Principles as important topics for dialogue and building a shared understanding and approach to implementing the Principles over time. **Kiva**, for example, has communicated with and encouraged 90 of its partner MFIs to endorse the Principles. As of June 2009, 25 had endorsed them. Kiva is in contact with its partners to assess why some have endorsed the Principles and others have not.

Many MFIs are asking questions: What does signing up to the Principles mean in practice? Do we have the time and capacity to make the operational adjustments necessary to implement the Principles? Are these issues a priority for our organization when we are still focused on getting the basics right and reaching sustainability? For example, one of the reasons cited by Kiva partner MFIs for not endorsing the Principles is that they want to make

sure they can translate endorsement into action. Individual MFIs are likely to give these issues serious consideration before signing up.

Some investors are providing incentives for MFIs to perform strongly on social issues, including client protection. For example, Incofin provides better financing conditions for MFIs that have achieved a minimum level of both social and financial performance. Kiva is considering giving visibility on Kiva.org to MFIs that have endorsed the Principles as an incentive to do so. Such incentives could play a very useful role in supporting improved policies and practices by MFIs.

Investors are generally aware that the pace of implementation of the Principles will be different for different MFIs. None wants to further increase the funding/resources gap between Tier 1 MFIs and less developed MFIs. Hence, the focus currently is on reaching agreement on the Principles and working out implementation plans that fit with MFIs' stages of development.

Given their ownership stake in the MFI, equity investors can take a more active role in ensuring the Principles are implemented, such as including discussion and endorsement of the Principles in the Board agenda and requiring regular monitoring and reporting on implementation to the Board. **KfW**, for example, has found that having a Board seat helps it to start the discussion about the Principles. By placing the topic on the Board agenda, it can ensure the Principles get attention at the senior level. Actions that Boards can take include agreeing to do a self-assessment of their MFIs' implementation of the Principles, promulgate relevant policy, and create an action plan to implement the Principles.

4. Develop, test, and refine criteria and procedures to assess investee implementation of the Principles during screening and due diligence processes.

Many investors are now at the stage of designing, testing, and refining criteria and procedures for incorporating the Principles into screening and due diligence processes. In some cases, client protection considerations are one aspect of assessing an MFI's social performance. This is the case, for example, for **EFSE**, **responsAbility** and **Symbiotics**. Other investors, such as **Credit Suisse**, which markets microfinance investment funds to social investors and underwrites initial public offerings, see these issues more as a part of risk assessment.

Many investors are initially focusing on those Principles they think are most important and/or can be easily verified during due diligence. For example, **Triodos** has started incorporating the Principles into its due diligence guidelines with a focus on preventing over-indebtedness and promoting transparent pricing.

Some investors have issued guidelines to staff on how to evaluate a responsible finance provider. For example, for several years **FMO** has had a set of guidelines (see [Annex 2](#)), approved by its Managing Board, that provides both basic guidance for evaluation and analysis as well as practical tools for due diligence when assessing consumer finance providers. These integrate the latest European Union consumer credit guidelines as well as best practice from FMO's own experience. (Note that these were not designed specifically to apply to MFIs but are relevant because they feature practical guidance on how to assess whether a responsible finance provider does a loan affordability check [see [Box 3](#)], so as to avoid over-indebtedness.)

Box 3: FMO's Guidance on Affordability Checks/Avoidance of Over-Indebtedness

Before extending a loan, the consumer finance provider needs to assess whether the consumer has sufficient and sustainable repayment capacity. Although there is no general rule for affordability, the provider should have debt servicing limit(s) in place. One criterion of affordability often used is the instalment (interest plus repayment amount plus fees) divided by disposable income. Disposable income is measured as net disposable income after fixed charges, such as rent, standard living expenses (water, electricity, etc.), and other recurring financial expenses (school fees, mortgages, other instalments, etc.). This instalment should preferably be below 30 percent but should not be above 50 percent of disposable income.

Avoidance of over-indebtedness is safeguarded by two means: (i) taking into account the repayment obligations of the consumer to other providers when calculating disposable income and the maximum limit and (ii) checking credit history at credit bureaus. Verify that the provider has these mechanisms in place.

Source: FMO Guidelines for Consumer Finance

Investors that do field-based due diligence are translating the Principles into specific questions or indicators that relate to MFI lending practices and that can be verified through staff interviews or document checks. For example, **Triple Jump**, which manages funds for investors such as the **Calvert Foundation** and **Oxfam Novib**, has incorporated 10 questions related to the Principles in its due diligence template; the questions are currently being field tested.

Many investors are referring to MIX's list of questions on client protection (in its new Social Performance Report) when developing their own indicators (see [Box 4](#)). In consultation with Beyond Codes and CGAP, MIX condensed the six Principles into easy indicators for MFIs to report. **BlueOrchard**, for example, has developed a proprietary internal scoring system used in due diligence processes and investment decisions, which is aligned closely with the principles, the indicators used by MIX, and the consensus client protection indicators agreed upon by the Social Performance Task Force (SPTF).

Box 4: MIX’s social performance report: Client protection indicators

In 2008, SPTF agreed on a new reporting framework including social, ethical, and environmental disclosure standards. The indicators cover disclosure of both (i) indicators on MFI policies and systems (e.g., whether the MFI conducts market research and discloses interest rates effectively and types of collateral taken) and (ii) outcomes at the client level, such as poverty level. While retaining a primary focus on assessing client outreach and benefits, the suite of indicators also includes proxies of ethical business practices by MFIs, environmental aspects, and client protection. The new indicators were incorporated into the MIX report on social performance and will be published in the MIX Market. In the MIX report, social responsibility to clients is the indicator that seeks to measure client protection.

Example: Indicators for client protection principle on over-indebtedness

POLICIES AND COMPLIANCE	ANSWERS
8 Social Responsibility to clients	
a What does your institution do to avoid client over-indebtedness? (Check all that apply)	<input type="checkbox"/> MFI's written credit policies give decision makers (loan officers, supervisors, etc.) explicit guidance regarding borrower debt thresholds <input type="checkbox"/> The credit underwriting process includes an evaluation of client ability to repay the loan <input type="checkbox"/> The credit underwriting process includes checks on client credit history and existing debt <input type="checkbox"/> Loan product options are flexible enough to fit client business and/or household needs <input type="checkbox"/> The institution does not rely solely on guarantees for repayment <input type="checkbox"/> Clients receive training/guidance on evaluating their own debt capacity <input type="checkbox"/> Management regularly obtains information about debt levels among its clients <input type="checkbox"/> Peer assessment (in group methodologies) <input type="checkbox"/> Other (please specify):

Additional details about the client protection indicator are available in the [MIX social performance report](#). As of June 2009, 89 MFIs had reported on social performance standards to MIX, including on client protection.

KfW has developed a “Checklist for Promoting Responsible Finance at Institutional and Macro Levels” (see [Annex 3](#)). Highlights of the KfW approach include the following:

- The checklist provides investment officers with issues to consider during the due diligence process. It covers nearly all of the Client Protection Principles.
- The checklist is meant to highlight possible areas of concern. Wherever such concerns materialize, analysis is expected to be deepened, to form a well-founded opinion on the performance of the MFI.
- The checklist includes analyzing financial indicators for any signs of potentially irresponsible lending practices. Specifically, KfW asks investment officers to check for a high correlation of high average return on equity, high interest rates, high level (also in absolute terms) of nonperforming loans/losses, and a low level of loan loss reserves. A constellation with a return on equity greater than 25 percent, a portfolio at risk (30 days) greater than 10 percent, interest rates greater than 40 percent, and insignificant levels of loss reserves (occurring together) would give a first hint of irresponsible lending practices.

Incofin was among the first investment managers to adhere to the Client Protection Principles. It developed a tool that assesses social performance of MFIs in its investment decision process, investment monitoring, and reporting to investors. The tool captures some aspects of responsible finance, including the Client Protection Principles (see [Annex 4](#)).

The tool incorporates 43 indicators across five dimensions. Four of the Principles are incorporated as a subdivision of “Quality of Customer Service.” Incofin chose to integrate those four Principles because they can be easily verified for due diligence, assessment, and monitoring.

The outcome of the tool is a score for each dimension leading to a weighted average total score. “Quality of Customer Service” has the heaviest weight in the overall score. The scoring system provides a robust and quantitative means of assessing an MFI’s social performance.

Deutsche Bank incorporated the Principles into its screening, due diligence, and annual review processes through a detailed set of questions based on MIX questions (see [Annex 5](#)). Questions related to the first five out of the six Principles are included in the Social Impact section of the loan application. (Issues related to privacy of client data are currently not covered.) The answers to these questions are reviewed, probed, and verified during due diligence in the field through both interviews with relevant staff and paper checks. The due diligence findings on social impact and other areas of the MFIs’ performance are then assessed and rated at the head office level. The due diligence assessment and rating is incorporated into the recommendation to invest in the MFI presented to the Investment Committee and is a part of the investment decision-making process.

Assuming the investment is made, the annual review process includes questioning how the Board ensures that the MFI is upholding the Client Protection Principles. Deutsche Bank has also developed an effective interest rate calculator to determine the actual rate that clients are paying and has written a short paper describing how it works. Staff use the calculator to review effective interest rates at the point of due diligence and also during annual portfolio reviews to ensure that pricing is fair and transparent.

Investors will also find it very useful to review the Beyond Codes [Self-Assessment Guide on Client Protection for MFIs](#), which provides a comprehensive set of indicators that could be incorporated into investor due diligence procedures. The purpose of the Guide is to help MFI leadership and staff explore how client protection practices are being implemented within their organization, identifying both strengths and areas for improvement. The Guide is a work in progress. However, it is the most rigorous set of indicators currently available, and it is being field-tested with MFIs in four countries. Each principle has a series of indicators associated with it. These indicators help to identify and analyze organizational practices, procedures, and systems that support a principle or undermine it. [Box 5](#) provides an excerpt of three indicators (out of 10) to assess preventing over-indebtedness.

Box 5: Beyond Codes Self-Assessment Client Protection Guide—example of indicators

Following each principle is a series of boxes to provide an overall assessment of each principle based on your responses to the statements.

<i>Principle 1: Prevent over-indebtedness.</i> A financial institution measures up to this principle by carefully establishing the borrower's ability to afford the loan and repay it. Clients should be able to handle debt service payments without sacrificing their basic quality of life.		Good	Adequate	Weak	Unmet
Applicable ▼	Productivity targets and incentive systems value portfolio quality at least as highly as other factors, such as disbursement or customer growth. Growth is rewarded only if portfolio quality is high.	✓			
Partial ▼	When available, the financial institution checks a Credit Registry or Credit Bureau for borrower current debt levels and repayment history. When not available, the financial institution maintains and checks internal records and, when possible, consults with competitors for same.			✓	
Insufficient ▼	Internal Audit checks lending practices that violate procedures including unauthorized re-financing, multiple borrowers or co-signers per household, and other practices that could increase indebtedness.				✓

5. Integrate the Principles into financing or shareholder agreements as appropriate.

Whether to integrate explicit Principles-related provisions into the financing (debt and equity) documentation used by lenders and investors in microfinance is a subject of debate. The issues range from questions about whether it is too soon to start including such provisions in financing documentation given the early stage of Principles implementation to questions about the scope and enforceability of such provisions.

To some extent, however, this framing of the issue masks even more complicated questions, such as whether certain types of investments or investors might want to require more explicit provisions than others and, a related point, whether certain types of MFIs might or should be better prepared to handle explicit Principles-related provisions in their financing documents than others. For example, if an MFI conducts a portfolio sale or securitization of its microloans, one could argue that such an MFI *must* be able to demonstrate its adherence to a fairly sophisticated consumer protection policy or program (to ensure that it is not pushing credit inappropriately on to customers, knowing it can then sell those loans to others). Before investors engage in such an operation, they should evaluate whether the originating MFI has adopted and is adhering to the Principles.² An equity investor may include a provision requiring that shareholders and directors be informed quickly of any significant allegations of unethical lending practices. On the other hand, lenders that do not have a governance role in the MFI may want to rely more on due diligence before they decide to disburse a loan. This suggests that lenders may be particularly interested in including representations and warranties in their loan documentation about the policies and systems in place for credit products and for managing customer complaints.

² CGAP blog: <http://microfinance.cgap.org/2009/07/27/what-subprime-mortgage-securitizations-can-teach-us-about-sales-of-microcredit-portfolios/>

Another factor that is likely to shape the scope and reach of embedding the Principles into financing documentation is the requirements of local law and regulation. In some jurisdictions, provisions already often found in financing documentation (such as those that require MFIs to comply with all applicable legal and regulatory requirements) will capture local consumer protection requirements covering all or some of the Principles. In other jurisdictions, however, there may either be no consumer protection principles set out by law or regulation or, if present, their applicability to the form of MFI being financed may be unclear. As a starting point, if an investor (debt or equity) includes a requirement in its documentation that the MFI comply with all applicable laws and regulations, then it would be appropriate for the investor to have its local counsel assess the extent to which such laws and regulations impose any customer care or ethical lending practice requirements on the MFI.

Finally, many socially responsible investors have long included in their financing documentation ethical business standards that may exceed standards of care imposed by local law or regulation (see, for example, the provisions used by some investors to ensure that the proceeds of their financing are not being on-lent to those who employ child labor or sell munitions and alcohol). Balancing compliance with these provisions and managing day-to-day lending operations is an area many MFIs already have mastered. It requires some flexibility and a sense of proportionality by the investing community as well.

Many investors feel that it is too early to start including explicit provisions related to the Principles into their financing agreements. Most feel that the priority should be on gaining buy-in from the investee’s management to make the kinds of organizational changes required to fully implement the Principles. This is likely to be a slow process, but working with MFIs on actions in the field clearly is more important than putting clauses in contracts. Some investors also note that there is not yet widespread industry consensus on the specifics of how to measure effective implementation of the Principles. The covenants would need to refer to the most generic level—for example, that the financing is conditional on an MFI’s endorsement/participation in the Campaign and ongoing adherence to the Principles. As long as it is not completely clear what MFIs need to deliver as part of engaging in the Campaign, there is room for interpretation of what is meant, and this could lead to disputes with the MFI.

However, a few investors have begun to include clauses expressly referring to the Principles in their financing agreements. Their view is that this provides a means to convey to partner MFIs that they, as investors, take these issues seriously. These investors recognize that these are general clauses that may be open to interpretation and difficult to enforce. However, they signal to MFI management that management is expected to focus on this area and that the investors will monitor implementation of the Principles.

KfW, for example, has drafted and inserted a clause into its model financing contract (see [Box 6](#)). This clause refers to avoidance of over-indebtedness, transparent pricing, and appropriate collections practices. It also adds a “cooling off” provision, by making sure that there is a period of time between disclosing complete loan terms to customers and their entry into the loan contract. This type of provision can help ensure that customers have adequate

time to reflect on whether they are prepared to manage this new debt obligation. **Aavishkaar Goodwell** refers to the Principles in its shareholder agreements. **Developing World Markets** is also considering amending its loan agreements to include additional covenants that will refer to compliance with the Principles.

Box 6: KfW's responsible finance clause

**Responsible Finance Klausel im
Mustervertrag für Förderkredite**



“The Borrower shall fully comply with all existing and future national laws and regulations on consumer protection especially in the area of financial services. The Borrower shall in particular provide its customers with clear and comprehensive information on the main characteristics of the financial services the customers seek. The Borrower shall, for example, have thoroughly informed its customers in good time before the signing of a loan agreement on the terms and conditions of the loan in a way easily understandable for the customer.

These loan agreements shall further contain such information and shall be drafted in a manner the customers are able to understand. Furthermore, the Borrower shall critically review the customer's repayment capacities before signing a loan agreement and shall refrain from any form of unfair or even harmful debt collection practices.”

6. Monitor implementation of Principles by investees through mandatory reporting and regular monitoring and evaluation.

Designing a system to monitor MFIs' progress in implementing the Principles is an important part of investor oversight. Monitoring processes will differ depending on the nature of the investor. Investors that invest directly and carry out field-based due diligence are typically incorporating a review of Principles implementation into their annual performance review. Others are designing surveys that will gather feedback from MFIs on implementation of the Principles.

Deutsche Bank conducts annual reviews of its investments. The process includes a question on how the Board ensures that the MFI is upholding the Principles. **BlueOrchard** has incorporated various Principles into its regular monitoring of MFIs. Investees are expected to report on social indicators, including client protection, as thoroughly and consistently as financial metrics. For example, investees report on transparency of pricing on a semi-annual basis by communicating their effective interest rate, which is then compared to their yield on portfolio. BlueOrchard is also in the process of incorporating into its reporting requests a question regarding avoidance of over-indebtedness and the maximum amount of disposable net income allowed as a client's monthly payment.

Grassroots Capital is first focusing on collecting examples of what MFIs are doing in this area to provide some concrete information about why MFIs think something is being achieved. This approach is designed to inform Grassroots Capital's own approach to measuring and assessing Consumer Protection Principles implementation performance and to build a database of practices that can be used to benchmark implementation of the Principles.

Lessons from Beyond Codes (see [Box 1](#)) will help inform investors of what indicators are the most objective and broadly useful when assessing implementation of the Principles.

7. Report on progress to investors and other stakeholders.

The final step is for investors to report their commitment to and action for implementing the Principles to their shareholders and other stakeholders. Some investors are already reporting on the Principles. With the financial crisis, many shareholders have increased their focus on the social impacts and returns of microfinance and are asking for more information to be reported. Equity funds, such as **Aavishkaar Goodwell**, have included the Principles in their social and environmental reporting, laying out the action steps taken to incorporate the Principles into their processes.

To hold investors accountable for progress in integrating the Principles into their processes, CGAP is proposing that each endorsing investor submit a simple annual report on concrete implementation actions. The report is very short and streamlined and focuses on specific steps that investors can take to move this work forward, using a checklist format (see [Annex 6](#)). The report was incorporated into the CGAP annual MIV survey initiative; a stand-alone

version was sent to investors that have endorsed the Principles but are not surveyed in the CGAP MIV Survey.

Results of the CGAP MIV Survey will be shared in September 2009 on the [CGAP Web site](#), but here are a few highlights: More than 60 percent of the MIVs have endorsed the Principles, of which over 40 percent informed their investees, nearly 50 percent included the Principles in their screening criteria, and more than 40 percent included them into their due diligence process.

Other investors that have endorsed the Principles through the investor initiative are strongly encouraged to report on these issues. Investors can send the report to Kate McKee (kmckee@cgap.org) and Estelle Lahaye (elahaye@cgap.org). The current report will establish a baseline against which future-year progress across the investor community can be measured. Aggregate results will be published each year in a benchmarking report and shared publicly on the CGAP Web site and at investor conferences, to increase the understanding of what action steps investors are taking to implement the Principles.

V. Implementation Challenges

Implementation of the Client Protection Principles is still at a very early stage. Developing due diligence criteria and procedures related to the Principles has only just started, and it will be possible only at a later stage to fully identify the successes and challenges involved in implementation.

However, questions and challenges that investors are facing have already emerged from the ongoing dialogue facilitated by CGAP. These critical questions and issues include the following:

- There are real challenges in evaluating implementation of some Principles (e.g., avoidance of over-indebtedness) because standards are not clear and are often market specific.
- How can endorsement of the Principles be checked and enforced? An MFI's adherence to the Principles may need to be externally verified (by the investor itself or, for instance, a rater) because it may be difficult to substantiate adherence through self-reporting (i.e., it is easier for MFI management to check boxes than to demonstrate actual behavior).
- How should an investor respond in a market where none of the MFIs is transparent? Should they decide not to invest, or invest while engaging with partners to improve practice?
- It is harder for an investor on its own to change behavior in a market; the roles of networks and policy makers are also important.

Some investors have taken action to address some of these implementation challenges. **Triple Jump**, for example, field-tested 10 client protection questions for its due-diligence protocol.

The questions turned out to be too open-ended, making responses challenging. Triple Jump is now developing more specific questions similar to those in the MIX Social Performance Standard questionnaire. **MicroCredit Enterprises** (MCE) has been working with **Microfinance Transparency** (a new organization that is working in selected countries to present information on credit products and their prices in a clear and consistent fashion and to educate stakeholders on the factors influencing MFI interest rates and product pricing decisions). All MFI partners of MicroCredit Enterprises in Peru have signed on to participate in the Peruvian Microfinance Transparency pilot. MCE expects that this will help ensure transparency in pricing among their partners.

Tools that could benefit investors have been developed to address some of the challenges at the MFI level. As mentioned earlier, the **Beyond Codes [Self-Assessment Guide on Client Protection for MFIs](#)** offers a set of rigorous indicators that investors can draw on for their due diligence process. Also, the **[MIX Social Performance Standards Report](#)** provides indicators on client protection. Some raters, such as Microfinanza Rating, MicroRate, and PlaNet Rating, have integrated the Principles into their ratings system. Such external ratings could be used to provide independent verification of implementation.

In terms of broader efforts to change market behavior, some investors may consider partnering with larger development finance institutions, such as KfW or the IFC/World Bank Group, which work on financial sector development at the macro level.

This Guide provides an overview of the current nascent state of practice among investors in implementing the Client Protection Principles. Given that these issues are very new and that there are challenges inherent in translating principles into practice, close collaboration and understanding between microfinance providers and their investors is necessary. Dialogue and sharing of experience will accelerate development of shared norms and high standards of responsibility across the microfinance industry.

VI. *Resources and Tools*

Investment policy and screening

FMO—[Guidelines for Consumer Finance](#) [PDF]

KfW—[Responsible Finance paper](#) [PDF]

responsAbility—[Guiding Principles](#)

Due diligence

Deutsche Bank—[Due diligence questionnaire for head office](#) [PDF]

Deutsche Bank—[Due diligence questionnaire for branch office](#) [PDF]

Deutsche Bank—[Loan application](#) [PDF]

Deutsche Bank—[Effective cost of borrowing](#) [PDF]

Deutsche Bank—[Effective interest rate calculator](#) [EXCEL]

FMO—[Guidelines for Consumer Finance](#) [PDF]

Incofin—[Social and Environmental Risk Methodology](#) [PDF]

KfW—[Responsible Finance Checklist at Institutional and Macro Levels](#) [PDF]

Oxfam Novib—[Social performance questionnaire](#) [PDF]

Triple Jump—[Due diligence questionnaire on client protection](#) [PDF]

Beyond Codes—[Self-Assessment Client Protection Guide](#)

Microfinance Transparency—[APR calculator](#)

MIX—[Social Performance Standards reporting for MFIs](#)

responsAbility—[Exclusion list for microfinance institutions](#)

Investment decision making

Deutsche Bank—[Investment decision memo](#) [PDF]

KfW—[Clause for financing contract](#) [PDF]

Monitoring

Deutsche Bank—[MFI annual review](#) [PDF]

Deutsche Bank—[Effective cost of borrowing](#) [PDF]

Deutsche Bank—[Effective interest rate calculator](#) [EXCEL]

Microfinance Transparency—[APR calculator](#)

Reporting

CGAP—[Client Protection Principles Reporting Guidelines for Investors](#) [EXCEL]

Grassroots Capital—[Social performance indicators](#) [PDF]

Annex 1

Draft Sample Letters from Endorsing Investor to Investee MFI

FOR INVESTORS WITH DIRECT RELATIONS WITH MFIS

Dear xxxxx

We wanted to let you know that [NAME OF INSTITUTION] has recently signed up to support the **Client Protection Principles for Microfinance**. The purpose of these Principles is to ensure that all providers of financial services to low-income populations take concrete steps to protect their clients from potentially harmful financial products and ensure that they are treated fairly.

There are six client protection principles:

- Avoidance of over-indebtedness
- Transparent pricing
- Appropriate collections practices
- Ethical staff behavior
- Mechanisms for redress of grievances
- Privacy of client data

Attached is a description of what each of these principles means in practice.

Additional text used by Developing World Markets

A commitment to avoid over-indebting clients is part of these core client protection principles, as well as carefully establishing the clients' ability to repay before granting the loan. Transparent pricing requires that the effective interest rate for the microcredit is prominently published in the loan contract and marketing materials. Ensuring that the microfinance client clearly understands the terms of the contract is a mutually beneficial practice to create a long-term relationship built on trust. A debt collection process should be established and clearly disclosed that does not deprive customers of basic survival capacity. Finally, incentives will also ideally be in place in your institutions to reward robust risk management.

You may have already heard of the accompanying *Campaign for Client Protection in Microfinance*, a collaborative initiative led by a broad coalition of microfinance institutions, networks and funders which reflects the consensus within the microfinance industry that now is the time to join together and proactively safeguard the interests of microfinance clients through appropriate policies, practices and products related to these principles.

[NAME OF INSTITUTION] is committed to building the Client Protection Principles into our own investment policies, including our due diligence and monitoring and reporting processes. We would like to do this as a collaborative process with our partner MFIs. Together we aim to identify how best to implement the principles and incorporate them into your policies, procedures, staff training, and compensation incentives.

During our next visit, we look forward to discussing the Principles with you in more depth. If you haven't already done so, we would also encourage you to review and consider endorsing the Client Protection Principles yourself (see www.campaignforclientprotection.org).

FOR INVESTORS WORKING THROUGH INTERMEDIARIES

Dear xxxxx

We wanted to let you know that [NAME OF INSTITUTION] has recently signed up to support the **Client Protection Principles for Microfinance**. The purpose of these Principles is to ensure that all providers of financial services to low-income populations take concrete steps to protect their clients from potentially harmful financial products and ensure that they are treated fairly.

There are six client protection principles:

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- Transparent pricing
- Appropriate collections practices
- Ethical staff behavior
- Mechanisms for redress of grievances
- Privacy of client data

Attached is a description of what each of these principles means in practice.

You may have already heard of the accompanying *Campaign for Client Protection in Microfinance*, a collaborative initiative led by a broad coalition of microfinance institutions, networks and funders which reflects the consensus within the microfinance industry that now is the time to join together and proactively safeguard the interests of microfinance clients through appropriate policies, practices and products related to these principles.

[NAME OF INSTITUTION] is committed to building the Client Protection Principles into our investment policies, and will be doing this in partnership with [[our fund managers]]. If you haven't already done so, we would also encourage you to review and consider endorsing the Client Protection Principles yourself (see www.campaignforclientprotection.org).

Annex 2

FMO Guidelines on Consumer Finance

Introduction:

Consumer finance should be executed in an ethical and responsible manner, which ensures consumer protection, provides transparency and discloses relevant information to the consumer. Abusive consumer lending practices, like usurious interest rates, overburdening and intimidation at collection should be avoided. Below you will find guidelines to evaluate a responsible consumer finance provider. We have used the EU guidelines (which are in proposal phase) as well as the best business practices from FMO's portfolio of consumer finance providers.

FMO Basic guidelines:

1. Disclosure of information:

In advertising, pre-contractual information and credit agreements the consumer finance provider should disclose basic information related to the credit: interest rate or annual percentage rate of charge (APR), total amount of credit, duration of credit, number size and frequency of installments, fees, total costs of the credit, overdue charge, conditions for prepayment. Although in advertising you will not find all the basic information requirements, these requirements need to be covered in the credit agreement between the provider and the consumer.

2. Right of withdrawal/early repayment

The consumer finance provider should provide a right of withdrawal. Although EU guidelines grants a 14 days right of withdrawal without paying a penalty, this seems quite long for emerging markets. At least a certain period should be stated in the contract. The consumer should have the option to repay early against a fair and objective indemnity for the provider of consumer finance.

3. Affordability check/avoidance of over-indebtedness

The consumer finance provider needs to assess prior to extending the loan whether the consumer has sufficient and sustainable repayment capacity. Although no general rule for affordability exists, the provider should have debt servicing limit(s) in place. One criteria of affordability often used is the installment (interest plus repayment amount plus fees) divided by disposable income. Disposable income is measured as net disposable income after fixed charges such as rent, standard living expenses (water, electricity, etc) and other recurring financial expenses (school fees, mortgages, other installments etc). This installment is preferably to be below 30% but should not be above 50% of disposable income.

Avoidance of over-indebtedness is safeguarded by two means: 1) taking into account the repayment obligations of the consumer to other providers into the calculation of disposable income and the maximum limit, 2) by checking credit history at credit bureaus. Check if provider has these mechanisms in place.

4. Responsible Credit collection

The consumer finance provider should follow responsible collection policies, i.e.:

- (a) communicate with the consumer directly at normal hours (not before 8 am in the morning or after 9 pm) at the borrower's premises;
- (b) not communicate with third parties with regards to the debt except with permission of the consumer;
- (c) do not harass, oppress or abuse any person in the collection of the debt including prohibition of publication of a list of consumers allegedly in default (no name and shame policy);
- (d) not make any false or misleading representations;
- (e) validate the debt by a written notice sent to the consumer stating the amount, name of creditor and response period (usually 30 days).

Additional guidelines for best practices:

1. Non-discrimination and Equal opportunity lending

Consumer finance provider may not restrict or deny a loan or discriminate in the credit terms based on age, race, color, religion or sex, handicap, family status or origin. In general a consumer finance provider will take into account the above-mentioned characteristics to determine the creditworthiness of a client however a provider should not have stated or implicit policies excluding certain groups.

2. Refrain from unfair contract terms

Examples could be forced cross-selling or change the rules on the interest rate, etc.

3. Treatment of non-performing credit agreements

Responsible providers will have transparent and modest application of late payment fees, arrears interest and/or penalty fees. Charges may not exceed legal limits (if applicable) or at least should not exceed the "in duplum" rule, which states that the total claim against the consumer cannot exceed twice the remaining outstanding balance in case of default.

Annex 3

KfW Checklist for Promoting Responsible Finance



Check List for Promoting Responsible Finance at institutional and macro levels

Note: These issues represent an incomplete sample of Responsible Finance-related questions. They need not to be addressed in each and every context nor with equal depth. They are meant to indicate possible areas of concern. Whenever such concerns materialize, analysis should be deepened accordingly in order to form a well-founded opinion.

Issues to be considered	Recommendations /documents to ask for
1. <u>Systems, Policies and Procedures to Avoid Client Over-indebtedness</u>	
<p>Assessing client repayment capacities. What is your policy for assessing client repayment capacities? Which systems, means of communication, tools etc. do you use to avoid client over-indebtedness?</p>	<ul style="list-style-type: none"> • Written policy, guidelines and/or manual should be in place. Provide a copy of policy or manual • How long does it take to extend a loan? • What are the differences in analyzing MSME and non-MSME clients? • What is the end-clients' Forex exposure? • Provide information on credit selection process
<p>Human resource policies. What training activities and incentives do you provide for staff in order to discourage practices leading to potential client over-indebtedness?</p>	<ul style="list-style-type: none"> • Provide information on such policies and activities
<p>Are financial indicators showing any signs for concern regarding responsible finance?</p>	<p>Check if there is a high correlation of (high) average Return on equity, high interest rates, high level (also in absolute terms) of NPLs/losses and a low level of loan loss reserves. A constellation with a RoE > 25 %, a PAR 30 days of > 10 %, interest rates of > 40 % and insignificant levels of loss reserves would give a first hint to irresponsible lending practices.</p>
2. <u>Transparency and Lending Practices</u>	
<p>Advertising/Marketing. What information do you disclose in advertisements and how? Particularly, how are loan and deposit conditions to clients marketed?</p>	<p>Please provide copies of your recent ads. Refrain from aggressive marketing (e.g. "blacklisted clients welcome", "0 % interest rate" and the like)</p>
<p>Transparency in loan contracts. Do you provide all the necessary information the customers need in order to take an informed decision when taking a loan? Are both the content and the language used in your loan contracts clear and understandable given the level of financial literacy of your clients? How do you inform the customer about his/her rights as borrower?</p>	<ul style="list-style-type: none"> • Please provide a specimen loan contract; • Disclose effective interest rates, including all fees, charges and commissions; • What would be the real effective interest rate? • In the case of variable interest rates, explain the consequences for the borrower and document your communication with the client; • Disclose all relevant info, such as amount of credit, total cost of credit, number and volume of instalments/payment schedule.
<p>Debt collection practices. What is your policy for debt collection practices? Are you selling loans in arrears to specialized collection institutions? If so, how is this being practiced?</p>	<ul style="list-style-type: none"> • Unfair debt collection practices, such as treatments undermining human dignity, not respecting data privacy, refusing any rescheduling arrangement e.g. in the case of natural disasters etc. are critical issues; • Be careful with outsourcing debt collection to debt collection companies; if you do, track their processes and ensure responsible practices.
<p>Complaint management. If clients wish to make complaints, what is your approach to deal with these?</p>	<ul style="list-style-type: none"> • Treat complaints as seriously as your clients!
<p>Data privacy. How do you ensure data protection and privacy of client related data?</p>	

Issues to be considered	Recommendations / documents to ask for
3. <u>Scale of Consumer Lending</u>	
<p>Scale of household/consumer lending. What is the percentage of Non-MSME credits in your loan portfolio?</p> <p>Which part of the non MSME loans are “pure” consumer loans (leisure related loan uses such as TV sets and the like)?</p>	<ul style="list-style-type: none"> • Keep a focus on MSME loans • Percentage of non MSME loans of up to 40 % in the overall loan portfolio is not problematic, provided that credit selection is made rigorously; • Under this condition, the share of “pure” consumer loans would not raise any concerns in a range up to 15-25 %; • In case of higher percentages, review critically and explain (e.g. well-known clients, loan use for asset building/preservation, income thresholds for loan amounts/debt service etc.)
<p>Policy for household/consumer lending. If you provide household/consumer credits, what is your policy?</p> <p>Risk Management. How do you manage risks of providing household credit through collateral?</p> <p>Exclusion criteria. Are there any exclusion criteria and/or risk mitigation instruments for household credits? Which ones?</p>	<ul style="list-style-type: none"> • Provide policy/risk document on household/consumer loans • Focus household/consumer lending on clients with good track record and doubtless debt repayment capacities, no consumer loans to clients with an arrear history; • Focus on loan uses that help build or preserve household assets (housing improvement, education, health) • Limit maximum loan amount to a certain percentage to available client income or debt service • Examples for collateral: payroll deduction, solidarity group guarantees, savings account with minimum of savings.
4. <u>Conducive Framework Conditions for Responsible Finance</u>	
<p>Does the country have a consumer protection regulation for financial services?</p> <p>Voluntary Codes of Practice: do they exist and how effective are they? Who develops them?</p> <p>Are there legal lending limits to customers, depending on their debt repayment capacities?</p> <p>What out-of-court-remedies are there for the settlement of client disputes besides your own complaint management system?</p> <p>Do industry-wide credit registry systems exist, and if so, do you have access to them?</p> <p>Does a deposit insurance fund exist and how effective is it in the event of bank failures?</p> <p>How do supervisory bodies take into account the need to improve the financial literacy of clients?</p>	<p>Check the existing documentation on existing laws and regulations, voluntary codes etc.</p> <p>Review the state of financial literacy of clients; what are the key bottlenecks in this area?</p> <p>All unfair client treatment, particularly loan collection practices should be banned.</p>

Annex 4

Incofin Social Performance Assessment Tool




Incofin IM's Social and Environmental Risk Score

→ INCOFIN ECHOS© uses 4 indicators (out of total 43) to capture aspects of Responsible Finance and Client Protection Principles

DIMENSION 3. QUALITY OF CUSTOMER SERVICE (30 points)			
3.1. Client satisfaction and client Desertion (drop-out)			
3.1.1	<input type="checkbox"/> 0 No <input type="checkbox"/> 1 Yes		
3.1.2	<input type="checkbox"/> 0 No <input type="checkbox"/> 1 Yes		
3.1.3	<input type="checkbox"/> 0 No <input type="checkbox"/> 1 Yes		
3.2. Products and services offer and adequacy			
3.2.1	<input type="checkbox"/> 0 No <input type="checkbox"/> 1 Yes		
3.2.2	<input type="checkbox"/> 0 No <input type="checkbox"/> 1 Yes		
3.3 Speed of Transactions:			
	<input type="checkbox"/> 0 > 1 week <input type="checkbox"/> 1 < 1 Week		
3.4. Responsible Finance and Client Protection Principles			
3.4.1	Is the information provided to clients - regarding pricing - transparent? <i>(e.g. In brochures, in the contract, etc.)</i>	<input type="checkbox"/> 0 No <input type="checkbox"/> 0.5 Partially <input type="checkbox"/> 1 Yes	
3.4.2	Does the MFI have clear consumer protection policies <i>against over-indebtedness? (e.g. In credit manual, using specific ratios, etc.)</i>	<input type="checkbox"/> 0 No <input type="checkbox"/> 0.5 Partially <input type="checkbox"/> 1 Yes	
3.4.3	Does the MFI have guidelines that prevent abusive debt collection practices? <i>(e.g. In Manuals of policies and procedures, training materials, etc.)</i>	<input type="checkbox"/> 0 No <input type="checkbox"/> 0.5 Partially <input type="checkbox"/> 1 Yes	
3.4.4	Does the MFI have responsive mechanisms for complaints? <i>(e.g. Complaints phone line, complaints boxes, special P&P, etc.)</i>	<input type="checkbox"/> 0 No <input type="checkbox"/> 0.5 Partially <input type="checkbox"/> 1 Yes	
3.4.5		<input type="checkbox"/> 0 No <input type="checkbox"/> 1 Yes	
SCORE FOR QUALITY OF CUSTOMER SERVICE		0 / 30	


Annex 5

Extract of Deutsche Bank Loan Application Related to the Principles

 <p style="font-size: 1.2em; font-weight: bold; margin: 0;">Deutsche Bank</p> <p style="font-weight: bold; margin: 0;">EXTRACT OF LOAN APPLICATION</p>																			
SOCIAL IMPACT																			
➤ <i>Is your institution a signatory to the Client Protection Principles?</i>	<table border="1" style="margin: auto; border-collapse: collapse;"> <tr> <td style="padding: 2px 10px;">YES</td> <td style="width: 20px; height: 15px;"></td> <td style="padding: 2px 10px;">NO</td> <td style="width: 20px; height: 15px;"></td> </tr> </table>	YES		NO															
YES		NO																	
➤ <i>Does your Board monitor the institution’s performance relative to the Client Protection Principles (avoiding client over-indebtedness, ensuring transparent communication with clients about terms of loans, ensuring appropriate collections practices are followed, ensuring ethical codes of conduct are followed, resolving client complaints)?</i>	<table border="1" style="margin: auto; border-collapse: collapse;"> <tr> <td style="padding: 2px 10px;">YES</td> <td style="width: 20px; height: 15px;"></td> <td style="padding: 2px 10px;">NO</td> <td style="width: 20px; height: 15px;"></td> </tr> </table>	YES		NO															
YES		NO																	
➤ <i>What does your institution do to avoid client over-indebtedness? (Put an X next to all that apply)</i>	<table border="1" style="width: 100%; border-collapse: collapse;"> <tr> <td style="padding: 2px;">Has written credit policies that give decision makers (loan officers, supervisors, etc.) explicit guidance regarding borrower debt thresholds</td> <td style="width: 50px;"></td> </tr> <tr> <td style="padding: 2px;">Credit underwriting process includes an evaluation of client ability to repay the loan</td> <td></td> </tr> <tr> <td style="padding: 2px;">Credit underwriting process includes checks on client credit history and existing debt</td> <td></td> </tr> <tr> <td style="padding: 2px;">Loan product options are flexible enough to fit client business and/or household needs</td> <td></td> </tr> <tr> <td style="padding: 2px;">Does not rely solely on guarantees for repayment</td> <td></td> </tr> <tr> <td style="padding: 2px;">Clients receive training/guidance on evaluating their own debt capacity</td> <td></td> </tr> <tr> <td style="padding: 2px;">Management regularly obtains information about debt levels among its clients</td> <td></td> </tr> <tr> <td style="padding: 2px;">Uses peer assessment (in group methodologies)</td> <td></td> </tr> <tr> <td style="padding: 2px;">Other (please specify): _____</td> <td></td> </tr> </table>	Has written credit policies that give decision makers (loan officers, supervisors, etc.) explicit guidance regarding borrower debt thresholds		Credit underwriting process includes an evaluation of client ability to repay the loan		Credit underwriting process includes checks on client credit history and existing debt		Loan product options are flexible enough to fit client business and/or household needs		Does not rely solely on guarantees for repayment		Clients receive training/guidance on evaluating their own debt capacity		Management regularly obtains information about debt levels among its clients		Uses peer assessment (in group methodologies)		Other (please specify): _____	
Has written credit policies that give decision makers (loan officers, supervisors, etc.) explicit guidance regarding borrower debt thresholds																			
Credit underwriting process includes an evaluation of client ability to repay the loan																			
Credit underwriting process includes checks on client credit history and existing debt																			
Loan product options are flexible enough to fit client business and/or household needs																			
Does not rely solely on guarantees for repayment																			
Clients receive training/guidance on evaluating their own debt capacity																			
Management regularly obtains information about debt levels among its clients																			
Uses peer assessment (in group methodologies)																			
Other (please specify): _____																			
➤ <i>How does your institution ensure transparent communication with clients about prices, terms and conditions of financial products? (Put an X next to all that apply)</i>	<table border="1" style="width: 100%; border-collapse: collapse;"> <tr> <td style="padding: 2px;">Contracts and information use plain language and provide full disclosure of prices, terms and conditions</td> <td style="width: 50px;"></td> </tr> <tr> <td style="padding: 2px;">Interest rates (incl. fees, commissions) or other product prices are published, displayed and provided to clients</td> <td></td> </tr> <tr> <td style="padding: 2px;">Penalty and pre-payment fees are disclosed before loan contracts are signed</td> <td></td> </tr> <tr> <td style="padding: 2px;">Amortization schedule in loan contract separates principal, interest, fees, and shows amount and due dates of installments</td> <td></td> </tr> <tr> <td style="padding: 2px;">Communications address client literacy limitations (e.g. reading contracts out loud, materials in local languages)</td> <td></td> </tr> <tr> <td style="padding: 2px;">Clients have an opportunity to ask questions and receive information prior to signing contracts</td> <td></td> </tr> <tr> <td style="padding: 2px;">Clients receive transaction receipts and regular, clear, accurate account statements</td> <td></td> </tr> <tr> <td style="padding: 2px;">Other (please specify): _____</td> <td></td> </tr> </table>	Contracts and information use plain language and provide full disclosure of prices, terms and conditions		Interest rates (incl. fees, commissions) or other product prices are published, displayed and provided to clients		Penalty and pre-payment fees are disclosed before loan contracts are signed		Amortization schedule in loan contract separates principal, interest, fees, and shows amount and due dates of installments		Communications address client literacy limitations (e.g. reading contracts out loud, materials in local languages)		Clients have an opportunity to ask questions and receive information prior to signing contracts		Clients receive transaction receipts and regular, clear, accurate account statements		Other (please specify): _____			
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Other (please specify): _____																			

Annex 6

CGAP Reporting Guidelines for Investors

 Client Protection Principles Reporting Guidelines for Investors	
<p>The Client Protection Principles for microfinance and the accompanying Campaign for Client Protection in Microfinance are part of a collaborative initiative endorsed and led by a broad coalition of microfinance institutions, networks, funders, and practitioners. The purpose of the Campaign, which is housed at the Center for Financial Inclusion, is to ensure that providers of financial services to low-income populations take concrete steps to protect their clients from potentially harmful financial products and ensure that they are treated fairly.</p> <p>Consensus has emerged about the following six Client Protection Principles (CPPs):</p> <ul style="list-style-type: none"> • Avoidance of over-indebtedness • Transparent pricing • Appropriate collections practices • Ethical staff behavior • Mechanisms for redress of grievances • Privacy of client data <p>Investors endorsers agree that the overall issue of client protection is important, and that these six specific principles are deserving of attention by the field as a whole. This entails a commitment to build the six principles into their own investment processes – screening, due diligence, monitoring, reporting, governance, and so on.</p> <p>To hold ourselves accountable for actual progress in implementing consideration of the CPPs into investor process, CGAP is proposing that each endorsing investor submit this simple report annually on the concrete actions they have taken to implement the principles.</p> <p>The report focuses on specific steps that investors are taking to move this work forward, using a checklist format.</p> <p>Details of this survey will remain confidential. Aggregate results will be analyzed and shared publicly to increase the understanding of what action steps investors are taking to implement the CPPs. This survey will be conducted yearly. Questions will be modified as practical implementation of the CPPs develops.</p> <p>We thank you in advance for completing this survey by June 8, 2009 and returning it to Estelle Lahaye (elahaye@worldbank.org) or Kate McKee (kmckee@worldbank.org)</p>	
General	
Organization's Name	
Institutional type	Select institutional type <input type="button" value="▼"/> If other, please specify: <input type="text"/>
For investment organization only:	
Total assets (December 31, 2008)	USD <input type="text"/>
Total microfinance investments (December 31, 2008)	USD <input type="text"/>
Contact to discuss implementation of CPPs	
First and last names	<input type="text"/>
Email	<input type="text"/>

Client Protection Reporting Guidelines for Investors

<p>Has your organization officially endorsed the Client Protection Principles?</p>	<p><input type="checkbox"/> Yes</p> <p><input type="checkbox"/> No</p> <p><input type="checkbox"/> Want more information</p>
<p>How does your institution incorporate the Client Protection Principles into your investment policies? (Check all that apply)</p>	<p><input type="checkbox"/> We have informed all our investee MFIs of our endorsement of the CPP</p> <p><input type="checkbox"/> We have revised our screening criteria to include CPP-related issues</p> <p><input type="checkbox"/> We have revised our due diligence guidelines to include assessment of MFIs' implementation of the CPP</p> <p><input type="checkbox"/> Staff/consultants/fund managers are trained on the CPP and how to integrate into the investment process</p> <p><input type="checkbox"/> MFI implementation of the CPP is a factor in our investment decision-making</p> <p><input type="checkbox"/> For equity investors: we have successfully got discussion of and endorsement of the CPP onto the Board agenda of partner MFIs</p> <p><input type="checkbox"/> Compliance with the CPP is referred to in our financing agreements (e.g. within covenants, as an annex)</p> <p><input type="checkbox"/> We have requested social auditors/raters we use to pay attention to CP issues</p> <p><input type="checkbox"/> MFIs are requested to report on their implementation of the CPP:</p> <p style="padding-left: 20px;"><input type="checkbox"/> As part of our regular MFI reporting format</p> <p style="padding-left: 20px;"><input type="checkbox"/> Through the MIX Social Performance Standards report</p>
	<p>If other, please specify:</p>
<p>If you have other policies or practices designed to protect clients and ensure their fair treatment, please provide details here:</p>	