



Keeping clients first
in microfinance

**Putting the Principles to Work:
Detailed Guidance on the Client Protection Principles**
Version 2.0. September, 2011

PREFACE

This draft guidance is intended to engage participants in developing a consensus on the meaning and interpretation of each of the Client Protection Principles (CPPs). It gives general guidance on how each principle should be applied.

The document is based on a slightly revised list of principles from the original six developed in 2008 which formed the basis of the Smart Campaign. The changes are proposed in order to open the CPPs beyond credit to accommodate all the major types of financial products. The new principles address the same issues as the original principles, though in a way that allows them to be applied to multiple products. Only one new concept has been introduced: non-discrimination, as part of the principle on respectful treatment of clients. The order of presentation has been adjusted to move from products and delivery mechanisms to client treatment, and ending with complaint resolution.

In revising the principles, we sought to keep the changes to a minimum. There are now seven principles. The following table shows how the new seven map into the original six.

Proposed Revised CPPs	Original CPPs
1. <i>Appropriate Product Design and Delivery</i>	
2. <i>Prevention of Over-indebtedness</i> <ul style="list-style-type: none"> • Slight wording change 	1. <i>Avoidance of Over-indebtedness</i> <ul style="list-style-type: none"> • In the original, product design and over-indebtedness were combined. They are now separated to ensure independent focus on both over-indebtedness and product design.
3. <i>Transparency</i>	2. <i>Transparent and Responsible Pricing</i> <ul style="list-style-type: none"> • Separated to highlight the importance of transparent communications as a broad principle while retaining the focus on responsible pricing.
4. <i>Responsible Pricing</i>	
5. <i>Fair and Respectful Treatment of Clients</i> <ul style="list-style-type: none"> • Collections practices and ethical behavior are incorporated here • New item here: non-discrimination 	3. <i>Appropriate Collections Practices</i> <ul style="list-style-type: none"> • This is credit-focused and so has been incorporated into a more inclusive item.
	4. <i>Ethical Staff Behavior</i> <ul style="list-style-type: none"> • See fair and respectful treatment principle
6. <i>Privacy of Client Data</i>	5. <i>Redress of Grievances</i>

<ul style="list-style-type: none">• Last two items are reversed in order. Resolution of complaints is a more suitable way to end the listing.	
<i>7. Effective Complaint Resolution</i> <ul style="list-style-type: none">• Unchanged except for new name	<i>6. Privacy of Client Data</i>

The guidance document begins with a general discussion of each principle and then discusses product-specific applications as the principle applies to credit, savings, payment services, and insurance. The discussions by product are at a relatively early stage of development. Detail will be added in the coming months, particularly in these areas: branchless banking, payments, savings, and microinsurance.

This is a working document, and comments are encouraged. Please address any comments to comments@smartcampaign.org.

1. Appropriate Product Design and Delivery Channels

Principle

Providers will take adequate care to design products and delivery channels in such a way that they do not cause clients harm. Products and delivery channels will be designed with client characteristics taken into account.

Introduction

Financial service providers have a responsibility to exercise good faith in designing products that are suitable for the clients and to not take advantage of client inexperience and/or underdeveloped markets. They should take active steps to consider the characteristics of target clients during the design process. Products should function as advertized, provide value for money, and not be deceptive in design.

The following six core elements of appropriate product design and delivery provide a fuller picture of what is meant by and encompassed in this concept: suitable product design; suitable product delivery; simplicity; no waivers of client rights; minimum changes; and affordability.

Suitable product design. Considerable care should be given to designing products that suit client needs while being simple and flexible. As one example, loan repayment schedules are best structured to correspond with the expected cash flows of borrowers. The point of suitability is not to over-design products for narrowly defined purposes, but to ensure that the products are designed to be useful for clients. In delivering products, providers should gather sufficient information from the customer to ensure that the product is likely to meet the customer's needs and capacity.¹

Suitable product delivery. Product design should take into account the process by which products will be sold, as discussed further under Fair and Respectful Treatment.

Simplicity. Simple products, including products with simple pricing, are easier for clients to understand and compare. Simple products may be more affordable and flexible for clients. Simplicity implies minimizing the use of bundled products (that is, requiring a client to buy a second product, such as credit life insurance, in order to use a first product, such as a loan).² We note that simplicity is not an absolute value: it must serve product relevance and usefulness.

¹ For more information see the Smart Campaign's "Avoidance of Over-indebtedness: Guidelines for Financial and Non-financial Evaluation" (<http://smartcampaign.org/tools-a-resources/514>).

² Product tying in the U.S. is often considered illegal because of its anticompetitive nature. (Sherman Antitrust Act and the Bank Holding Company Act Amendments of 1970.

No waivers of client rights. As a general rule, clients should not be asked to waive their rights, such as the right to sue the provider, receive information, cancel use of the product, maintain privacy, etc.³ If a financial service provider considers a waiver imperative, for example if a product is not viable without a waiver, then this should be made clear to the client. Waivers requested for the convenience of the provider are generally not appropriate.

Minimum changes. Products should be designed in a way that minimizes the possibility that product changes, such as unexpected changes in pricing, terms or fees will become necessary during the course of the product's life.

Affordability. Affordability consists of two elements: the cost to the client in the form of interest rates, fees, premiums, etc. (addressed in detail under the principle on responsible pricing) and, for loans and insurance products, the size of the product (loan size or insurance coverage amount) and periodic payment required. These costs should fit reasonably within the client's paying capacity, taking into account the client's overall financial situation. At the time of issuance, providers should confidently expect that clients will not have to make significant sacrifices to their standard of living or business affairs in order to pay for their financial products.⁴

Client Responsibilities⁵

Microfinance clients are responsible for educating themselves about their financial requirements and working with the providers to ensure that they select the products that suit their needs and take their financial capacity into account. Microfinance clients should understand that they are not compelled to take any products that do not meet their needs.

Appropriate product design and delivery issues by product

Credit products

Over-indebtedness. A major focus of credit product design is the prevention of client over-indebtedness, as described in the section on that principle. Over-indebtedness is avoided in product design through eligibility criteria and other terms that balance loan size against a client's capacity to repay.

Cooling off period. For some loan products and types of clients it can make sense to include a cooling off period, which is defined as a period of time during which the borrower can decide to cancel the loan (or other product) after the contract has been signed. Cooling off periods help to compensate for situations in which the borrower simply changes his or her mind or might have experienced sales or other pressure.

³ Rights provided by legislation typically cannot be waived unless the legislation specifically allows waivers.

⁴ For more information, see the Smart Campaign's "Smart Note: Transparent and Responsible Pricing at Mi-Bospo" (<http://smartcampaign.org/tools-a-resources/330>).

⁵ For more information, see the Smart Campaign's "Educating Clients about Client Protection: A Guide for Financial Service Providers" (<http://smartcampaign.org/tools-a-resources/499>).

Savings products

Minimum balances. The purpose of minimum balances should be to compensate the financial institution for the cost of maintaining the account. If balances fall below the minimum, the fees should be calculated on the basis of these costs (that is, not excessive). Providers are encouraged to evaluate whether their minimum balance level might be inadvertently excluding part of their target market.

Fee structure. The importance of transparent fee structures is discussed in the section on Transparency. A topic of particular concern for savings accounts is fees that significantly deplete small account balances. Financial institutions are encouraged to assess how they can viably provide the account while offering a service of value for clients.

Account closing. Unless there are significant or other regulatory costs associated with closing accounts, it is inappropriate to charge fees or create other restrictions to closing accounts.

*Compulsory savings.*⁶ For loan products for which compulsory savings serve as collateral, the savings product should be designed specifically for that purpose and there should be full disclosure of the purpose of the savings. Clients should have the right to withdraw their savings after the loan has been repaid, because there is no longer any need for collateral. In addition, it is recommended that the provider evaluate the pros and cons of combining voluntary and compulsory savings in one account or keeping them in separate accounts, such as a trust account. All financial institutions that provide compulsory savings, especially those that are not regulated as deposit taking institutions, should take the necessary prudential steps to ensure that these savings are not at risk.

Overdraft protection. In a number of more developed markets overdraft protection creates a risk of over-indebtedness for inexperienced clients. This refers to allowing clients to overdraw savings accounts when they submit payment or withdrawal requests that deplete the account and then charging interest and/or fees for this service. Financial institutions should analyze the client's creditworthiness before providing overdraft protection, and ensure that the client understands and agrees to the product terms. The service should only be activated with client consent.

Cooling off periods may be relevant for long term savings products with postponed access or penalties for access.

Insurance products

Exclusions for health insurance policies. Policy exclusions are not always well understood by clients and can be difficult and expensive for the provider to monitor and enforce. While they may be necessary, at times, for the overall viability of the product, there is a general preference in favor of simplicity and fewer exclusions. Waiting periods can be a means of reducing the overall cost to the insurance provider and therefore making the policy more affordable for the client.

⁶ For more information, see the Smart Campaign's "Smart Savings: Client Protection in the Savings Process" (<http://smartcampaign.org/tools-a-resources/286>).

Cooling off period. Particularly for clients of low income or limited education it can make sense to include a cooling off period during which the client can decide to cancel the policy after the contract has been signed.

Credit life products. Mandatory credit life products can be designed responsibly, but sometimes they are not, for example when premiums are significantly higher than expected payouts or when clients are not made aware that they are purchasing insurance. Instead of insurance, a well structured loan with appropriate collateral or guarantees, together with a policy for general loan loss reserves, may be sufficient to protect the lender if a client dies.

Payments products⁷

Reliable payment agents. For domestic and international payments, the paying agents that receive and disburse cash are central to product delivery, particularly given the rise of mobile phone banking and agent/correspondent banking. As a general principle, providers are responsible for ensuring that their agents operate according to the client protection principles. Payment service providers must use their best efforts to ensure that the organization receiving and making the payment is reliable. For international payments, providers should consider advising their clients if the payment agent is not known to them.

Excessive delay of payment. Money transfer payments should be made within a reasonable period of time, although this advantage should be weighed against the potentially higher cost of the service.

Predictable exchange rate. For international transfers, it is recommended that payment providers develop a standard system for fixing the exchange rate that can be advised to the client. It is recognized that fixing the exchange rate is often the prerogative of a third party and can therefore be beyond the control of the payment provider.⁸

⁷ Additional information about appropriate product design of payments products, including efforts to create a global code of conduct for international payments, can be found at www.worldbank.org/grwg. This site includes a document entitled “An International Remittances Customer Charter: Toolkit for National Action,” November 2009. (<http://siteresources.worldbank.org/FINANCIALSECTOR/Resources/282044-1257537401267/G8GRWG-CodesofConduct.pdf>.) Currently the only relevant national charter is Remittances Customer Charter developed by the UK Remittances Task Force (www.moneymadecear.org/uk/pdfs/remittances_customer_charter.pdf)

⁸ The two most common constraints are: (1) the sending agent does not know the exchange rate at the time that the payment order is made and therefore adds a margin of protection to the rate and (2) if the payment is made through an “open” system and the sending agent does not have a contractual relationship with the paying agent, the sending agent will not know what fees or taxes or waiting period will be applied by the paying agent.

2. Prevention of Over-indebtedness

Principle

Providers will take adequate care in all phases of their credit processes to determine that clients have the capacity to repay without becoming over-indebted. In addition, providers will 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).

Over-lending is perhaps the client protection problem most likely to cause significant harm, both to individual clients and to providers. One of the most critical lessons learned from overheated credit markets is the difficulty borrowers have in realistically assessing their loan repayment capacity. Practical experience and behavioral research indicates that borrowers often have difficulty judging their loan repayment capacity and may be 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. The most important way to do so is through credit processes that analyze client capacity to repay. The entire credit process⁹ (from sales through collections) should be designed with this in mind, and other internal systems (human resources, information, internal audit, etc.) should provide further reinforcement. As over-indebtedness appears in markets that are especially competitive or expanding rapidly, it is also important for providers to participate in market-level initiatives to prevent over-indebtedness, such as the development of credit reference systems.

Elements of prevention of over-indebtedness include: the client underwriting process, loan terms and conditions, sales techniques, staff incentives, monitoring systems, and market initiatives.

*Client underwriting process.*¹⁰ For individual borrowers, an analysis of his or her repayment capacity is the best practice for assessing creditworthiness. This assessment will typically include a careful analysis of the borrower's existing cash flow, with considerably less emphasis on additional cash flow anticipated as a result of any new borrowing. Collateral and guarantees can be used as a secondary source of repayment and as confirmation of the borrower's commitment to repay, but the lending decision should be made on the basis of repayment capacity.

⁹ For more information, see the Smart Campaign's "Smart Lending: Client Protection in the Individual Loan Process" (<http://smartcampaign.org/tools-a-resources/100>).

¹⁰ For more information, see the Smart Campaign's "Avoidance of Over-indebtedness: Guidelines for Financial and Non-financial Evaluation" (<http://smartcampaign.org/tools-a-resources/514>); "MicroFund for Women: Client Business Evaluation Toolkit" (<http://smartcampaign.org/tools-a-resources/257>); "Opportunity Bank Serbia: Loan Calculator" (<http://smartcampaign.org/tools-a-resources/255>); "KMF: How to Assess Client Businesses" (<http://smartcampaign.org/tools-a-resources/256>); and "Smart Note: Facing Over-indebtedness at Partner Microcredit Foundation" (<http://smartcampaign.org/tools-a-resources/109>).

It is recommended that the methodology for assessing the creditworthiness of individual borrowers be reinforced by a quantitative loan approval limit based on the ratio of available cash flow to debt service payments. This ratio should incorporate a cushion for error and unexpected expenses. It should also be adjusted as needed; for example, during a period of high system-wide delinquency¹¹ a more conservative ratio may be called for.

In the case of group lending, the methodology for the assessment of creditworthiness can vary by group.¹² The key objective is a clear system for quantifying and monitoring the repayment capacity of group members. Guidance, as well as targeted training if possible, should be provided to the groups for assessing creditworthiness.

For group loan products that use group guarantees, it is important to ensure that the members understand the financial and reputational risks that they face if one of the group members becomes over-indebted and is unable to fulfill its responsibility to the group.

It is also useful to have a qualitative definition of over-indebtedness to help staff keep the main objective in mind and to avoid the rote use of numeric tools. An example of such a definition is a state in which a borrower has to make significant sacrifices to his or her standard of living or business affairs in order to repay debts.

The analytical process for assessing debt capacity should include a requirement for confirming information provided by a potential client, such as reference checks and site visits. This information can be useful for assessing not only the client's ability to repay but also his or her willingness to repay the loan.

Credit bureaus can be useful sources of information about a potential borrower's other loan commitments and borrowing history. However, it is important to have a realistic understanding of the reliability of this information and to adapt its use accordingly. If credit bureau information is known to be incomplete or out of date, for example, or if there is no credit bureau at all, then it is recommended that calculation of the client's repayment capacity take into consideration the possibility of additional non-disclosed client debt.

Procedures for automatic loan renewals or increases should be carefully evaluated to ensure that they do not conceal borrower problems or create problems by allowing clients to over-borrow or "bicycle" loans. Updating client assessments at the time of a new loan request or at an established periodic interval is an important element of these procedures.

One sometimes overlooked point is that too small a loan can also inadvertently create problems. Too small a loan can lead to situations in which the borrower seeks additional loans from one or more other lenders, thereby weakening the original loan provider's relationship with and understanding of the borrower's financial condition.

¹¹ For more information, see the Smart Campaign's "Fonkoze: Guide for Credit Agents—Evaluating Clients for Fonkoze's Post-Disaster Recovery Program" (<http://smartcampaign.org/tools-a-resources/254>).

¹² For more information, see the Smart Campaign's "Smart Lending: Client Protection in the Group Lending Process" (<http://smartcampaign.org/tools-a-resources/288>).

Loan terms and conditions.

Appropriate repayment schedule. Appropriate loan repayment schedules correspond with the borrower's cash flow. Requiring small, regular payments is the most convenient way to encourage borrower discipline and monitor performance. However, consideration should also be given to the needs of clients with seasonal cash flows, such as farmers, or those who have borrowed to buy equipment that will take time to be able to use effectively. Large bullet and balloon payments should be avoided because they put a burden on the client to accumulate a large sum of money. Large prepayment penalties can also reduce a client's ability to use loans for productive financial management.

Appropriate use of collateral. Collateral can be an important element of good loan product design. The borrower's willingness to provide collateral is an indication of the seriousness of the borrower's commitment to repay the loan. Collateral can also be used to protect the lender's interests in case of the borrower's default. As noted, however, the availability of collateral should not be the primary decision-making criterion.

The type of collateral used should be commensurate with the borrower's commitment. Excessive over-collateralization can create undue hardships for the client if the collateral is liquidated. Careful consideration should also be given to the results of liquidating collateral that is critical to the borrower's livelihood or home. On one hand, collateral should be important enough to the borrower that he/she does not want to lose it. On the other hand, removing a source of livelihood, such as a piece of equipment, can exacerbate a borrower's problems. It is important for lenders to have clear guidelines for what constitutes acceptable collateral.

Guarantees. Guarantees can be useful as a way to protect the lender's interests in case of the borrower's default, but the availability of guarantees should not be the primary decision-making criterion. There should be standard procedures for evaluating the creditworthiness of guarantors as well as the effective relationship to the client, and the consequent ability to call on that guarantor in case of default.

Foreign currency risk. If the provider has access to local currency funding and the borrower's operations are only in local currency, then local currency loans are preferred. If local currency loans are not available, then it is important to make this risk clear to the borrower and to add an extra margin to the calculation of the client's repayment capacity to allow for devaluation risk.

Sales techniques and staff incentives. To be added
(including avoiding aggressive sales; paying for clients on commission, financial education)

Monitoring systems. To be added

Market-level initiatives. To be added
(financial education and credit bureaus)

Client Responsibilities.

Clients are responsible for educating themselves on the prices, terms, and conditions of the financial products they consume. They 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. Clients are also responsible to provide full and accurate information about their financial situation, and to inform the provider if they are having difficulty repaying the loan.

3. Transparency

Principle

Providers will communicate clear, sufficient and timely information in a manner and language that clients can understand, so that clients can make informed decisions. The need for transparent information on pricing, terms and conditions of products is highlighted.

Introduction¹³

Transparent communications enable clients to take responsibility for their own financial decision making. When clients have clear, sufficient and timely information about product options, they are equipped to decide what products are best for them and to accept the consequences of their decisions. By fostering an atmosphere of open communication, transparency also strengthens the relationship between microfinance providers and clients. In addition, transparency – particularly pricing transparency – contributes to the development of efficient financial markets by laying the groundwork for fair competition and supporting the principle on responsible pricing.

Because microfinance clients typically have low levels of education or literacy and may be unfamiliar with formal financial products and their terms and conditions, it is the responsibility of providers to ensure that they communicate with clients in a way that clients can understand, such as using plain language, using the local vernacular, and in some cases communicating orally or in pictures. It is especially important to highlight the need for complete information on interest rates and fees, which may need to be communicated in multiple times, places and formats. “Key Facts” documents that summarize all the most important terms and conditions in easily understood language can be especially useful.

The following four core elements of product transparency provide a fuller picture of what is meant by and encompassed in this concept: clear use of language; complete cost and non-cost information; timely provision of information; and advising clients of their rights.

*Clear use of language.*¹⁴ Transparency requires using plain wording and straightforward terms, in the client’s own language, wherever possible. If complex wording has to be used for some reason, this should be highlighted and explained. Extensive use of footnotes, small font size

¹³ For more information, see the Smart Campaign’s “Transparency in Promotions and Sales: A Checklist for Financial Service Providers” (<http://smartcampaign.org/tools-a-resources/494>).

¹⁴ For more information, see the Smart Campaign’s “Loan Agreement for Small Business Clients” (<http://smartcampaign.org/tools-a-resources/275>).

and other presentational issues are best avoided, because these can be confusing or even misleading for clients. Particular attention should be paid to the needs of clients who cannot read or who have other barriers to understanding, such as blindness or, for youth, lack of experience. These guidelines for the use of language apply to all means of presenting information, including advertising, product descriptions and contracts.

*Complete cost information.*¹⁵ Complete cost information entails explaining interest rates, exchange rates, penalties, premiums and fees. Information about third party fees and commissions should be provided as well. Advance termination penalties and fees for late payment should also be disclosed. Information about all fees should be provided, along with details about when the fees are payable and the events that will trigger payments. In addition, clients should be advised whether and by how much any of the product terms, such as interest rates, can change during the client’s use period, under what circumstances, how much notice will be given, and how the notice will be provided. Pricing and return information should be readily available to clients in multiple locations (e.g. posted, in market materials and in the client’s own account documents).

A combination of total cost of credit (TCC) and a standard annual percentage rate (APR) or effective interest rate (EIR) format is ideal and should be used for savings and credit, based on local industry norms or regulations, in addition to other information.

Complete Non-Cost Information. Providers should also ensure that any non-cost attributes of products are made clear to clients, such as switching barriers, what happens in the case of delinquency or default, and the like. Bundled products require particular attention, because they can be harder for clients to understand and to compare with other products. Transparency also entails advising clients of their rights, including any waivers of their rights, how to make complaints, and privacy of information. These issues are also discussed under Appropriate Product Design and Delivery, Mechanisms for Complaint Resolution, and Privacy of Client Data.

Appropriate timing of disclosures (before, after and at time of purchase). Because clients need time to review product information and contracts, to compare options, to ask questions, etc., relevant information must be provided in a time frame that enables clients to make their decisions without rushing. This concept applies to information provided during the marketing period and when the product contract is signed. In addition, loan and insurance products can sometimes have cooling off periods that give the clients a certain number of days after contract signing to cancel the contracts without penalty. Cooling off periods are designed to protect clients from making decisions under pressure, and ultimately they protect the financial institution from potential defaults from product-client mismatches. Timeliness also applies to providing clients with information during the lifetime of their product use, such as providing account statements and access to information between account statement periods.

¹⁵ For more information, see the Smart Campaign’s “Putting Transparency into Practice: Communicating about Pricing” (<http://smartcampaign.org/tools-a-resources/498>); “Calculating Transparent Prices Tool” (<http://smartcampaign.org/tools-a-resources/81>); and “Client Welcome Kit (page 5)” (<http://smartcampaign.org/tools-a-resources/507>).

*Confirming client understanding.*¹⁶ Microfinance providers are responsible to the best of their ability for ensuring that their clients understand the products that are offered. Fulfilling these responsibilities goes beyond using these guidelines as a check list to taking the further step of making sure that the procedures actually work. Other procedures and/or materials that providers can use include client call-backs to follow up on a meeting or phone call, check lists to review with clients, key facts documents and/or use of glossaries. A broader perspective on client understanding can be gained through analysis of complaints and inquiries,

Information provided by and about agents: When services are provided by an agent rather than staff of a financial service provider, the agent should ideally meet the same standards of transparency as the provider. Nevertheless, it is recognized that agents may not be in a position to provide highly detailed information or respond to detailed questions. At a minimum, agents should inform clients of their relationship to the principle service provider and make available contact information for the principal service provider, to enable clients to make enquiries or lodge complaints.

Client Responsibilities¹⁷

It is the client's responsibility to take advantage of the opportunities that transparency provides to select the products and providers that best suit her/his needs. Clients should not accept a product whose terms they do not believe they can meet. The client is expected to review the information provided, to make comparisons with other products and providers as relevant, and to make sure that all questions are answered before making a decision.¹⁸ Clients are also responsible for being transparent and honest about the information that they give to providers.

¹⁶ For more information, see the Smart Campaign's "How to Talk to a Bank: A Brochure for Consumers" (<http://smartcampaign.org/tools-a-resources/82>); "Smart Note: Transparent and Responsible Pricing at Mi-Bospo;" and "Loan Contract Summary Handout" (<http://smartcampaign.org/tools-a-resources/276>).

¹⁷ For more information, see the Smart Campaign's "Educating Clients about Client Protection: A Guide for Financial Service Providers" (<http://smartcampaign.org/tools-a-resources/499>).

¹⁸ For more information, see the Smart Campaign's "How to Talk to a Bank: A Brochure for Consumers" (<http://smartcampaign.org/tools-a-resources/82>).

Transparency issues by product

Credit products¹⁹

Cost of credit. The minimum standard of information to provide to clients about the cost of credit is a total cost of credit (TCC) approach that details:

- The amortization schedule, with:
 - disbursement and payment dates
 - amounts due for principal, interest, taxes, insurance and fees and commissions, by date
 - compulsory savings deposits required, by payment period and the total balance of the client's compulsory savings
- Total interest charges over the life of the loan
- Total payments associated with fees, commissions, penalties, and mandatory credit life insurance
- Total payments of compulsory savings/cash deposit/loan guarantee fund and any interest earned thereon²⁰

In addition, it is highly desirable for MFIs to provide the APR or EIR equivalent on the repayment schedule to clients.

Microfinance industry participants should also work to create an environment where comparative transparency is possible using standardized, annualized calculations such as APR or EIR. In countries for which MF*Transparency* (www.mftransparency.org) is conducting pricing analysis, MFIs should participate by disclosing the requested information and sharing it with clients.

Location of Disclosures. In addition to public posting of general product-based interest rate information in branches and on informational materials, MFIs should indicate the APR or EIR of the specific loan on the loan documentation – e.g., on the loan contract and repayment schedule or passbook.

Foreign currency risk. Clients that borrow in foreign currency without having corresponding foreign currency revenue should be advised of the risks entailed, including examples of the changes in required interest and principal payments in different exchange rate scenarios.

Cooling off period. If a cooling off period is part of the credit product, it is important to make clear to clients how long the period lasts, what they must do if they decide to cancel the loan, and if any cancellation fees apply.

¹⁹ For more information, see the Smart Campaign's "Putting Transparency into Practice: Communicating about Pricing" (<http://smartcampaign.org/tools-a-resources/498>); and "Client Welcome Kit (page 5)" (<http://smartcampaign.org/tools-a-resources/507>).

²⁰ For loans that have a compulsory savings requirement, transparency requires advising the borrower of the cost of the loan net of the savings deposit.

Guarantees. Clients and third party guarantors of individual borrowers should understand the responsibilities entailed in providing guarantees, including how much time they will have to make a payment when a guarantee is called; whether the guarantee will be called on a payment-by-payment basis or for the full amount of the outstanding loan; and what are the consequences if the guarantee obligations are not met. Guarantees should be for specific amounts (not open-ended) and for specific loans and the guarantor should receive a copy of the loan agreement. Depending on the practices followed in the provider's country and the relevant privacy laws, it is recommended that providers consider the advisability of ensuring that both spouses in married couples be aware of any borrowing or guaranteeing obligation undertaken by the spouse and the role of parents in guaranteeing the financial obligations of youth.

For group lending products with group guarantees, it is important to ensure that the group members understand their responsibilities if one of the group members is delinquent on loan payments or defaults. This should be specified in writing.

Delayed or failed payments. Clients and guarantors should be provided with information about what will happen in the case of delayed or non-payment. The consequences can include increased interest rates, increased fees, visits by loan collection agents, worsened credit rating, calling of guarantee, legal fees, court procedures, loss of collateral and/or savings balance. It is also important for clients and guarantors to understand their obligations if the proceeds from liquidation do not cover the loan amount due.

Savings products²¹

Access to savings. It is important for clients to have clear information about when and where they can access their savings accounts and any access restrictions that might apply to voluntary or compulsory savings.

Fees. All fees should be disclosed, including for account opening and closing, account maintenance, balance inquiries, withdrawals, payments, transfers, use of ATMs and use of mobile phones for payment transactions. If fees vary depending on account balances and/or usage (for example, if certain services are free if balances are above a certain minimum), this should also be made clear.

Interest rate calculations. The interest rate information required is: the percentage interest rate; how it is calculated (on the basis of the original deposit or compounded for interest accruals) and how often; the annual percentage yield; whether the interest rate can be changed and, if so, how often.

Minimum balances. Any minimum balance requirements and consequences (higher fees, ability to earn interest, account closure, etc.) if balances fall below the minimum.

²¹ For more information, see the Smart Campaign's "Smart Savings: Client Protection in the Savings Process" (<http://smartcampaign.org/tools-a-resources/286>).

Compulsory savings. If there is a compulsory savings requirement, the client should be advised about the terms of his or her access to the account, including any procedures by which the lender can use the savings account to compensate for unpaid loan installments by blocking the account or seizing the balances in the account. It should also be clear whether there are different terms for compulsory savings and voluntary savings that are held in one account, such as different pricing and terms of access, as well as how the account holder can readily determine what are the levels of compulsory and voluntary savings in his or her account. Clear information about pricing is particularly important, because the client's costs potentially include interest foregone on the compulsory savings deposit. Also, because a blocked deposit effectively reduces the lender's total risk exposure, the client is paying a higher interest rate on the net funds received.

Account closure. The account closing procedure, including any additional fees and the time required to liquidate final account balances, should be made clear.

Guarantees or deposit insurance. Clients should be advised about the existence of guarantees, whether internal or provided by a third party, to cover depositors if the institution fails, with information about the amount of deposits guaranteed and any insurance fees, if relevant. In cases without guarantees, it is important for clients to understand that their savings may be at risk if the institution fails.

Insurance products

Transparency in the insurance sector entails a unique set of issues, because the client is purchasing a product whose suitability can only be assessed at an indefinite time in the future, from a provider whose future is also unpredictable. Regulation of the insurance market therefore plays a key role in the effective implementation of the Client Protection Principles, although this topic is beyond the scope of these guidelines. Issues specific to insurance products fall into the following five categories:

Type of product. Clear information is necessary about specific loss events covered and the amount of coverage, including deductibles and co-payments, because clients often do not realize that policies do not compensate them for the full amount of their loss. The concept of waiting periods, in which it takes some time after the beginning of the policy or even the beginning of a health condition, for the policy to take effect, also requires careful explanation.

If certain conditions and/or events are excluded from coverage, these exclusions require highlighting to clients. This is particularly important if the policy excludes pre-existing conditions. Clients must also understand any expiry conditions, such a health insurance policy that expires after the client reaches an age limit.

The issue of whether the client is reimbursed for expenses (an indemnity policy), or if the insurance company pays on the client's behalf, is particularly relevant for microinsurance clients, because of the difficulties they might have in making upfront payments.

Specifics of the application process. Clients should clearly understand that there are potential penalties for non-disclosure in the application form, including giving the insurance provider grounds for denying claims. This can be a particularly relevant consideration for clients with pre-existing conditions.

If the application process includes an application fee, clients should be advised whether the fee will be reimbursed if the application is refused.

If there is a cooling off period in which clients are given a period of time after contract signing to reconsider whether they want the policy, the terms of the period should be made clear. This includes the length of the cooling off period, any policy cancellation fees, and what specifically is required to cancel the policy.

Insurance sales people can have different incentives depending on whether they are agents (working for the insurance company) or brokers (working for the client). In the latter case, it is important for the client to know what fees, if any, the broker is receiving from the insurance company, because this could potentially create a conflict of interest. Cases in which a lender is receiving a fee from an insurance company should also be made clear.

Premium payments. The consequences of late payments are also critical for the client to understand, since the client risks losing the policy and the value of all preceding payments. This consideration can be particularly important in the insurance sector, because the common practice of annual premium payments can create a significant challenge for the client's cash flow management. Providing sufficient advance notice of premium payments can help clients remember and prepare for making these payments.

Claims. Clients should be given clear information about how to file claims, how they will be paid, whether there are any conditions to being paid (such as having a bank account), and how long they should expect to wait for payment. The client has to understand that it is his/her responsibility to initiate this process.

Surrender value. It is important for client to understand whether they are entitled to the surrender value of a life insurance policy (if a policy is cancelled before it becomes payable) and if so how it is calculated.

Payments products

Full transparency from a payment provider requires providing the following information in response to inquiries, regardless of whether the inquirer has committed to make a payment or take any other action, such as opening an account:

Net amounts. The amount of money to be paid by the sender, in the sender's currency, and the amount of money to be received by the recipient, in the recipient's currency.

Fees and other costs. The fees to be charged by the paying agent and the receiving agent, as well as any other costs (for example taxes).

Exchange rate. The exchange rate to be used, as well as any margins added to the exchange rate.

Timing. When the payment will be made and, if there is any time lag, when it will be received.

Collection. For payments not made directly to bank or other accounts, where and how the money can be collected (as examples, what kind of identification is required, is a payment confirmation number required).

Possible variations. Whether any of the factors above varies depending on such issues as whether the sender has an account with the sending agent; whether the payment is cash to cash, cash to account, account to account, etc; whether there is detailed information about the receiver (such as account information), etc.

Cancellation. Information on cancellation/amendment procedures and any charges.

Errors. Information on how to follow up if a transfer is not correctly executed or is delayed.

Although in an ideal scenario the above product information would always be made available, there are constraints that could make this infeasible. In these cases, the payment provider should explain to the client why the information cannot be provided.²²

Sources

The Smart Campaign. “Conducting Client Protection Assessments: A Guide.” February 2010. www.smartcampaign.org/component/taxonomy/term/list/37/12

Rodney Lester. “Consumer Protection Insurance.” The World Bank. August 2009.

Committee on Payment and Settlement Systems. “General principles for international remittance services.” The World Bank. January 2007.

[http:// worldbank.org/grwg](http://worldbank.org/grwg)

[http:// remittanceprices.worldbank.org](http://remittanceprices.worldbank.org)

<http://www.sendmoneyhome.org>

<http://www.sendmoneypacific.org>

<http://www.fsa.gov.uk/Pages/Doing/Regulated/tcf/measure/index.shtml>

UK Remittance Task Force. “UK Remittance Market.” Profile Business Intelligence Ltd. No year. www.eldis.org/vfile/upload/1/document/0708/DOC22284.pdf

²² Even in cases where not all information is available, payment providers can share with their clients the available information about remittance costs from the World Bank data base (<http://remittanceprices.worldbank.org>).

4. Responsible Pricing

Principle

Pricing, terms and conditions will be set in a way that is affordable to clients while allowing for financial institutions to be sustainable. Providers will strive to provide positive real returns on deposits.

Introduction²³

Providers should price their products and services in a way that contributes to the long-term financial health of their clients while meeting their own needs for financial sustainability. Financial sustainability is a necessary requirement for continuing to serve clients, rather than an end in itself. Therefore, providers should strive to achieve efficiencies that allow prices to be as affordable as possible and deliver reasonable value-for-money. Pricing requires careful attention when serving the poor, because low income clients operate with such constrained financial resources. Pricing can be a particular challenge in less developed local markets, where competition is not playing a significant role. Therefore financial service providers have a responsibility to take into consideration the client's ability to pay while examining their operational efficiency and profit levels. Transparency is a pre-condition for responsible pricing, because it enables clients to understand and compare products and providers.

The following two elements of responsible pricing provide a fuller picture of what is meant by and encompassed in this concept: pricing procedures and fees.

*Pricing procedures.*²⁴ It is recommended that financial service providers have a formal (internal) pricing procedure for each product that takes into account the cost of providing the product; affordability for the client; the desired profit for the provider; and any other objectives to be achieved by the product, such as serving very poor people, maximizing cross-selling opportunities, etc.

The pricing procedure should include a comparison of the provider's pricing with that of the competition.²⁵ If the provider's pricing is substantially higher or lower, responsible pricing implies that the provider should be able to justify this difference to its clients and other stakeholders. Lower pricing is inappropriate if it reveals that the provider is unsustainable or has a strategy to gain market share and then raise prices later. Higher pricing should raise concerns if the provider has higher operating costs than the competition, because the provider is passing the cost of its inefficiencies on to its clients. Higher pricing might be appropriate if the provider has made a deliberate decision to use high profits in one product area to subsidize an unprofitable product that is very important for clients.

²³ For more information, see the Smart Campaign's "Responsible Pricing the State of Practice" (<http://smartcampaign.org/tools-a-resources/243>).

²⁴ For more information, see MF*Transparency's* "Calculating Transparent Prices Tool" (<http://smartcampaign.org/tools-a-resources/81>).

²⁵ For more information, see the Smart Campaign's "Smart Note: Transparent and Responsible Pricing at Mi-Bospo" (<http://smartcampaign.org/tools-a-resources/330>).

In addition to reviewing pricing on a product-by-product basis, it is recommended that providers consider how product pricing and product costs are reflected in the provider's overall profitability. The provider's board of directors should consider establishing target return on assets (ROA), return on equity (ROE) and other relevant profitability targets and have a specific rationale for why these targets are appropriate. Financial service providers that appear to be unusually profitable on an overall basis compared to their competitors could then evaluate whether this profitability is consistent with the long-term benefit of clients. It should not be automatically assumed that high profits are inconsistent; they could be justifiable, for example, when client needs are being served and the profits are being used to build up equity (and attract loans and investment) to strengthen the provider over the longer term. Particular attention must be paid to monopoly and near-monopoly markets, in which competitor comparisons alone are unlikely to provide the full picture of whether the provider's profitability is commensurate with responsible pricing.

Fees. Fees can contribute to a lack of pricing transparency, both for calculating overall product cost and because some fees are contingent and may not be anticipated or even understood by the client. Therefore, as a general principle, it is desirable to minimize fee-based pricing.

When fees are necessary, the purpose should be to provide a reasonable coverage of the provider's costs and to encourage appropriate behavior by the client. It costs money for financial institutions to open accounts, accept loan prepayments, pay insurance claims, etc., and it is legitimate for providers to be compensated for those services. Fees can also help to encourage appropriate client behavior, such as late payment fees that encourage on-time principal and premium payments. In encouraging appropriate client behavior, however, it should be borne in mind that poor clients face a relatively high level of unpredictability in their lives. Therefore a fee structure that is costly for clients facing unexpected situations, such as one featuring high penalty changes, is to be avoided.

It is not appropriate to charge fees that are so high that they significantly harm the client, such as late payment fees that make repayment burdens unrealistically high or account maintenance fees that rapidly reduce client savings. It is also not appropriate to charge fees that are designed to limit client choice, such as account closing fees.

Client Responsibilities²⁶

Clients have a responsibility to inform themselves about price, other relevant product characteristics, and attributes of the provider. As a general rule, it is responsible for clients to comparison shop to ensure they have selected the product and provider that meets their needs well. Clients should be aware that price is not the only relevant factor in making a decision about products (and indeed, research shows this to be true for low-income users among others); other product terms as well as the reliability of the provider should be considered as well. Clients should be alert to situations in which the product pricing seems unusually high or unusually low and try to understand the rationale.

²⁶ For more information, see the Smart Campaign's "Educating Clients about Client Protection: A Guide for Financial Service Providers" (<http://smartcampaign.org/tools-a-resources/499>).

Responsible pricing issues by product

The product issues noted below specifically concern pricing. Other issues that are not related to pricing are discussed above under Appropriate Product Design and Delivery.

Credit products

Mandatory savings levels that are appropriate for the level of risk of the loans.

Loans with compulsory savings. Loan products with compulsory savings reduce the net loan exposure to the lender and therefore raise the effective interest rate for the borrower. Responsible lenders are expected to take this into account when calculating the appropriate loan interest rate, in addition to ensuring that mandatory savings requirements are appropriate for the risk level of the loans.

Savings products

Fees. As was noted, fees that are disproportionately high relative to small deposit balances do not serve the needs of clients. Providers are encouraged to assess how they can best provide deposit services to clients without charging fees that absorb a major share of the principal of the account. If this is not possible, they may consider whether the product has sufficient value to clients to warrant offering it.

Insurance products

Claims ratios. Claims ratios vary according to a number of variables, such as whether the product is mandatory and pricing methods used. While standards for microinsurance are still evolving, a minimum claims ratio of 50 percent could be used as a lower limit, although providers are encouraged to achieve a higher ratio. It is considered best practice to adjust pricing based on actual claims experience.

Premium discounts. Providers can also adjust pricing based on risk incurred by providing policy renewal discounts for clients that have made all payments on time and have not had any claims.

Payment products

Competitive information. As was noted, payment providers cannot always control the cost of payment products, because they often rely on at least one other party to effect the payment. However, providers can compare their pricing with the market by using the World Bank data base on remittance costs: <http://remittanceprices.worldbank.org>.

Sources

Larry Reed. “Responsible Pricing: The State of the Practice.” Presented to the Smart Campaign Steering Committee by the Task Force on the Evolution of Principles, Bern, Switzerland, June 28, 2010.

5. Fair and Respectful Treatment of Clients

Principle

Financial service providers and their agents will treat their clients fairly and respectfully. They will not discriminate. Providers will ensure adequate safeguards to detect and correct corruption as well as aggressive or abusive treatment by their staff and agents, particularly during the loan sales and debt collection processes.

Introduction

Every direct interaction between clients and staff should be characterized by honesty, fairness, and respect. Because of their low socioeconomic status, low income clients may often receive poor treatment when interacting with mainstream business or government organizations. This is not acceptable for pro-client financial service providers.

Client selection and treatment should not involve discrimination on the basis of race, ethnicity, gender, political affiliation, disability, religion or orientation. Non-discriminatory treatment is important for providing access to financial services to all clients who can use them and builds their confidence in the fairness of the provider. It is also important for the provider, because it builds a service culture for the staff in which people are perceived and treated as clients, regardless of affiliation or other characteristics. This approach is particularly important to maintain during the problem loan collection process, when clients are sometimes perceived as problems and no longer deserving of respectful behavior.

Financial service providers should have zero tolerance for any form of corruption on the part of their management, staff or agents, including fraud, kickbacks and favors requested or demanded from clients.

Respect is to be maintained even in difficult situations: abusive debt collection practices are not acceptable. Inappropriate selling practices (e.g., over-selling, mis-selling or aggressive sales practices) are often driven by inappropriate compensation schemes for staff or third-party agents. This is true for abusive or coercive collections practices as well. Staff members should understand the definition of over-indebtedness, so that they can recognize and avoid it.

The following seven core elements of the respectful treatment of clients provide a fuller picture of what is meant by and encompassed in this concept: commitment to code of ethics; non-discrimination; appropriate incentive structure and sales practices; responsible use of agents; preventing staff corruption; informing clients of their rights; and client feedback.

*Commitment to code of ethics.*²⁷ A code of ethics is a document that states the institution’s mission and articulates its organizational values, such as fair treatment of clients. In some codes unacceptable behavior is explicitly defined, and in some of these cases the penalties are specified, while in other codes the concept of unacceptable behavior is implicit.²⁸

The core of the responsible treatment of clients derives from a genuine commitment to the code of ethics that is upheld and enforced throughout the institution, from the board of directors to entry level staff. A written code alone will not generate this behavior; it has to be embedded in how employees think, interact with each other, and interact with clients. A code of ethics can help to reinforce this behavior by being treated as a relevant, “living” document: it should be approved by the board; signed by all employees as well as board members; reviewed on a regular basis and updated as appropriate; re-signed by all employees on a regularly scheduled basis, such as annually. All staff must receive practical training on applying the code to their daily work.²⁹

Non-discrimination. Non-discrimination means treating all clients equally, regardless of their race, religion, ethnicity, political affiliation, disability or gender. It means, in the case of persons with disabilities, for example, making microfinance institutions as physically accessible as reasonably possible and ensuring that staff and practices are disability friendly. The effective implementation of non-discrimination can sometimes be complicated in microfinance, because some financial service providers have been created specifically to address the needs of people who have suffered from discrimination in their efforts to obtain financial services. One example is providers focused on serving female clients. The theoretical way to address these situations is for providers with a specific focus group to ensure that there is not discrimination within that group. For example, a provider focused on female clients should serve all women without discrimination. Less theoretically and more practically, a provider with a specific focus group of clients should evaluate periodically whether this focus is the best way of achieving its objectives.

As is noted under the Client Protection Principle entitled Privacy of Client Data, information about the client that could be used for explicit discriminatory purposes should not be compiled, for example, political or religious affiliation.

²⁷ For more information, see the Smart Campaign’s “How to Develop an Institutional Code of Ethics” (<http://smartcampaign.org/tools-a-resources/84>); “Smart Note: Building an Institutional Culture Around a Code of Ethics at Compartamos” (<http://smartcampaign.org/tools-a-resources/96>); and “Smart Note: Implementing a Code of Conduct at PMN” (<http://smartcampaign.org/tools-a-resources/261>).

²⁸ References to sample codes are in the notes at the end of this Guidance.

²⁹ For more information, see the Smart Campaign’s “Code of Conduct E-Learning Module” (<http://smartcampaign.org/tools-a-resources/502>); and “Illustrations and Activities for Training Loan Officers” (<http://smartcampaign.org/tools-a-resources/501>).

*Appropriate incentive structure and sales practices.*³⁰ In addition to being influenced by the code of ethics, staff is influenced by its compensation policy. It is therefore important to ensure that compensation is aligned with responsible behavior. Not only it is important to ensure that irresponsible behavior is not rewarded (for example high bonuses linked only to sales, without regard for other factors such as loan quality), but providers could create incentives to reward staff for good client relations. In designing their incentive structure, providers are also encouraged to be vigilant about the risk of mis-selling products that clients cannot afford or otherwise unsuited to their clients' circumstances and needs.

Responsible use of agents. Agents play a number of different roles in providing financial services, including selling products, managing contract renewals, and loan collections. The use of agents raises different client protection issues depending on the role of the agents and their relationship to the provider. The key point that underlies all provider relationships with agents is that the provider is responsible for the behavior of the agent that is providing the service. Therefore providers are encouraged to carefully review how to ensure that their agents comply with the required standards for responsible treatment of clients. It should be noted that outsourcing of client acquisition for loans to commissioned agents has been associated with aggressive sales.

Preventing staff corruption. The responsible treatment of clients clearly excludes obtaining money or other favors from clients in return for providing products, as well as other forms of corrupt staff behavior. A strong corporate culture can help limit corruption to some extent, because it should create an environment in which other employees feel safe to be whistle blowers if conditions warrant. An important tool is a secure way for an employee to report anonymously any inappropriate staff behavior. However, financial service providers should also implement a robust system for detecting and correcting corruption, including effective internal controls and a commitment to address all cases of corruption quickly and, if possible, openly, in order to create deterrents. Clients should be made aware of these policies to help remove any fear they may have of reporting on unethical behavior.

*Informing clients of their rights.*³¹ Client have to understand their rights in order to recognize and respond appropriately when they are not being treated responsibly. Information about client rights, including what is not acceptable behavior by the provider's staff, how to make complaints (and what to expect about their resolution) can be provided orally and in written materials.

³⁰For more information, see the Smart Campaign's "Smart Note: Ethical Staff Behavior at ASKI" (<http://smartcampaign.org/tools-a-resources/471>).

³¹ For more information, see the Smart Campaign's "Educating Clients about Client Protection: A Guide for Financial Service Providers" (<http://smartcampaign.org/tools-a-resources/499>); and "Client Welcome Kit (page 7)" (<http://smartcampaign.org/tools-a-resources/507>).

Client feedback. Important tools for assessing a provider’s success in fostering the responsible treatment of clients are regular client surveys; random third party interviews; “mystery shopping” in which a specialist poses as a client; and an effective system for addressing client complaints. The latter topic is addressed in detail under the section on Mechanisms for Complaint Resolution.

Client Responsibilities³²

Clients are expected to behave responsibly in their dealings with providers, which above all means honesty in representing themselves, good faith efforts to comply with the terms of product use and non-abusive behavior towards provider staff and agents. Clients must never accept unethical behavior from staff or from other group members in the case of group-based financial services by paying bribes or providing favors in order to obtain services. It is important for clients to register serious complaints, including cases of attempted corruption, and to participate seriously in client surveys, in order to enable providers to improve their services.

Responsible treatment of clients issues by product

Credit products

*Avoiding overselling.*³³ Although the importance of appropriate sales techniques has already been noted, avoiding the overselling of credit products deserves highlighting as a critical element of the responsible treatment of clients. Overselling poses risks for all clients, as research shows that human beings are often susceptible to sales pitches or unable to realistically assess their current and future loan repayment capacity. Clients with less education and many unmet needs may be even more susceptible. Clients in highly competitive markets in which there is not reliable credit bureau information can be particularly vulnerable to overselling, because it is difficult for lenders to assess their clients’ true financial picture. Comments made earlier about incentive structures of those involved in the sales, approval and product delivery process are particularly relevant in the case of credit.

*Appropriate collections practices.*³⁴ Ensuring the responsible treatment of clients during the debt collection process is a complex challenge. It is common in these circumstances for a client to no longer be perceived as a “client” but as a “problem” who does not deserve respectful behavior from the lender. In addition, some lenders believe that the most effective way to collect late payments is by frightening the client. It is therefore important for lenders to have written procedures that clearly articulate inappropriate collections behavior and the sanctions that will be applied if that behavior is used.³⁵ Clients should understand the collections

³² See above.

³³ For more information, see the Smart Campaign’s “Transparency in Promotions and Sales: A Checklist for Financial Service Providers” (<http://smartcampaign.org/tools-a-resources/494>).

³⁴ For more information, see ACCION’s “Best Practices in Collections Strategies” (<http://smartcampaign.org/tools-a-resources/83>); and “Smart Note: Collections with Dignity at FinComun” (<http://smartcampaign.org/tools-a-resources/48>).

³⁵ For more information, see the Smart Campaign’s “Collections Guidelines for Financial Service Providers” (<http://smartcampaign.org/tools-a-resources/496>);” and “Code of

timeline, as well as what behavior they should not tolerate from collections agents.³⁶ If collections are outsourced, the outsourcing agency must commit to these procedures as well, while the provider remains accountable for the behavior of the collections agent, and there must be mechanisms to assess practices and recourse if principles are not being upheld.

Examples of inappropriate behavior, which differ by country and culture, include the use of physical force; contacting the client at inappropriate times; contacting the client frequently with the intention of exhausting him/her; humiliation; and compromising the client's right to privacy. As was noted under the section on Appropriate Product Design and Delivery, lenders should have clear guidelines for what constitutes acceptable collateral. Collateral that is critical to a client's daily survival or that is substantially in excess of the value of the loan is not acceptable, because seizing that collateral will only exacerbate the borrower's problems.

Savings products

Compulsory savings. Institutions that do not have deposit-taking licenses but whose loan products include compulsory savings have a particular obligation to ensure that the clients' deposits benefit from adequate protection measures.

Insurance products

Mis-selling and overselling: Clients face unusual challenges in assessing the need for and value-for-money of insurance products. They are at risk of purchasing a product that does not fit their circumstances, paying too much, losing the full value of their premiums if they are unable to continue making regular payments, or having their claim denied when the insured event occurs. These inherent challenges are exacerbated by the prevalence of intermediaries such as brokers or MFIs. Providers that are marketing insurance products to lower-income people need to exercise particular care to be sure that sales practices as well as products are appropriate for this client segment.

Use of call centers. Requiring clients to contact a call center in order to activate an insurance policy can be an effective way to ensure that the client actually wants the policy (and to counter the risk of possible overselling) and to ensure the client's understanding of the product terms.

Payments products

Agents. Providers cannot be responsible for every detail of the treatment of their clients by third party agents, however, they must take due care that the fundamental principles described here are practiced by their agents, and that procedures for recourse and problem resolution are available to clients.

Sources:

<http://www.fsa.gov.uk/Pages/Doing/Regulated/tcf/library/index.shtml>

Conduct for Collections and Collections Practices for Group Loans”

(<http://smartcampaign.org/tools-a-resources/472>).

³⁶ For more information, see the Smart Campaign's “Client Welcome Kit (page 15)” (<http://smartcampaign.org/tools-a-resources/507>).

<http://www.ethicsweb.ca.codes>

“Debt collection guidelines for collectors and creditors: joint publication by ACCC (Australian Competition and Consumer Commission) and ASIC (Australian Securities and Investment Commission). www.accc.gov.au/content/index.phtml/itemId/733222

6. Privacy of Client Data

Principle

The privacy of individual client data will be respected in accordance with the laws and regulations of individual jurisdictions. Such data will only be used for the purposes specified at the time the information is collected or as permitted by law, unless otherwise agreed with the client.

Introduction

The confidentiality of personal information is a right that protects privacy and individual liberties. Privacy of personal financial information is particularly important because it helps to prevent losses due to theft and fraud. It can also help individuals build assets by protecting them against appropriation or pressure from friends and family. The increasing complexity of the technology used to manage client data creates a particular challenge for financial service providers to maintain the privacy of client data. Clients also have a responsibility to safeguard the confidentiality of financial information that they hold and to correct any inaccurate data held by their financial institutions.

The following six elements of client data privacy provide a fuller picture of what is meant by and encompassed in this concept: complete policy and procedures; information security; information provided to clients about their rights and responsibilities; waivers of privacy rights; data that could be used for discriminatory purposes; and sharing client data.

Complete policy and procedures. Regardless of the status of national privacy laws, the financial services provider must have a privacy policy and procedures.³⁷ The purpose of the policy is to establish the basic principle that client data should be kept private unless otherwise mandated by law and refer to any relevant laws and regulations. Private data is defined as any information that can be identified with the client that is not publicly available and that the institution has collected in connection with providing products or services to the client.³⁸ The procedures explain the processes by which client data privacy is ensured. The primary issues covered in the procedures are:

- Definition of what client data is covered by the privacy policy
- What organizational position in the financial institution bears overall responsibility for ensuring client data privacy

³⁷ Sample privacy laws are listed at the end of this guidance.

³⁸ Examples include information required for a product application; financial information obtained from other sources, such as a credit bureau; and information about the individual's relationship with the financial services provider, including even the simple fact that the individual is a client.

- What data is obtained, who obtains it, the sources of the data, and the purposes for which the data are used
- The legal and regulatory requirements for collecting, sharing and using information
- Advising the client about the legal and regulatory requirements for collecting, sharing and using information
- Procedures to be followed for mandatory sharing of information
- Procedures to be followed for sharing information with outside service providers, such as marketing companies, data processing companies, collections agencies, etc., including ensuring the adequacy of their data privacy policies and procedures
- Ensuring that sales agents and other third parties involved in the application process follow appropriate data privacy procedures
- Procedures to be followed for sharing information within the same financial institution or corporate group for purposes of cross-selling
- Procedures to be followed in the case of voluntary waiving of client data privacy (under the general principle that waivers should be as limited to specific information and uses as possible)
- Ensuring information security (addressed in more detail below)
- Procedures to be followed in the event of a privacy breach or complaint

*Information security.*³⁹ The financial services provider should have clear procedures for ensuring the security of written and electronic information. Procedures that apply to written information include access, copying, storage, transmission within the financial institution and outside, archiving, disposal and overall security. Procedures that apply to electronic data include data entry, changing data after it has been entered, updating data, access to data, secure transfer of data within the institution and outside (including internationally), archiving, disposal, security of back-up systems and overall data security. Staff should be informed and trained regarding these policies.

*Information provided to clients about their rights and responsibilities.*⁴⁰ It is important for clients to have information about the financial services provider's privacy policy and procedures. Key topics to include are any legal or regulatory requirements to share client data; the procedures to be followed for voluntarily waiving privacy rights; what data is shared on a mandatory and/or voluntary basis; and the procedures that the provider will follow if information privacy is accidentally breached. Clients should also be provided with clear and simple information about how to check the accuracy of data being maintained about them and how to correct any inaccurate information.

Clients should be instructed on their responsibilities for ensuring data confidentiality, such as storing any records in a secure location and not sharing personal identification codes.

³⁹ For more information, see the Smart Campaign's "Smart Note: Customized IT at Caja Morelia" (<http://smartcampaign.org/tools-a-resources/248>).

⁴⁰ For more information, see the Smart Campaign's "Client Welcome Kit (page 12-14)" (<http://smartcampaign.org/tools-a-resources/507>), and "Security is Key: Pocket Guide to Financial Security for Clients" (<http://smartcampaign.org/tools-a-resources/85>).

Waiver of privacy rights. It is important for the financial services provider to have clear procedures for instances when a client chooses to waive his or privacy rights, such as sharing credit history with another lender or a potential employer. Waivers should be for specific and limited purposes; clients should not be requested or required to sign more general waivers that eliminate all rights to privacy. Any waivers should be written simply and clearly, be explained to the client, and, when feasible, signed by the client. For clients that are not literate, providers are encouraged to develop an alternate mechanism for documenting the waiver.

Data that could be used for discriminatory purposes. Any data that could be used for illegal or merely arbitrary discrimination, such as information about ethnicity, religion, political affiliations, etc., should not be collected.

Sharing client data. In cases where financial institutions share client information with affiliates for cross-selling purposes, the client should be given the right to opt out of participating. (Note that clients do not typically have the right to opt out of sharing information with third parties that are contracted to provide services to the financial services provider, such as marketing, data processing, collections agencies, etc.) Careful attention should be paid to ensuring client privacy in cases when a client applies for bundled products when the other products are provided by another financial institution. Best practice is for the financial services institution to provide only the information required by the other institution, not the entire client file. In the case of mandatory bundling, the client should understand clearly that the data is being shared. In the case of optional bundling, the client should agree in writing to share the information.

It is a common practice in the microfinance field for financial service providers, and the organizations that support them, such as investors, lenders, donors and government agencies, to use photos and other information about clients in their marketing and other informational materials. Any use of such client testimonials, photos and/or case studies in marketing or other public materials should be agreed upon in advance in writing by the client. The provider is responsible for ensuring that this principle is enforced not only with its own staff but with other organizations that have client contact on the provider's behalf, such as investors.

Client Responsibilities⁴¹

Clients have three roles to play in contributing to effective data privacy. First, they should understand their rights and use them responsibly, such as by carefully thinking through the pros and cons of voluntarily sharing credit history information. Second, they should protect any access to data over which they have control, such as personal information codes, passwords and account statements. Third, they should confirm that the data maintained about them is accurate and ensure that any inaccurate data is corrected.

Privacy of Client Information issues by product

Credit products

Establishing a credit history. Sharing confidential client information can be beneficial to a client when it helps him or her to establish a credit history. In some countries it is mandatory to provide this information to a credit bureau, in which case the responsibility of the provider is to make this requirement clear to the client. In cases where providing credit information is not mandatory, but a voluntary credit bureau exists or there is an information sharing arrangement among a group of lenders, the lender should explain the options and potential advantages clearly to the client. Sharing of data should require the client's affirmative consent.

Group lending. Privacy issues have an additional complexity for group lending, because group members have access to extensive personal information about each other and the group as a whole, such as its loan size and account balances. Therefore it is important for group training to emphasize the importance of privacy and of keeping confidential information safe within the group and for policies to be developed and agreed to by group members regarding treatment of member information.

Savings products

Controlled access. The client's family members (including spouse) should not have access to the client's saving account nor account information unless specified by the client in writing. If additional people have access to client's savings account, inform the client about how to keep their savings account secure. Advise client to keep debit/savings/ ATM cards and PIN codes secret.

Account closing procedures. The provider should have a clear policy for how client information is stored/disposed of upon account closing.

Insurance products

Privacy of health information. Privacy of health information is as important as privacy of financial information. Health and life insurance providers and financial institutions that work with health and/or life insurance providers must have adequate safeguards in place to protect this information.

⁴¹ For more information, see the Smart Campaign's "Educating Clients about Client Protection: A Guide for Financial Service Providers" (<http://smartcampaign.org/tools-a-resources/499>).

Payments products

Reliability of other payment agents. Payments providers that are not part of large networks face the difficult challenge of not always knowing whether the various parties involved in the payments process have adequate client data privacy policies and procedures. When this information is not available, the clients should be advised.⁴² As noted previously, the principle of providers remaining responsible for the conduct of their agents should be observed.

Sources

Guidelines for the Regulation of Computerized Personal Data Files, Adopted by General Assembly (of the United Nations) resolution 45/95 of 14 December 1990 (Section A, Principles concerning the minimum guarantees that should be provided in national legislations). www.unhcr.org/refworld/publisher,UNGA,THEMGUIDE,3ddcafaac,0.html

Directive 95/46/EC of the European Parliament and of the Council of 24 October 1995 on the protection of individuals with regard to the processing of personal data and on the free movement of such data. www.eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:31995L0046:en:HTML

OECD Guidelines on the Protection of Privacy and Transborder Flows of Personal Data. www.oecd.org/document/18/0,3343,en_2649_34255_1815186_1_1_1_1,00.html

OECD Guidelines for the Security of Information Systems and Networks: Towards a Culture of Security. www.oecd.org/document/42/0,3343,en_2649_34255_15582250_1_1_1_1,00.html

Sample privacy laws:

The Privacy of Consumer Financial Information Rule (Privacy Rule) and other information about the U.S. Gramm-Leach-Bliley Act on financial services reform, www.ftc.gov under the heading “Gramm-Leach-Bliley Act Financial Privacy and Pretexting.”

Data Protection Act, UK, 1998. www.legislation.gov.uk/ukpga/1998/29/contents

Privacy Act, Australia. www.privacy.gov.au (Proposed new principles can be seen at www.privacy.gov.au/law/reform)

⁴² As was noted, updates on efforts to develop a global code of conduct under the aegis of the Global Remittances Working Group can be found at <http://www.worldbank.org/grwg>.

7. Mechanisms for Complaint Resolution

Principle

Providers will have in place timely and responsive mechanisms for complaints and problem resolution for their clients and will use these mechanisms both to resolve individual problems and to improve their products and services.

Introduction

Dissatisfied clients and their complaints are inevitable. Providers should address these problems quickly and effectively. They should ensure that clients are aware of their right to complain, that they know how to complain and that the process is easy for clients to use. Providers should track complaints in order to improve their products and services. Mechanisms for managing complaints should include processes for communications with clients about their rights and about how to complain, and processes for monitoring and analyzing complaints.

The following elements of mechanisms for effective complaint resolution provide a fuller picture of what is meant by and encompassed in this concept: communications with clients about their rights and about how to complain, the complaints handling process itself (intake, resolution, appeals), oversight of the complaints process, and use of complaints to identify broader problems.

Policy and procedures. ⁴³The provider must ensure that it has a clear policy and procedures for managing complaints. ⁴⁴It is important for the policy to highlight the fact that the client has a right to complain and that a key element of client service is responding quickly to those complaints. The policy should also state that complaints should be handled fairly and without discrimination.

The procedures for addressing complaints typically include the following:

- The procedure for advising clients of their right to make complaints and how to do so
- The organizational structure for responding to and resolving complaints, including what types of complaints are managed at the source and what types are referred to a specialized complaint handling area
- How to record complaints made by clients and the resolution of those complaints⁴⁵
- The process for responding to complaints (by letter, email, phone, etc.), including the time frame

⁴³ For more information, see the Smart Campaign’s “Complaints Handling Manual, Tamweelcom” (<http://smartcampaign.org/tools-a-resources/106>); and “Complaints Handling Manual, FONDESCURO” (<http://smartcampaign.org/tools-a-resources/105>); and “Smart Note: Implementing a Code of Conduct at PMN” (<http://smartcampaign.org/tools-a-resources/261>).

⁴⁴ Examples are noted in the Sources listed at the end of this guidance.

⁴⁵ For more information, see the Smart Campaign’s “Complaints Analysis Spreadsheet, FMMB” (<http://smartcampaign.org/tools-a-resources/104>).

- Who is responsible for evaluating overall trends in complaints and complaints handling and determining when these issues reflect systemic problems that have to be addressed separately from resolution of any one client's problem
- The process to follow if complaints cannot be resolved, such as referring the problem to an internal dispute resolution department or an external dispute resolution (EDR) mechanism, if one exists

Ensuring effectiveness. The provider must ensure that the complaints and problem resolution process works effectively, not only that it is place. Senior management attention to complaints and complaints handling is a critical element of effectiveness; best practice is for a member of the senior management team to have ultimate responsibility for complaints management and for complaints to be reviewed regularly at senior management meetings. In addition, assessments of the provider's effectiveness in addressing complaints should include an evaluation of whether the resolutions are fair for the clients, not only whether the complaints have been resolved.

At the staff level, appropriate training is required for all staff that interacts with clients as well as any specialists that manage complaints. It is particularly important for non-specialist staff to have clear instructions about how to handle the most common complaints and when to refer complaints to others. Specialized staff require training in identifying the root causes of complaints and determining when recurring complaints reflect systemic problems.

Clients should be provided with several easily accessible ways to make complaints, such as hotlines, suggestion boxes (though these alone are insufficient), emails to a specific complaint account, and meetings with appropriate staff. They should be assured that use of these mechanisms will not be held against them. It is also important to determine whether low usage of these tools indicates a high level of client satisfaction or whether it might indicate that the tools are not effective. The use of surveys to proactively measure client satisfaction, instead of relying only on clients taking the initiative to complain, can help to clarify this issue.

*Advising clients of their rights*⁴⁶. Clients should be provided with clear and simple written and oral information about their right to complain, how to register a complaint, the steps that take place after a complaint is filed, the time frame within which clients should expect their complaint to be addressed, and the steps to follow if they are dissatisfied with how their complaint is handled. Toll-free telephone numbers have proven to be very effective in some circumstances. Some providers will have access to mechanisms for external dispute resolution, such as an ombudsman or other impartial third party arbiter. If this mechanism exists, clients should be advised how and at what point in the process to use it.⁴⁷

⁴⁶ For more information, see the Smart Campaign's "Complaints Handling Brochure for Clients," and "Client Welcome Kit (page 9)" (<http://smartcampaign.org/tools-a-resources/507>).

⁴⁷ Although ombudsmen are used in a number of countries to resolve financial services problems and complaints that cannot be resolved by the provider, it should be noted that they are most effective in environments where there are enforcement mechanisms and standardized contracts. A lack of enforcement mechanisms can reduce the credibility of the

Client responsibilities⁴⁸

Clients should make good faith efforts to resolve problems directly first, and then to make use of the complaints procedures available to them. Providers rely heavily on their reputations and it is not fair for a client to make negative comments about a provider to friends and colleagues or seek assistance from government officials if he or she has not tried conscientiously to resolve the complaint. Clients should also avoid making frivolous complaints about issues that have not caused them serious inconvenience or cost, because these are a waste of time, money and good will for the provider.

Problem resolution issues by product

Payment Products

When providers use agents to deliver services outside their branches, it is important for signage and written materials to inform the customer how to register a complaint. Such communication should make clear who is responsible for resolving complaints, and how to lodge complaints against the behavior of agents.

Sources

Financial Services Authority. “Review of complaint handling in banking groups.” April 2010. www.fsa.gov.uk/pubs/other/complaint_review.pdf

www.fsa.gov.uk/pages/Library/Other_publications/complaint_handling/index.shtml.

Among other documents, this site includes a template that the FSA uses to assess complaint handling by financial institutions.

Standards Australia. “Customer satisfaction-Guidelines for complaints handling in organizations.” ISO 10002:2004, MOD.

www.saiglobal.com/PDFTemp/Previews/OSH/AS/AS10000/10000/10002-2006.pdf

ombudsman’s role, while non-standardized contracts put a considerable burden on the ombudsman to review the details of each case.

⁴⁸ For more information, see the Smart Campaign’s “Educating Clients about Client Protection: A Guide for Financial Service Providers” (<http://smartcampaign.org/tools-a-resources/499>).