Beyond Codes: The Foundation for Client Protection in Microfinance

Synthesis Report

October 2010
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Acknowledgements

The lessons in this report were generated from a number of perspectives and experiences.

I would like to thank Alexandra Annes da Silva, Ewa Bankowska (Micro Finance Centre in Poland, Hema Bansal (ACCION India), Cara Forster (Center for Financial Inclusion), Lalaine Joyas (Microfinance Council of the Philippines); Eulogio “Eo” Masilungan and John Owens of Microenterprise Access to Banking Services (MABS) and the Rural Bankers Association of the Philippines (RBAP), Rochelle and Angela Wambugu of MicroSave (Kenya), and particularly Elisabeth Rhyne, who provided a constant vision for the Beyond Codes project and served as a valuable sounding board.

Many industry professionals contributed to the Dialogue Groups where experience was discussed, analyzed and challenged. The Dialogue Groups were valuable platforms for synthesizing lessons.

Financial institutions participating in the client protection assessment and design and monitoring of the pilot initiatives contributed their experience to the body of lessons. I’d like to thank:

• In Bosnia and Herzegovina, Mi-Bospo Microcredit Foundation (Tuzla) and Partner Microcredit Foundation
• In India, Yes Sampaan; Swadhaar and Saija Finance Pvt Ltd.
• In Kenya, the Small and Medium Enterprise Programme – SMEP and Stima Sacco
• In Mexico, Caja Morelia Valladolid, Compartamos Banco, and FinComún
• In the Philippines, Cantilan Bank, Inc. and Kasagana-Ka

Special thanks go to the Beyond Codes Project Steering Committee for their guidance and support from the earliest days of the project: Isabelle Barres, Kiva.org; Deborah Drake, ACCION and the Council of Microfinance Equity Funds (CMEF); Grzegorz Galusek, Micro Finance Centre; David Grace, World Council of Credit Unions (WOCCU); Masami Hayashi, Microfinance Network; Patrick McAllister; Kate McKee (CGAP); and Peter Wall, Microfinance Information eXchange (MIX).

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Introduction to “Beyond Codes”

Project Summary
Beyond Codes was an action research project of the Center for Financial Inclusion at ACCION. The project was designed to provide a body of experience and knowledge from leading financial institutions serving low-income people about how consumer protection codes of conduct are implemented. The two-year project started in mid-2008 and ended in June 2010. The project aimed to develop the tools and experience that could inform the subsequent work in client protection by grounding it in practices of financial institutions.

Grounding in Practice
Twelve financial institutions (FIs) participated in the project. FIs were of various ages, from less than three to more than ten years. The institutions included banks, non-deposit finance companies, NGOs, and credit unions. Some were large operations with close to one million clients, while others were medium-sized and even small, with fewer than 10,000 customers. The countries represented in the research were: Bosnia, India, Kenya, Mexico, and the Philippines. All the FIs engaged in lending including a range of loan products using various methodologies. More than half also offered savings, transaction accounts, and insurance.

Assessments by external consultants evaluated how the FIs implemented the client protection principles (CPPs). The assessment process had two aims: to learn about the most promising indicators for assessment of the principles and about the state of practice among financial institutions, and to provide the FIs with a structured report on the effectiveness of their client protection practices that would assist them in making improvements.

Following the assessment, most of the FIs identified and developed pilot initiatives to address weaknesses and bolster strengths.

Box 1: The Client Protection Principles

1. Avoidance of Over-indebtedness
2. Transparent and Responsible Pricing
3. Appropriate Collections Practices
4. Ethical Staff Behavior
5. Mechanisms for Redress of Grievances
6. Privacy of Client Data

(see www.smartcampaign.org)

Developing Tools
The Beyond Codes research provided the knowledge base to develop four tools and resource sets, and these, in turn, are basic tools that the Smart Campaign uses to assist the microfinance industry in applying the CPPs.

- “Getting Started Questionnaire: Client Protection Self-Assessment for Microfinance Institutions”. The “Getting Started” Questionnaire is an online tool that helps microfinance institutions to begin investigating client protection practices within their organization. The questionnaire provides a framework for evaluating a microfinance institution’s practices, principle by principle, focusing on the 5-10 most important practices for assessing effective implementation of the principles. A second worksheet contains a radar graph to help the user more easily identify strong and weak practices as well as see which principles offer the institution its best opportunity to improve
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- This popular tool has the potential to eventually incorporate industry experience into the radar graph that could show how the organization compares to peers. It also has the potential to weight core indicators higher than the others, or establish core indicators as a hurdle to achieve a minimum score of adequate. “Getting Started” can be found and downloaded at: http://www.smartcampaign.org/tools-a-resources/2/48

- “Conducting Client Protection Assessments: A Guide”. This guide provides guidance to an assessor on how to conduct a consumer protection assessment that evaluates the financial institution’s client protection practices. The guide leads the assessor through a step-by-step process for collecting information and documents and offers advice on how to evaluate the information against the indicators for each principle. A companion “Resources” piece offers practical advice for organizing and facilitating the assessment process, such as suggested interview questions, agenda templates, and how to organize the team.

- The guide can be used by institutions to assess their own performance or by an independent assessor. The Smart Campaign has begun a process for certifying assessors.

- The assessment is a relatively rigorous process that requires significant staff participation and approximately 3-5 days of on-site work. “Conducting Client Protection Assessments: A Guide” can be found and downloaded at http://www.smartcampaign.org/tools-a-resources/2/42

- Smart Notes. Smart Notes are brief publications that highlight good client protection practices drawn initially from institutions participating in Beyond Codes. Smart Notes can be found at: http://www.smartcampaign.org/tools-a-resources. The Smart Notes show a wealth of experience for several of the main client protection principles, such as:


  - “Collections with Dignity at FinComún,” http://
The Synthesis Report

This synthesis report outlines the main lessons from the Beyond Codes project. It pulls together the experience gained from the assessments, not primarily for the purpose of refining assessment methodology (as this has already been done), but for the purpose of adding to the microfinance field’s knowledge about how providers implement the CPPs. Nevertheless, it does make some comments about conducting assessments. The lessons are grouped into four areas:

1. General lessons from the Beyond Codes Assessments
2. Lessons about financial institution performance – Client Protection Principles and Practices
3. Lessons about the Principles and Indicators
4. Lessons about the Assessment Process

A recommendations section follows the main lessons. “Conducting Client Protection Assessments: A Guide” details lessons about how to assess a financial institution’s client protection practices. These lessons are not repeated here.

1. General Lessons from the Beyond Codes Assessments

We begin with a note of caution. The project included a very small sample size of 12 FIs. The sample included mature FIs and start-ups, banks, NGOs, and credit unions. The countries – Bosnia, India, Kenya, Mexico, and the Philippines – represented four regions. Each country has quite a different regulatory and market conduct environment. Levels of awareness, attention to and enforcement of client protection practices vary considerably from a highly regulated environment, to a highly regulated but loosely enforced regulatory environment, to an environment where client protection practices are admired and promoted but are not part of the regulatory frame-work. For a summary of how country context affects assessments by principle, see Annex 1.

Usefulness of Assessment Reports

Overall, financial institutions have found the assessment process and the report useful. Prior to the assessment, none of the FIs participating in the Beyond Codes action research willfully ignored CPPs—in fact, quite the opposite. FIs participating in the project are considered pioneers in the field; they were interested and willing participants. There was, however, a lack of awareness about the principles and why they are important.

The assessment process built awareness about practices within the institution and stimulated discussion about the opportunities and challenges, benefits, and costs of change. The report provided a snapshot of FI practices and should be helpful to management for benchmarking progress and planning change.

Pilot Initiatives

As a result of the assessment (and a deliberate part of the process), financial institutions developed pilot initiatives to revise systems and implement programs for the benefit of clients, the financial institution and the industry.

By the end of Beyond Codes, six FIs had experience monitoring pilots, and three were in the process of determining initiatives. The pilots range from those in the “win-win” category, such as improving or developing complaints and redress mechanisms, to those that are expected to have a longer term impact on clients and the industry. In this latter category, pilots in Mexico include client education with respect to savings, business, and household budget management; in Bosnia, they include the establishment of a debt resolution and education center. One organization in the Philippines developed initiatives
to examine the loan evaluation system and how its code of ethics is incorporated systematically into the organization.

Some excerpts from pilot monitoring reports:

- We are codifying all policies and practices in all departments as basis for standards in delivering services to members and to promote the principles of client protection;

- [We have...] started including a parameter for ethical behavior in the semi-annual performance evaluations and determining how to include client feedback into rating branch and employee performance.

Although several pilots are still too early to evaluate, all have identified expected results, such as:

- Drop-outs and delinquency rate related to weak and erroneous loan evaluation will decrease.

- Grievances of members will be addressed promptly and properly.

- Standardization in all levels of operation will gradually take place through the codification process.

- Financial literacy will be echoed from the branch level up to the center level, and this is expected to aid the employees in their evaluation of members, particularly in conducting cash flow analysis.

Where results are available, they vary widely. An initiative on client education noted that after taking the course, “98 percent of the course participants indicated that they would make it a habit to save. Prior to the course, the pre-test showed that only 23 percent of the participants were in the habit to always save.”

On the other hand, a revamped complaints mechanism has not met expectations to date. The system includes hotline numbers, a “Talk ‘N Txt” phone messaging format, customized comments and suggestions form, and staff briefing on the standard procedure for implementing the system and communicating with customers. However, not one customer has used the system; clients are not accustomed to providing feedback and are ashamed of offering criticism. The FI continues to experiment with developing a complaints mechanism to suit customer preferences.

Not all of the FIs participating in the project implemented pilots. As of June 2010, three FIs had not initiated pilots. Two FIs requested technical assistance before implementing pilots, and one FI has been unresponsive.

Lessons from Networks

National networks have become champions of the CPPs. There is high interest in promoting the CPPs among their membership, training network members in the CPPs and performing assessments, together with social audits, and as stand-alone assessments. National networks and associations are the recommended point of entry for further work on engaging FIs to integrate client protection principles and practices into standard operating procedures. Two networks, the Microfinance Council of the Philippines, Inc. (MCPI) and the Rural Bankers Association of the Philippines (RBAP), featured client protection in their annual conferences and a national roundtable dedicated to consumer protection principles and practices.

This experience led to an important finding about how to engage FIs and interested stakeholders in client protection: When initiating CPP assessments in a country, engage with the national networks first. They can and are generally highly interested in holding a national dialogue group for members, stimulating interest in the topic, and obtaining insight and experience within the national context. Participants from the microfinance regulatory authority are often featured in these dialogue groups, promoting an opportunity for collaboration.

National networks have also undertaken joint pilots for their members as part of industry-wide initiatives, as with the Association of Microfinance Institutions (AMFI) in Bosnia. Together with leading network members, AMFI is establishing a debt resolution and education center.
2. Lessons about FI performance – Client Protection Principles and Practices

This section of the report discusses overall FI performance trends and then turns to a discussion of the practices that support each principle.

Overall Performance: Lessons

Overall FI performance on the principles is not equal, either among the group of participating FIs, or within one institution. One lesson from the assessments is to expect the same financial institution to show strong performance in some areas, and weaknesses (or nothing) in other areas.

Beyond Codes findings showed that more formal financial institutions, such as banks and credit unions, tended to have better overall client protection practices than less formal organizations such as NGOs. The reasons include: Compliance with formal regulation in other areas tends to spill over into client protection; regulated institutions have developed compliance systems and procedures widely throughout the organization; monitoring and internal audit are especially well developed as reputation risk is formally considered at the senior management and board levels; and many formal financial institutions have developed good customer service departments, including complaints handling and resolution mechanisms.

Good client protection practices are directly linked to the FI’s mission to serve all customers well, regardless of the customer’s economic status. Good client protection practices do not appear to be directly related to an institution’s mission to serve the poor. Even organizations dedicated to serving the poor can neglect client protections during their pursuit of growth, profitability, or competitive advantage. Short-term performance targets can emphasize market share or cost reduction to the detriment of paying prudent attention to customers.

As a group there are certain trends regarding performance on principles, as shown in Box 2 below. Most FIs performed well on appropriate collections practices and avoiding over-indebtedness, demonstrating strong or adequate practices for these two principles. There was mixed performance on ethical staff behavior, and dramatically mixed performance for transparency. As a group, FIs showed the weakest performance on complaints mechanisms. Privacy and security of client data showed mixed results due to methodological issues rather than particular FI practices.

“Fair pricing” was a special research project of Beyond Codes. The objective was to determine if fair pricing could be assessed in a quantitative way with clear indicators. We started the project with the notion that “you know what is unfair when you see it,” as one dialogue group member noted. Conversations with FIs during the assessment process and experimenting with indicators brought us further along. However, specific quantitative measures and process indicators for responsible pricing are topics that require more discussion before consensus is reached about minimum standards. The results on this principle should be seen as experimental.

Performance by Principle

The discussion of each principle starts with a summary of what the assessment examined, the overall results of financial institution performance, and a brief comment on the validity of the indicators. The second section turns to a discussion of lessons about the context and lessons from financial institutions participating in the project.

Avoid Over-indebtedness

To assess protections against over-indebtedness, assessors looked at credit methodology and products suitable for the customer base. Treatment of borrower repayment capacity and knowledge of existing debt levels were critical components of the assessment. Loan officer incentive systems were checked to see whether they provided pressure to over-lend.

2. Fair pricing was later changed to “responsible” pricing and added to the CPPs.
Most FIs performed well on the implementation of this principle, with 80 percent assessed as having strong or adequate practices. More mature FIs tended to score higher, indicating that all systems, such as loan underwriting, are in place and backed by experience. However, not all mature FIs were the strongest performers. There was no difference in scores regarding FI size or legal charter.

The set of indicators represents the implementation of this principle well, as shown by a clear differentiation among the scores, i.e., assessors could distinguish among strong, adequate, and weak practices.

**Context is very important for this principle.** Market behavior norms in a given country influence how FIs implement this principle. Regulation does not appear to be important, but the existence of a quality credit bureau and mandatory participation in it is important.

**Lessons from institutions.** The level of competition, market saturation, and FI growth strategies—priority given to reaching new markets or existing ones—are all important factors in how an FI performs on this principle. Several FIs showing weak practices placed priority on growth in the market, as indicated by productivity and incentive plans that supported growth over quality. Others lent larger loans than a borrower could prudently afford in order to stave off the competition and secure a competitive edge.

**Competition** in saturated markets created stress on the routine measures FIs “normally” used to prevent over-indebtedness. Even so, appropriate credit products and loan evaluation remained important for preventing over-indebtedness. Several inappropriate products from different FIs—or the same FI—led to increasing debt levels on the part of the clientele. Borrowing multiple loans is not the same thing as over-indebtedness. However, two early warning signs should not be ignored: First, when FIs flag multiple borrowing as a serious issue, even when official statistics are not available from a credit bureau; and second, when industry-wide performance statistics show high annual portfolio growth rates and increasing numbers of borrowers in mature, saturated, and competitive markets.

**Credit bureaus** help an institution prevent over-indebtedness; however, they are not a silver bullet. One country that experienced a full-blown over-indebtedness crisis had a credit registry in place (albeit a young one that did not capture past data on long-term loans). Preventing over-indebtedness also depends on how the organization uses the data. For example, one organization had a liberal policy on providing debt to borrowers with problematic credit histories. Later the policy was revised due to poor performance with these loans. In the absence of credit bureaus, informal information sharing is not seen to be very reliable. However, FIs do use these methods, particularly at the branch level, as they are “better than nothing”.

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**Box 2: Overall FI Performance on Principles**

![Bar chart showing overall FI performance on principles](chart.png)
Assessing repayment capacity: While there is no common standard for assessing repayment capacity, most FIs used a disposable net income to installment payment ratio between 20 and 60 percent. That is, 20-60 percent of net income after routine household and business expenses could reasonably be set aside for debt service. A common reason for low scores on this principle was high debt service thresholds (in organizations that used them), such as 80 percent.

Group lending: There was no discernable difference in scores among lending methodologies used. This was an initial concern before the research, as features of group-lending methodologies might create automatically lower scores when rated against the indicators, such as the group’s ability to evaluate loans, solidarity guarantees used as the sole means for loan approval, security and privacy of an individual’s data within the group, and appropriate collections practices. The research found that in general (but not always), FIs using group-lending methods tended to pay strict attention to these matters by following standard operating procedures and investing heavily in group training for loan assessment, special precautions regarding safety of savings, and accurate and timely information about account balances. Elements of excellent practices in group lending are embodied less in formal systems than in consistent and quality training of groups to manage their own operations, including assessing repayment capacity. Group lending relies heavily on the peer guarantee, but it was rarely used as the sole means for loan approval; character and cash flow played the predominant roles.

One of the most important lessons deals with staff incentives and productivity targets. The first few assessments under-rated their importance, but the teams quickly recognized the need to give incentives greater weight. Many systems were difficult to understand and required a demonstration to see exactly what is rewarded. Good practices rely on systems that are: 1) clear, that is, they do not parse percentages; 2) use of PAR and write-off as an “entry pass” for any bonus to be awarded as an incentive, and “bonus discounts” based on higher levels of PAR and write-off; and 3) monitored throughout the month to prevent end-of-month distortions and high pressure for end-of-month disbursements.

Finally, it should be noted that the indicators supporting this principle measure FI efforts to prevent over-indebtedness, not results. The measurement of efforts, however, should provide early warning signs if enough data from assessments is available for the industry at large, and not just a few FIs.

Transparency in Pricing, Terms, and Conditions

To assess transparency, assessors looked at how the FI disclosed complete information on prices, terms, and conditions, penalties and fees for all products, and whether those could change over time. Methods of communications with customers, especially customers with low financial literacy, were given priority. How staff are trained to communicate with customers was also checked, as were the methods staff use to ensure customers understand the product terms and conditions.

Forty percent of the FIs assessed demonstrated “good” practices and 40 percent showed “weak” practices. Regulated FIs – banks and credit unions – generally scored higher on this principle than their NGO or finance company counterparts. Younger and smaller FIs tended to score lower, indicating that all systems, such as multiple channels for information disclosure and customer interactions, are not fully developed. However, some mature FIs also scored low on transparent communication with customers.

The results show that the indicators used to determine transparency are quite strong. They yield a clear differentiation in the scores.Transparent practices can be assessed clearly with these indicators. FIs either showed strong practices, or weak ones.

Context is very important for this principle. Market conduct regulation is important for the implementation of this principle and not as dependent on individual FI leadership initiatives, as for example “ethical staff behavior” is. However, there were examples where no transparent pricing regulation exists, and the FI upheld adequate practices by ensuring that customers received full information about prices, terms, and conditions. These FIs also tended to emphasize special initiatives with respect to customer education and administering standard inter-
view tests or questionnaires with customers prior to signing loan or insurance contracts or opening accounts.

An issue with many assessments was the absence of industry-wide APR requirements and full-disclosure requirements. For example, licensed FIs were required to use APR pricing formula and others (e.g. NGOs) were not. As a result, patchy coverage and perverse incentives tended to undermine the regulation. Transparency laws, such as use of an APR or similar formula, work only when all microfinance providers comply at the same time.

**Lessons from institutions.** The use of flat rates of interest on loans can be assessed as adequate practice. From the client perspective what is most important is not the percentage rate, which customers tend to ignore, but a complete and clear listing of all costs and terms of the loan, and savings accounts fees. Customers often prefer a complete list of all costs associated with a loan, and amounts they will earn on savings accounts, rather than a percentage. This method is easier to understand. In contexts where an APR (or similar formula) is commonly used, customers become familiar with what it means over time and use it to compare products. An APR or similar method has long-term benefits for the industry; it tends to drive down prices, and customers become more accustomed to using it. In the meantime, many FIs participating in the project used the APR or similar formula in all contracts to comply with the law, and complemented the loan contacts with a complete amortization schedule that detailed all costs in amounts – including linked products – and a savings product description that showed interest income in monetary values, not percentages.

Common reasons for lower scores for weak practices included: flat percentage interest rates charged on loans with little explanation of the total price, opaque terms and conditions regarding collateral, lack of information provided to guarantors about their responsibilities, absence of timely statements or information about account balances, and treatment of savings (both mandatory and voluntary) as a source of loan repayment without the customer’s prior knowledge.

Weak scores reflected practices of omission, not commission. No instances were found of FIs intentionally promoting products in false or misleading ways. Communications with clients and their guarantors were areas that showed the most weaknesses.

**Appropriate Collections**

To assess the appropriateness of collections, assessors looked for standard procedures; clear, detailed steps; and time frames spelled out in a staff handbook. They also looked for knowledge of the ethical codes and practices among collections agents, and monitoring and systematic enforcement of violations by the FI. Training of collections agents and policies regarding acceptable and unacceptable pledges of collateral and the use of debt rescheduling practices were also checked.

All FIs performed well on this principle, with 50 percent showing strong, and 50 percent showing adequate practices. The overall scores on this principle were the highest of all, showing that all the FIs participating in the project paid attention to appropriate collections practices. Regulated FIs tended to score higher. There was no scoring distinction between small or large, young or mature FIs.

The indicators appear to be valid, although verifying consistency of practices throughout the organization is challenging.

**Context is relatively important for this principle.** Market conduct regulations do not tend to be important for assessing this principle, but business norms do tend to be important (i.e. what is considered appropriate practice.)

**Lessons from institutions show** that the reasons for this strong performance are varied. First, FIs pay attention to a combination of the business case and ethics – it is not worth it to harass customers with such small loan amounts to ensure repayment once the borrower is in default. Second, FIs in the sample were serious about treating clients with dignity and respect even when they could not fulfill their contractual commitments. A visit by a collection agent is never welcomed, but at least it can be a visit that does not violate ethical principles. Many FIs sub-
scribed to the principle that “once a customer, always a customer, despite the difficulties.” Third, FIs in the sample were concerned with reputation risk, and aware that inappropriate collections practices can provide fuel for incendiary media attention. Finally, based on experience, many FIs preferred to rely on a legal approach to collections.

The strongest collections practices are in institutions where collections are supported by the FIs’ legal department (or within it), or a specialized collections department. Specialization appears superior to collections by originating loan officers both in terms of collections results as well as time invested and appropriate collections practices. This does not mean that loan officer relinquishes responsibility for the quality of the loan. Specialized collections models incorporate focused training on collections techniques and “appropriateness” consistent with the FI’s code of ethics.

Weak practices included ad hoc collections by non-specialized loan officers that often crossed the line of appropriate behavior. In some cases ad hoc and deceptive collections practices, as well as granting debt extensions, were driven by a “zero tolerance of delinquency” policy. Based on this experience, FIs underscore the importance of staff manuals that clearly identify steps in the collections practice, a specialized collections department that handles cases headed towards default, and an internal audit department that regularly monitors collections practices as part of its remit. Debt rescheduling policies forbid automatic debt extensions and are subject to management approval.

Use of third-party collections agents is not necessarily a bad practice if it complements the FI’s human resource base. While few FIs used third party collection agents, those that did hired professional legal firms which held themselves to standards of transparent client communications through the use of recorded sessions.

Ethical Staff Behavior
To assess ethical staff behavior, assessors looked at how the corporate culture values and rewards high standards of ethical behavior. A board-approved and written code of conduct, staff training and knowledge of the code, and staff performance reviews that reinforce ethical behavior were critical elements of the assessment. The internal audit and fraud control system was also checked to see how it detected customer mistreatment.

The results of the assessments show mixed performance, with 50 percent of the FIs displaying strong practices, 20 percent demonstrating adequate practices, and 30 percent with weak practices. There is no performance distinction with regard to size or regulatory status. Age may be a factor, as younger FIs and start-ups generally scored lower on this principle than their more mature counterparts. Nevertheless, some young FIs scored well on the implementation of this principle and some mature FIs did not.

The results show that this set of indicators is very strong, based on a clear differentiation in the scores. Ethical practices can be assessed clearly. FIs either showed strong practices, or weak ones.

Context is relatively unimportant for this principle. Market conduct regulations do not tend to be important for assessing this principle. The established culture within the organization matters, as does being a signatory to association or network codes of conduct.

Lessons from institutions. The combination of ethical leadership and clear rules is what makes this principle powerful in practice. Ethics is management-led. Strong ethical practices are a function of the individual FI leadership and the organizational culture that leaders develop. Each organization that scored well on this principle, regardless of age, size, or regulatory status, was led by committed management, leaders, and founders who were/are ethical role models, instilled ethical behavior in the staff, and developed systems to support ethics.

Good business ethical practices are systematically applied within an organization and regularly monitored. An ethical code which is distributed to all staff is only the starting point for FIs showing excellent practices. A business ethics system starts with staff recruitment processes that seek employees with values that match those of the institutions and trains them in ethical dilemmas likely to be found on the job. The best training is based on organizational experience and tailor-made
for the position. Systems include “ethics mentors” on staff, internal complaints and whistle blower systems, and procedures for protecting whistle blowers.

No sound system was complete without compliance monitoring and rewards. The strongest ethical practices include an incentive system that rewards ethical behavior, and an internal audit or similar department that is tasked with examining practices for ethical violations, including mistreatment of clients.

Mechanisms for Redress of Grievances

To assess complaints and resolution mechanisms, assessors evaluated the accessibility and active use by customers of a mechanism to handle customer complaints and staff resources dedicated to handling and resolving problems in a timely manner without bias. How customers were informed about their right to complain, and how information was used to improve products and interactions with customers, were also checked to assess the system for robustness.

This principle showed the overall lowest scores. Seventy percent of the FIs participating in the project showed weak practices with respect to implementing this principle. FIs that are more mature or whose leadership is committed to the principle scored better than others. In addition, credit unions showed strong performance in this area. Credit union leadership and management tend to have a genuine concern with communicating well and often with their client owners. This extends to complaints and resolution mechanisms.

The set of indicators for this principle is robust. The indicators are concrete and enabled rapid assessor verification as shown by a clear differentiation among the scores.

Context is relatively unimportant for this principle. Market conduct norms and business practices within FIs (not regulation) tend to be important for assessing this principle. That is, where a complaints mechanism is implemented by many FIs, there is a likelihood that the others will follow.

Few government complaints systems reached clients of FIs participating in the project. Clients of the FIs participating in the project generally had complaints or problems that are too small to be considered by the government agency, for example, how to access an electronic payment system, solve a problem about a late account balance, the late arrival of a credit officer to the meeting, or being assessed an unjustified late fee. These problems can only be solved between the FI and the customer. A strong government complaints mechanism and resolution system is important, but it is no substitute for the FI’s own customer complaints department.

Lessons from institutions. Unless there is abundant evidence that customers regularly and actively use suggestion boxes, they are not considered adequate practice. A client-accessible complaints system requires multiple channels, and the choice of channels depends on the ways customers prefer to provide their comments and concerns. Call centers are popular where mobile phones are used by the majority of the customers, and in group methodologies, group officers are the first-line representatives of the problem to the institution.

Customer satisfaction surveys are also important supporting documentation for assessing this principle, as they provide insights into what customers like and do not like about the FI’s services. But a customer satisfaction survey is not the same thing as a complaints handling and resolution system, and several surveys reviewed did not specifically ask customers if they had problems, or if any problems were resolved fairly and in a timely manner.

Strong practices for this principle showed an organization that used a procedure of informing all clients of the call center and demonstrating its use. The internal audit department was specifically tasked with asking clients if they were informed about the system and knew how to use it. Weak practices included suggestion boxes that were never used, and checked by internal audit once every three months.

The overall weak performance on this principle is surprising because the implementation of this principle has a clear business case associated with it. A basic complaints and redress system is not exceptionally costly to implement. Staying in touch with customers and responding when things go wrong are
beneficial in terms of customer satisfaction and managing risks within the institution.

**Privacy of Client Data**

To assess protections of privacy of client data, assessors looked at the FI’s data-sharing policy, and the accessibility of the system to unauthorized personnel. Emphasis was placed on reviewing when and how customers are informed about the use of their personal and financial information, and to what extent the FI asks permission and obtains consent to use customer information.

It is not surprising that this principle has mixed performance. What is surprising is the almost perfect bell curve, which does not show up elsewhere. This is most likely due to the fact that this principle measures two different topics: security of client data and privacy of client data. An FI can have excellent security systems but fall short on client consent for sharing information. We found few examples of the reverse.

The recommendation is to separate the two concepts entirely, or focus on client knowledge of FI information-sharing practices and obtaining client written consent. Implementing the latter recommendation would consider “security of client data” a minimum hurdle for getting on the scoring chart.

**Context is somewhat important for this principle.** Market conduct regulation tends to be an important factor for the strength of the practice within FIs. For example, privacy standards that incorporate customer consent requirements for information-sharing have a positive effect on the implementation of the principle. The absence of regulation or secrecy laws that prevent information-sharing lead to ad hoc practices at the institutional level and generally have a negative effect on the implementation of the principle.

**Lessons from institutions show** that privacy of client data remains an issue when assessing group methodologies. Current guidance is that information must be kept within the group. Group members generally know each other well, and know about members’ income streams and financial health. Good practices include group training that covers the importance of security and privacy of individual group members, access to joint savings accounts, and safety procedures for disbursements.

Good practices show institutions that explain in detail how the clients’ information will be used and seek their permission for using personal stories and photographs in marketing campaigns or informational brochures. In one context, however, client consent for photographs did not appear to violate privacy concerns. It is difficult to determine whether this is a particular cultural trait, or due to current practices and customer expectations. This finding underscores the importance of vetting practices and norms within a particular context.

It is also important to note that signing of blanket waivers allowing institutions to share any data at any time is not considered an adequate practice. Client consent should be sought for specific circumstances.

**Fair Pricing**

As noted previously “fair pricing”, or, as it is now termed, “responsible pricing”, was a test case for the Beyond Codes research.

To assess fair pricing, assessors looked at two areas that show an organization’s commitment to maintaining mutually beneficial relationships with customers: 1) the efficiency, profitability, and competitiveness of the institution in its context, and 2) how benefits of institutional growth are passed on to customers.

All scores showed “strong” or “adequate”. There were no “weak” scores, which may indicate methodological or assessor failure.

**Context is relatively unimportant.** Market conduct norms are more important than regulation for this principle. For example, pre-payment penalties and amounts tend to be the same in a given market.

**Lessons from institutions show** that privacy of client data remains an issue when assessing group methodologies. Current guidance is that information must be kept within the group. Group members generally know each other well, and know about members’ income streams and financial health. Good practices include group training that covers the importance of security and privacy of individual group members, access to joint savings accounts, and safety procedures for disbursements.

4. Refer to “Conducting Client Protection Assessments: A Guide”.

that regularly monitors performance, networks appear to be a good potential source of information, but often do not collect it because their members have not granted them this role or authority.

Second, at a minimum, responsible pricing relies on full disclosure by the seller to enable a customer to make informed decisions. If the financial institution scores poorly on full disclosure, it cannot reasonably score well on responsible pricing. A high score on transparency should be mandatory for an adequate score on responsible pricing. If transparency is weak, prices are unlikely to be fair. Without transparency, fees tend to be opaque and often high.

Deeper training of assessors is important to carry the assessment of this principle forward. Most assessors do not have the financial skills and experience that adequate assessment of this principle requires.

All of the markets in the BC were competitive markets. The indicator regarding “competitive markets” should be dropped, and the emphasis should be on comparative pricing within a set of similar competitors in any market.

Evaluating this principle requires comparative pricing information from an array of similar competitors in any given market. The efforts of Microfinance Transparency have gone a long way towards establishing benchmark pricing data for many countries and FIs. Further work in this area requires a definition to be established for responsible pricing that includes quantitative indicators and ranges of acceptable prices and responsible pricing practices. Meaningful analysis also requires timely data that is updated often and disaggregated by similar competitors.

3. Lessons Concerning the Principles and Indicators

Developing the Assessment Tool: The Process was a Learning Experience

The project started by building on the current state of the practice and involved a number of industry experts and national associations and networks. Client protection codes of conduct had been developed by several FIs that belonged to international/national networks and associations that had taken a leadership role in this area, although each code of conduct was tailored to the national context, the general tenor and concepts were similar.

Desk research included client protection regulation and guidance from a number of countries, including those participating in the project.

The assessments and the dialogues within the FI during and following the assessment provided substantial learning for the validity of the indicators … and the principles.

Validating Indicators

Two international industry-wide expert dialogue groups were held during the project. The first, in late 2008, aimed to identify indicators with promise for measuring the principles. The group emerged with over 100 indicators to be tested by the project.

As assessments progressed, indicators were culled as follows:

Too prescriptive or too detailed: Some indicators were dropped because they were too prescriptive; the project intended to develop indicators that allowed for a range of good practices. Examples of prescriptive indicators include elements of specific group-lending methodologies, such as group size and structure, required times, such as 24 hours or 3 days, for “cooling off” periods when a borrower can cancel a contract with no penalty, or reading contracts aloud when some contexts and customer bases may call for this special initiative, but others may not. Some indicators were merged because they always appeared as a result of one practice, e.g., the indicator reflected only a piece of a much larger process. For example, an indicator for appropriate collections practices was broadened to focus on acceptable and unacceptable practices that were clearly spelled out in a staff book of rules or codes of ethics, rather than detailing specific practices as separate indicators.

Able to verify in a reasonable amount of time: Other indicators were good ideas, but almost impossible to verify in a reasonable way during the assessment period. For example, reasonable data collection directly from client interviews vs. reviewing FI customer
surveys, and then complementing that information with interviews. The timeframe for the assessment did not allow for thorough primary research at the client level; instead, secondary sources were used. The best sources of information at the client level were customer surveys that had been conducted by professional, independent firms.

**Focus on client protection:** Indicators were further culled to focus more closely on client protection practices as opposed to more general good organizational or microfinance practice. For example, publishing annual audited finance reports is clearly a good practice for transparency, as is reporting to the MIX. Systems enabled to report portfolio at risk (PAR) on a daily basis by branch, local officer, etc. are also important for a well-functioning organization, as are board committees that meet regularly. These examples are good organizational practice. Assessments of client protection focus on specific aspects of these practices – for example, for transparency, publishing transparent prices for products; for portfolio quality, how rising PAR and high growth signal assess the potential for over-indebtedness; and for boards, whether the board is aware of the potential for over-indebtedness and mindful of ethical culture.

**Ambiguity:** Finally, indicators received scrutiny for their ambiguity. While the assessment will always rely on the judgment of the experienced assessor, indicators that relied on a “leap of faith” were removed from the protocol.

**What Makes a Good Indicator?**
In late 2009, with the assessment experience well under way and partially synthesized, the second dialogue group homed in on common indicators that were considered promising across all contexts, institutional forms, and product variations. With this experience it was possible to identify the “core” indicator or indicators for each principle.

Valid and verifiable indicators have certain characteristics:

- The information to assess the indicator must be commonly available.
- The measures must be valid regardless of the type of organization, size, age, or context.

- Meaningful indicators must capture the main practice for the principle.
- Some indicators will always be process indicators; some will develop into quantitative measures
- The existence of a written policy is more important for some principles than others. Written policies are more critical when the clarity of the rule is important. Management leadership is more critical when the clarity of values can reinforce the rule – or replace it.
- The existence of a written policy does not necessarily mean that it is followed consistently throughout the organization. Consistency can be determined by answers to the following questions:

1. Is there a system or procedure with someone in charge of quality control?
2. How does the FI hold staff accountable for following the system?
3. Is the system monitored by a specific person, or department, such as internal control or internal audit departments or the credit department manager, or an ethics committee?
4. How regularly is the system reviewed and revised?

**What Levels of Verification are Appropriate and Possible?**
The Beyond Codes assessment methodology combined desk research and document review, systems demonstrations, in-depth interviews with staff, and sample client interviews to gain insight into the FI’s customer base and observe staff-client interaction.

Based on this methodology, it is possible to determine three levels of verification. Each has advantages and disadvantages.

**Level 1:** A review limited to a desk review of documents. This type of review has the advantage of being quick and inexpensive. The disadvantages: The assessor would have to be an expert reviewer, well-
versed in all aspects of consumer protection and how they might play out, given the quality of the written documentation and experience in different contexts. Knowledge of the country context, market trends, and microfinance good practices are essential. A desk review allows very little interaction with FI staff and less weighing of perspectives and differences of practice often found on the ground.

The assessment is a review of formal documents and systems. Some of the CPPs are more conducive to this type of assessment than others, for example, those that rely on whether a concrete process exists or not (such as a complaint mechanism) or parts of a principle, such as transparent advertisements, or review of standard loan contracts. In summary, a Level 1 assessment does not appear to have many of the features that would be required to produce a meaningful assessment, but it is feasible and not costly.

Level 2: The Beyond Codes methodology included a review of written documentation, systems demonstrations, staff interviews (at both head office and branches) and staff-client interactions. This is important for many organizations that do not have all the required written documents, or are in the process of updating information or practices.

Many principles rely on an assessment of leadership and organizational culture, not written documents, where interviews are important. Interviews also serve as an important feature for seeking clarification, and for confirming active systems or functions such as training. Staff interaction with clients – group meetings and individual interviews – is the basis for assessing several of the principles, such as ethics, transparent communications with customers, and collections practices. Handling confidential information, always an issue, is less problematic face-to-face.

In summary, a Level 2 assessment has many of the features that would be required to produce a meaningful assessment. This type of assessment is certainly possible, although it requires a commitment by FI staff and leadership, and resources to pay for the assessment.

Level 3: This level adds client interviews and comparative information from other FIs in the market, such as mystery shopping. This option would rely on a professional, independent sample of the customer base, and a cadre of expert mystery shoppers.

A Level 3 assessment is an intensive and likely lengthy process. However, it may be called for in some cases. Before offering an analysis of this option, it would be necessary to test the process, comparing time, costs, and added benefits. Customer surveys are generally beneficial to the institution, and many FIs in the Beyond Codes sample had completed surveys. Communications with survey firms regarding the CPPs would be essential for carrying this interesting prospect forward.

Many FIs in the Beyond Codes sample also carried out mystery shopping surveys. These surveys were helpful to the FI and the assessment process, as they tended to position the FI within a sample of similar competitors on a timely basis. The information collected could be honed to incorporate the CPPs in a more comprehensive fashion.

In summary, a Level 3 assessment adds two important features to the assessment process – customer perceptions and competitor data. This type of assessment is certainly possible, although it requires additional resources to pay for the assessment, and an investment in survey providers to ensure CPPs are represented. It may make practical sense for client surveys and mystery shopping to be carried out at the national level or by associations that can invest in data collection covering several FIs at once.

Weightings and Ratings
Initially, measurement included three categories: “strong or good”, “adequate”, and “weak”. Later, five categories were introduced as FI practices could be categorized as “adequate leaning toward good”, or “adequate leaning toward strong”. As assessors did not have these two additional categories initially, there was a preponderance of “adequate”.

With experience during the project, it was possible to identify “core” indicators – those indicators that had to be met for a minimum rating of “adequate” for the principle. These indicators are weighted more highly in the “Getting Started Questionnaire”. However, it is also possible and desirable for an external evaluation to consider these indicators as hurdles for achieving a rating of adequate.
4. Lessons About the Assessment Process

Basis for Developing Standards
Questions often surface about assessing practices, such as: “Isn’t it difficult to assess client protection practices when standards are not clear, are often specific to the market, or the experience of the assessor?”

Some basic minimum standards are emerging for several of the CPPs that are applicable to all markets.

- Standards are emerging for the principles on transparency, collections practices, ethics, complaints mechanisms and resolution, and privacy of client data.

- The questions and measures regarding preventing over-indebtedness assess FI efforts, not results. This complex principle generally requires substantial analysis and knowledge of the context, such as market penetration rates, growth trends and specific institutional practices regarding expansion patterns, loan evaluation procedures, productivity targets and loan officer incentives, among other factors.

- Specific quantitative measures and process indicators for responsible pricing are topics that require more discussion before consensus is reached about minimum standards. However, several FIs have developed practices that set the bar for the current state of minimum standards. These practices include thorough and regular reviews of product pricing, rewarding efficiency at the branch level and organization-wide, asking customers to “opt-in” to linked products, such as credit life insurance (as opposed to bundled products as the default option), and avoiding prepayment penalties and excessive fees on savings accounts and transfers.

Process Indicators vs. Quantitative Indicators
It is important to recognize that some principles will always rely on “process” indicators, while quantitative indicators are suited for some principles.

Process indicators are just as verifiable as quantitative indicators. Process indicators follow a certain path and can be used as a “checklist”. The checklist questions ask “does it exist?” The score relies on the assessor’s judgment about the quality of the items in the checklist.

- Is there a written policy (more important for some principles than others)?
- Is there a staff manual that includes the policy, set of standards, step-by-step procedures, timeframes, and personnel involved?

<table>
<thead>
<tr>
<th>Box 3: Process and Quantitative Indicators by Principle</th>
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<tbody>
<tr>
<td>Principle</td>
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<tr>
<td>-------------------------------</td>
</tr>
<tr>
<td>Avoiding Over-indebtedness</td>
</tr>
<tr>
<td>Transparency</td>
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<tr>
<td>Appropriate Collections</td>
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<tr>
<td>Ethical Behavior</td>
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<tr>
<td>Complaints &amp; Redress</td>
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<tr>
<td>Privacy of Data</td>
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<tr>
<td>Fair Pricing</td>
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</tbody>
</table>

5. The Dialogue Group held in November 2009 discussed this issue extensively.
6. Refer to “Conducting Client Protection Assessments: A Guide” for the methodology used.
Beyond Codes: The Foundation for Client Protection in Microfinance

• Is staff trained in the process?
• Is someone (person or department) in charge of quality control?
• How is staff held accountable for following the system?
• Is the system monitored for compliance by a designated department, such as internal audit?
• What happens when the system or procedure is ignored?
• How regularly is the system reviewed and revised?
• What information is used and how is it used to improve operations? (See the discussion above regarding levels of assessment depth.)

Several principles that rely mostly on process indicators for measurement include quantitative indicators. For example, over-indebtedness includes quantitative indicators for staff incentive systems that value portfolio quality at least as highly as growth, as well as loan underwriting procedures that make use of debt thresholds and debt service ratios based on the amount of installment payments to disposable income. Pricing transparency includes calculations of the effective interest rate for loans compared with the stated interest rate. An analysis of the principle complaints and redress reviews the number of complaints and the time involved for resolution.

Practical Aspects of the Assessment Process
The assessment is always sensitive and dependent on timing.

1. Senior management support and enthusiasm for client protection enable a more fluid assessment process and more comprehensive and useful results.

2. Confidentiality of reports was a prerequisite. As progress and client protection assessments become commonplace, confidentiality may become less of a concern and FIs may be willing to share reports. However, during Beyond Codes this was not the case. The concern with confidentiality does not appear to stem from reluctance to share the FI practices regarding treatment of clients. Rather, the main concern appears to be about the competition gaining access to the FI’s internal systems information. In addition, the assessment looks at confidential internal processes: internal audit reports, incentive systems, complaints, pricing policy, market intelligence and strategic plans, and business plans.

3. Voluntary nature: All Beyond Codes assessments were voluntary. Recruitment of the pioneering institutions was more difficult than originally anticipated, partly because of the newness of the initiative, and partly because of the time involved. Assessments required dedicated time by key FI staff members for hosting a team, interviews, and gathering information. There is also a common concern that many assessments and research projects on a range of topics are occurring at the same time. This problem could be addressed by integrating client protection assessments into other assessments planned by the FI, such as Social Performance Audits, financial ratings, and investor due diligence processes.

4. A well-planned debriefing immediately following the on-site assessment is essential. Prior preparation and communication of preliminary results in a smaller meeting is good practice. None of the results of the assessment should come as a surprise to the FI management. The debriefing is also an opportunity for the assessor to learn more about the institutions, staff perspectives, and their practices. In those assessments that either did not regularly communicate initial findings, or did not hold the debriefing immediately after the assessment, the FIs in question either lost interest, or resented assessment findings and became entrenched in their positions about the findings. Communication before, during, and after the assessment is important for a good assessment, the likelihood that the FI will improve practices, and building the experience of the assessor.

5. Pilot projects were a part of the Beyond Codes research. At the end of the project, only a few pilots had enough experience to determine how well they functioned and whether the initiatives would become permanent features of the FI operations. Pilots were determined in consultation with the assessment team, but the decision to initiate a pi-
lot was made by the financial institution. Pilots were voluntary and seen as the FI’s contribution to the field. Generally, the pilots nearing completion have had beneficial results. Several FIs have used the assessment as an opportunity to review major systems for incorporation of the CPPs. It may be possible to make the pilot process more formal by developing comprehensive action plans in place of specific initiatives.

5. Recommendations – The Road Ahead

1. Partners: National networks and associations are keys to successful progress and dissemination of client protection issues, training, advocacy, and resources. They can also play an important role in data collection, wherever they have the mandate and expertise to do so. Strengthening network and associations roles in training, providing services to members, and advocacy should be an immediate focus. Working with and through national networks and associations is the recommended point of entry to engage financial institutions on integrating client protection principles and practices into standard operating procedures.

2. Indicators: The current set of indicators is valid; and the weighting assigned to the core indicators appears reasonable based on the research to date. The next steps include:
   - Define specific ranges for quantitative indicators, testing them, and developing them into standards. This is especially important for responsible pricing, which requires a common definition and specific ranges.
   - The concept of core indicator or indicators was developed under the project because some indicators have more weight in assessing a principle than others. Ensure the “core indicator” concept is reflected in the tool formula to generate a score that reflects core indicators as minimum hurdles to meet “adequate”.

3. Assessors: Assessments are dependent on building an experienced and excellent cadre of assessors.

   - Bolster assessor training using experienced assessors as trainers of others, including on-site training. See Annex 2 for lessons from assessors during the Beyond Codes project.
   - Assessors need to have practical experience carrying out appraisals and due diligence prior to undertaking a client protection assessment. Knowledge of how financial institutions work, being able to distinguish standard operating procedures from client protection practices, and good financial and analytical skills are minimum requirements.
   - Develop an assessor certification that incorporates knowledge tests and a field practicum together with experienced assessors.

4. Expand indicators and assessment procedures for specific products. The general framework appears appropriate as insurance and savings products were assessed within the scope of the products. There is ample room to expand the range of specific indicators for insurance and savings products, which were given less focus in the initial research.

5. Test Level 1 and Level 3 assessments to determine the relative advantages and disadvantages of each level, as well as the cost and benefits of these alternatives. (Beyond Codes was Level 2).

6. Integrate client protection assessments into Social Performance Audits, ratings, and investor due diligence processes. There are clear advantages to integrating CPPs into investor due diligence. Stand-alone client protection assessments should be carefully designed to support the interests of various parties – the FI, investors, and networks. The costs of a stand-alone client protection assessment are significant enough to require cost-sharing among interested parties.

7. Build the database of client protection scores to enable the generation of an industry profile of practices. This might be expanded to include peer groups, such as age, legal charter, and country specific performance, depending on the number of assessments that contribute to the database.
Annex 1: Lessons from Assessors: Judgment Calls

Assessors raise concerns about using information to make judgment calls, ensuring context is critically analyzed, and their own subjectivity and qualifications. These lessons were generated from assessor experience during the Beyond Codes project:

1. Always look at the big picture – the relationships among the indicators – and how the principles of over-indebtedness, responsible pricing, and appropriate collections practices may be interrelated.

2. Think through the indicators, what they really mean, and how they are represented in the organization’s operations.

3. Don’t get side tracked with issues that are fascinating, but not relevant.

4. Use the contextual part of the assessment to analyze FI performance. Context is particularly important for assessing the principles of “preventing over-indebtedness” due to market saturation rates and FI growth rates.

5. Use and interpret financial performance data during the assessment – not later.

6. Understand the incentive system and how it works. Ask for a demonstration that compares a loan officer’s portfolio that is focused on growth of client numbers and portfolio, and one that is focused on portfolio quality.

7. Productivity targets and the bonus system may provide an incentive for loan officers to reduce PAR at the end of the month (when it counts) by over-disbursing. Ask for evidence that quality loans are also made at the end of the month when it counts, or evidence that demonstrates rational growth throughout the month.

8. Check biases. Don’t assume that one way of doing business is necessarily bad (or good) without looking at the FI’s experience. For example, use of third-party debt collectors is not necessarily bad practice, if the collections agents uphold a code of ethics and act professionally; group lending is not always implemented well; a standard practice where clients visit branches (instead of FI staff visits to their home or business) does not necessarily mean there is no trusted relationship between the client and the institution.

9. Ensure front-line staff and clients are interviewed and staff/client interaction observed during the on-site assessment.

10. Assess the FI practice against the indicator, not the practices of others.

11. Check optimism and pessimism. Ensure the assessment is not overly optimistic because the FI is committed or has many future plans, even though the current operation may not warrant such a high rating. Ensure the rating is not overly pessimistic because the FI may not meet the highest standards of other FIs that the assessor may know.

12. Ensure the summary ratings page is supported by evidence in the report.

13. Use the debriefing session to facilitate a discussion immediately following the assessment. Ensure questions are addressed and the FI owns the pilot ideas or next steps for implementation.

These lessons were generated from assessor experience during the Beyond Codes project and compiled by the Beyond Codes project for use during the CP Assessor Training in Kenya, April 2010.
Annex 2: Summary - How Important is Context and What is Important in the Context

The age, size, and type of MFI all affect client protection practices. So do the regulatory environment and market norms. Should the grade take these factors into account or should the judgment of client practices be independent of context? The following table is presented to address the importance of context. Context is extremely important for assessing several principles, and less important for assessing others. Different contextual factors are important, and others are relatively less important depending on the principle. Financial institution leadership is very important for assessing all of the principles.

<table>
<thead>
<tr>
<th>Principle</th>
<th>How Important is Context?</th>
<th>What is Very Important</th>
<th>What is Relatively Less Important in the Context</th>
</tr>
</thead>
<tbody>
<tr>
<td>Avoidance of over-indebtedness</td>
<td>very important</td>
<td>How FIs behave together in the marketplace regarding the level of competition and growth strategies Quality Credit Bureaus FI leadership</td>
<td>Regulation</td>
</tr>
<tr>
<td>Transparent Pricing, terms and conditions</td>
<td>very important</td>
<td>Market conduct regulation FI leadership</td>
<td></td>
</tr>
<tr>
<td>Responsible Pricing</td>
<td>relatively unimportant</td>
<td>Business norms FI Leadership</td>
<td>Regulation</td>
</tr>
<tr>
<td>Appropriate Collections Practices</td>
<td>relatively important</td>
<td>Business norms FI leadership</td>
<td></td>
</tr>
<tr>
<td>Ethical Staff Behavior</td>
<td>relatively unimportant</td>
<td>FI Leadership Established Culture Signatory to codes of conduct</td>
<td>Market conduct regulations</td>
</tr>
<tr>
<td>Mechanisms for Redress of Grievances</td>
<td>relatively unimportant</td>
<td>Business Norms FI leadership</td>
<td>Regulation</td>
</tr>
<tr>
<td>Privacy of Client Data</td>
<td>relatively important</td>
<td>Market conduct regulation FI leadership</td>
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</table>
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