

# **Self-Assessment Guide: Client Protection**

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## Foreword

Welcome to the Self-Assessment Guide on Client Protection.

The purpose of the guide is to assist microfinance institution (MFI) leadership and staff to explore the implementation of client protection practices within their organization. The aim is to gain a better picture of the organization's strengths and where improvements can be made. The guide is not intended as a resource to judge or "score" institutions.

The guide is a work in progress. It is based on the work to date in the Center for Financial Inclusion's Beyond Codes action research project. As you review the guide you will note more progress on assessing some of the principles than others. We cannot yet provide standards of achievement for all principles.

The self-assessment guide provides advice on what to look for and points to the most important information for analysis. Some guidance on how to interpret findings is also included. However, you will have to use your own judgment to interpret many of the findings and draw conclusions on the more complex principles.

"Fair Pricing" is a special topic of the Beyond Codes research project. There is no one definition of fair pricing, or wide agreement on the indicators to measure this principle. We appreciate your organization's dedication to this topic and would like to hear your thoughts and experience.

We would like to express our appreciation to the financial institutions and networks that have collaborated with the Beyond Codes research project. The Expert Dialogue Group members provided valuable advice for advancing indicators of good practices.

Your feedback is important, and we would like to hear from you on your experience using this tool.

## Note to Users

This assessment is a relatively rigorous process that requires significant staff participation. It is suitable for organizations that:

- a) express a serious interest in finding out how their organization measures up to implementing the principles;
- b) have a commitment to carry out an assessment internally with their staff and management in a participatory, open mode;
- c) understand that they are testing a tool not using a final product; and
- d) are willing to set aside the time and the human resources to carry out the exercise.

When implemented by outside consultants, we estimate this process will take two people one week to conduct the data collection and perform preliminary analyses.

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- Box 3: The Importance of Market Conduct Rules
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Table 1: Assessing Practices

Table 2: Assessing Key Factors in the Context

Table 3: Key Institutional Data

## Part One: Get Ready

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### ***What is a self-assessment?***

The self-assessment is your organization's own analysis of performance on a series of consumer protection indicators that have been developed under the Beyond Codes action research project. The self-assessment guide will help you explore implementation of client protection internally, together with leadership and staff. The aim is to gain a better picture of where your organization's client protection practices are strong and where they may need to improve.

### ***Why conduct a self-assessment?***

A structured review of your client protection (CP) practices can serve as an important process for better serving customers and treating them fairly. Engaging your staff in many departments provides a focused view of your CP practices, and you may be surprised at the number of good ideas that surface. You may also uncover vulnerabilities that require attention.

A completed self-assessment may help you engage with social investors and banking authorities who are interested in consumer protection issues.

### ***What do you assess?***

You assess how your organization implements six CP principles where there is wide consensus among microfinance stakeholders.

#### **Box 1: The Six Principles**

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

The assessment focuses on how your organization inter-acts with customers. Each principle has a series of indicators associated with it. These indicators serve as a guide to identify and analyze organizational practices, procedures and systems that support a principle or counter it.

By walking through each of the indicators with your staff, you examine your own procedures.

Your analysis goes beyond codes and beyond policies. The existence of a code or policy is generally a first step. The focus of the self-assessment is how the policies and codes are implemented, supported, enforced and reviewed within the organization.

***How do you assess?***

The assessment reviews the degree that codes of conduct are reflected in practices within the organization. It identifies good practices as well as adequate or weak ones, and offers this information to management for review and decision making on new initiatives to bolster CP practices.

The self-assessment guide provides advice on what to look for and points you to the most important information for your analysis. Some guidance on how to interpret findings is also included. However, you will have to use your own judgment to interpret findings and draw conclusions.

**Box 2: Looking at the Big Picture**

The big picture means looking for interactions between indicators – not simply adding up the indicators. For example, inadequate loan evaluations, product rigidity, high volume targets, incentives that reward growth over quality, and high competition in a saturated market can drive client over-indebtedness systemically.

The self-assessment evaluates practices as shown in Table 1

<b>Table 1: Assessing Practices</b>	
<b>Good practice</b>	<b><i>The organization addresses the principle well</i></b>
Practices demonstrate that a consistent effort is being made and the right incentives are in place. There may be room for improvement, or there may be several practices that might not meet organizational expectations. Changes likely are minor and could be made in a short time frame.	
<b>Adequate practice</b>	<b><i>Minimum standards achieved</i></b>
The organization addresses the principle(s), and practices generally meet the letter of the law. Some practices may be inconsistently applied throughout the organization, and internal incentives may not fully support the principles. There may be a commitment on paper, but the commitment is not consistently backed by action. There do not appear to be serious vulnerabilities, but there are no overwhelming strengths that would counter deterioration in market conditions or within the institution.	
<b>Vulnerable</b>	<b><i>Practices are weak or absent</i></b>
Some practices may counter implementation of the principle. Either achievement is not a goal, or implementation is in the planning stage. This may reflect an organizational culture that does not value a practice, or one where incentives may serve as barriers to improving practices. There may be a low level of awareness about the principle involved. Considerable effort may be required to make improvements and vulnerabilities exist in several key areas.	

**Tip:** It is not uncommon for organizations to demonstrate good practices in several areas and vulnerability in others.

### ***How do you proceed?***

The self-assessment will require time, effort and leadership.

**Step 1:** Review this manual to see what the self-assessment involves and the content of the principles and indicators.

**Step 2:** Engage senior management. In the guided self-assessments undertaken by the project to date, support from senior management has been critical to set the stage for open and frank discussions.

**Step 3:** Designate a point person to organize and manage the process, keep track of findings and disseminate the results within the organization. You should designate a senior level internal consultant or hire an external consultant to manage the process. The assessment is likely to take at least one week.

**Step 4:** Select a pace that suits your organization. An intensive one-week process to conduct interviews and analyze information works well; a more in-depth process over a longer period of time that incorporates discussion groups can also work. The key is to keep momentum going.

## **People, Paper and Process**

### ***People***

Involving a number of different department staff, middle and senior managers and board members allows both a broad and in-depth view of CP practices within the organization.

- Involving staff who have been with the organization a long time, as well as new staff, adds richness to the analysis.
- Field staff and staff who regularly interact with customers are well placed to inform the analysis.
- Staff in marketing, research, product management, human resources, legal, finance, technology and internal audit departments have perspectives and information that is critical to the self-assessment.
- Ultimately, who you choose to involve will depend on how your organization is structured.

You will need to involve your colleagues in different departments, ask them for an interview or to complete sections of a questionnaire. This guide identifies who among your colleagues is likely to provide information to analyze a principle, although you should adjust the list to fit your own organizational structure.

The people are:

- Executive management
- Marketing and market research
- Product development/research
- Human resources department
- Product management departments (credit management, savings, remittances, insurance, etc.)
- Sales force and staff who interact directly with customers (credit officers, tellers, collections agents,)
- Finance department
- Risk management department
- Legal department
- Internal audit/internal control
- MIS and information technology

**After you review the manual, consider this exercise to identify key interviews for each principle.**

<b>Exercise 1: Identifying People</b>
Principle 1 – Avoiding over-indebtedness
Who has important information and views for the following topics: <ul style="list-style-type: none"><li>• Credit analysis &amp; decision making</li><li>• Products</li><li>• Productivity targets</li><li>• Incentive system</li><li>• Delinquency &amp; default</li></ul>

### ***Paper***

Some of the indicators will require reviewing your own source documents and information. The key documents you will need are:

- Your code of ethics, network codes or codes of banking associations
- Staff book of rules, or administrative policies
- Marketing material
- Product descriptions
- Credit manual
- Loan applications
- Contracts
- Customer satisfaction surveys
- Training curricula
- Productivity targets and incentive programs
- Pricing information
- Financial statements
- Industry-level statistics from networks or banking authorities
- Laws and regulations
- Internal audit reports

### ***Process***

Set aside some time to complete the process. You might consider some of these suggestions in your planning:

#### ***Prior to the assessment:***

- Hold a kick-off meeting with key staff, particularly department heads to discuss client protection. (You will find a Power point on CP principles in the Resource section of the guide.)
- Identify the main reason for conducting a self-assessment at this time.
- Take a quick survey among staff to raise awareness about the topic. (See the Resource section of the guide for a quick survey.)

#### ***During the assessment:***

- Hold group discussions with front line staff -- loan officers and staff who support other products
- Interview Board members or include a special agenda item in the next Board meeting
- Interview clients or conduct focus groups
- Hold stakeholder interviews (e.g. Consumer Protection Agency, regulators, networks)

#### ***After the assessment:***

- Hold a discussion meeting with staff to review the results of the assessment
- Organize a meeting to brain-storm on a pilot initiative (or several) that your organization would like to implement to shore up strong practices or address weaker ones.

Part Three of this guide provides tips on the people, paper and process for each principle.

**Summary Checklist: Are you ready to undertake a self-assessment?**

- \_\_\_\_\_ Do you have management/board support for the self-assessment?
- \_\_\_\_\_ Is client protection part of your organization's mission or code of conduct?
- \_\_\_\_\_ Do you have good reasons for undertaking the self-assessment at this time?
- \_\_\_\_\_ Are you clear about the main audience for the results of this process?
- \_\_\_\_\_ Do you have a good understanding of what topics will be included?
- \_\_\_\_\_ Do you have a clear idea about how your results can be used?
- \_\_\_\_\_ Have you set aside time to take on a focused effort?
- \_\_\_\_\_ Can you assemble the suggested written documents?
- \_\_\_\_\_ Did you identify people to inform the process?
- \_\_\_\_\_ Did you estimate the time to schedule interviews?
- \_\_\_\_\_ Have you surveyed staff about their availability to participate in the self-assessment?
- \_\_\_\_\_ Did you identify a point person or a team to manage the self-assessment?

**Caution:** Some topics may be sensitive since they may challenge the organization's current practice. The self-assessment attempts to get a clear idea of what the organization's strengths are and where vulnerabilities may lie. If the organization is not open to discuss strengths as well as vulnerabilities, you may not be ready for this exercise. The results of the self-assessment are only as good as the analysis.

## Part Two: The Institution and Its Context

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### *Context: The Starting Point*

This part of the self-assessment puts the institution in its context by identifying key factors and market conduct rules and norms that influence or govern a financial institution's (FI) interactions with customers. Laws, regulation and market conduct rules play a part in understanding CP practices within the organization. An analysis of these factors often indicates whether an adequate practice in one context, may present serious vulnerability in another. The absence of enforced market conduct rules for all FIs may make it more difficult for one FI alone to implement consumer protection practices, since it may disadvantage the well-intentioned in the market place.

#### **Box 3: The Importance of Market Conduct Rules in Consumer Protection**

Can one organization reasonably implement a principle without rules that are enforced by the authorities? Certainly there are principles that rest entirely with the decision of the financial institution's management. For other principles it is less clear. Does the absence of market conduct rules on transparent pricing disadvantage transparent institutions or favor less transparent ones? For example, can one organization publish an APR while all others publish a flat rate that looks much lower to the borrower, even though the price is often much higher?

Some analysts think there is no incentive for a responsible lender to take this task on alone; others think the problem is over-rated and used as an excuse for inaction. Knowing the market conduct rules, who they favor and who they disadvantage is often the first step in organizing a platform for action to change them. However, just because an enforced rule for transparent pricing does not exist in that context, does not mean an organization would receive a more favorable assessment for this principle.

### *Analysis*

Purpose: To identify and assess key contextual factors regarding consumer protection and financial services that influence your organization's operations.

How to proceed: Table 2 is presented as a tool to get you started. The steps are outlined as follows:

1. Common key contextual factors are listed below. However, be open to other factors that are important in your context.
  - Market conduct rules on transparent pricing, such as Truth in Lending Laws
  - Requirements for publishing audited financial statements.
  - Consumer protection agencies dedicated to financial services
  - Credit registries or credit bureaus
  - Court procedures for recovering bad debt, lender protection, customs or conventions about debt collection and repossessed property
  - Level of awareness among clients about consumer protection, including financial education programs
  - Level of competition and trends within the microfinance industry and broader financial sector
  - Trends in delinquency and default (in the industry) including debt crises

- Negative press and media, political campaigns or interference that may present a reputation risk for the industry and may directly or indirectly affect the institution
2. Note the absence of such rules or support institutions. Assess the trends that may have an effect on the way financial institutions relate to customers. These questions may guide your analysis.
    - How thoroughly are the rules monitored and enforced by the authorities? Are there exceptions to the rules or the practice?
    - Are agencies, courts, credit registries and credit bureaus effective? Do they reach microfinance clients or the microfinance institutions?
    - What are the significant trends? For example, is competition increasing? Is the market contracting, stable or expanding? Are there new institutions entering the market or current operations exiting the market? Are new products gaining popularity that may not be well understood by customers?
  3. Assess which factors positively or negatively influence consumer protection in the context. Use a simple coding system such as:
    - ★ very supportive of consumer protection practices
    - + positively influence consumer protection practices
    - 0 no effect or influence
    - negatively influence consumer protection practices
  4. Use Table 2 to highlight the most important findings regarding whether the context is supportive, or presents significant vulnerabilities. Note the top three issues you want to flag as serious.
  5. To wrap up this part of the self-assessment, use Table 2 to comment on how these factors affect the ability of your organization to implement consumer protection practices.

<b>Table 2: Assessing Key Factors in the Context</b>	<b>Yes</b>	<b>No</b>	<b>*</b>	<b>+</b>	<b>o</b>	<b>-</b>	<b>Comment: How does this affect your client protection practices?</b>	<b>Check (✓) A top issue?</b>
<b>Rules on pricing transparency exist</b>								
They are monitored & enforced								
There is an established pricing formula that <i>must</i> be followed by all FIs								
The formula must be published in marketing materials								
The formula must be included in client contracts								
Do these guidelines enable clients to easily understand the full price they pay for or earn from the product?								
FIs are required to publish annual audited financial statements								
<b>Institutions supporting consumer protection are present &amp; active</b>								
A consumer protection agency dedicated to financial services, including microfinance, exists								
They are active and accessible to MF clients								
They enforce pricing transparency rules								
They handle complaints and resolution								
They promote financial education								
Other:								
Participation in a credit registry or credit bureau is mandatory								
Data is extensive, useful and current								
Court proceeding for bad debt recovery are efficient and reasonable								
<b>Trends: Increasing ↑ Decreasing ↓ Staying the same ↔</b>	<b>↑</b>	<b>↓</b>	<b>↔</b>					
Level of awareness about consumer protection								
Level of competition within the industry								
Trends in delinquency and default in the industry								
Reports of fraud, aggressive collections practices, debt protests, etc								
Negative press, political campaigns, etc.								
Other:								

## Key Institutional Factors and Codes

Purpose: You know your organization. This is an opportunity for you to identify important features and consider how they affect client protection. Details about your consumer protection practices follow in Part Three of this guide.

### Organizational Summary

- What is your organization known for in the market?
- Is the organization mature, starting up, gaining or losing market share?
- Who are your main customers? Is there an established, loyal customer base; are products and services reaching a new market segment?
- Financial health & growth indicators for the last 3 years. Fill in Table 3. This data will later be used to analyze a few of the indicators. Organizing it now for quick reference will save time.

Table 3: Key Data	Most Recent Year	Last Year	Year Before Last
Active Borrowers			
Savers (voluntary)			
Gross Portfolio Outstanding			
Voluntary Deposits			
PAR > 30 days			
Write-off Ratio			
Portfolio Yield			
Total Operating Costs/Avg. Assets			
ROA			
ROE			

- Highlight areas of significant growth, positive trends and negative trends and reasons why. Provide a summary of management's plan to address any adverse trends. Positive trends, such as expansion or new products, should be noted as well.
- Make a statement about how your organization compares to its peers on key factors that are relevant in the environment. You will need industry level data for this part of the analysis, either from a network or the banking authority. These are brief analytical statements, not a comprehensive analysis.

For example, if delinquency and over-indebtedness are concerns, note whether the FI has a lower PAR or default rate than others. If high interest rates are concerns, note the pricing ranges for products and where your organization fits.

### What Makes Your Organization Tick?

Now that you have answered the easy questions, try these questions which attempt to get a view about organizational values. You might consider a group meeting to get a variety of views on the answers:

- What drives your institutional culture? What staff values does your organization officially recognize (for example, in performance reviews or recruitment)? Is there a single value or a set of key values that management would be pleased to hear that all staff hold?
- If the largest popular newspaper published a front-page article about microfinance what would you most like to see highlighted about your organization? What would cause your organization the most concern?
- How would your main competitor describe your organization's reputation?
- Do you know how clients perceive your organization? How do you obtain this information?

## ***Codes of Conduct***

Codes can be called Codes of Conduct, Codes of Professional Ethics, Business Ethics or Staff Codes of Conduct and Rules.

1. Does your organization belong to networks or associations that have codes of conduct? Which national, regional or international networks? Do these network codes include the six principles?
2. Does your organization have its own code of conduct? When and why was it developed? How is it disseminated to staff?
3. How does staff view the code? Is there strict adherence to it? How does the organization ensure compliance with the code?
4. Does the code include the six principles? Some organizations may highlight one principle over another. If this is the case, state why.
5. Does the organization view the code (or parts of it) as part of the business case for its operations?
6. Is your organization known as a leader in a specific consumer protection area? Review each of the six principles to determine if the institution is recognized for a particular effort, or noteworthy accomplishments when compared to others in the context. You should consider notoriety as well.

## Part Three: Principles into Practice

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Purpose: Assess organizational performance for each of the principles. “Principles into Practice” is the main part of the self-assessment. A Summary Assessment Tool is attached in Appendix I to show your ultimate destination.

### *Three Steps*

**Step 1:** Review the Summary Assessment Tool in Appendix 1.

**Step 2:** Review the principles and the indicators in this section and discuss with your colleagues. Each principle is presented with a definition and the key measurement for achievement. A more detailed list of indicators is provided to help you identify specific practices that support implementing the principle. For each principle, you will find the following topics:

- Getting Started: People, Paper and Process
- Analysis: Guidance on interpreting findings and a group of indicators that will help you focus your discussions
- Tips for analyzing the principle
- Guiding questions, exercises and examples – These tools help focus key information that is important for your analysis.
- Drawing conclusions and planning next steps
- Case highlights that illustrate how some organizations implement the principle

**Step 3:** Use the tool in Appendix 1 to complete your assessment.

- Check the indicators that you are able to assess.
- Revisit Part 1 of the guide for “how to assess.”
- Rate how well your organization performs.
- Provide a summary of your key strengths and where your vulnerabilities may lie.
- Identify actions to enhance strengths and address vulnerabilities.

### *Principle 1: Prevent over-indebtedness*

#### **Definition**

A financial institution measures up to this principle by carefully establishing the borrower’s ability to afford the loan and repay it. Clients should be able to handle debt service payments without sacrificing their basic quality of life, including some ability to absorb shocks. Customers are also expected to make prudent borrowing decisions and take responsibility for them.

#### **Getting Started**

This is a complex principle that requires information from different sources. It is however, one of the principles where concrete, objectively verifiable evidence is available.

The evidence is found in written information: credit policies, credit manuals, product descriptions, productivity targets, loan applications, financial indicators—PAR and write-off ratios, staff incentive formulas, and internal audit reports. This information can be verified and complemented by interviews with loan officers, credit managers and internal auditors to see how consistently and regularly procedures are followed.

People	Paper	Process
Credit Department	Credit Policy or Manual	Document review
Loan Officers/Branch Mgmt	Product Descriptions	Observation
Credit Committee	Loan Applications	Interviews
HR Dept	Loan Analysis Procedures	
Internal Audit	Credit Committee Notes	
	PAR and Write-off Ratios	
	Training Curriculum	
	Productivity Targets	
	Incentive System & Formula	

## Analysis

The analysis focuses on four aspects of how the organization avoids over-indebtedness and actively seeks to prevent it. They are: 1) the level of awareness that over-lending is a potential problem 2) the policies and procedures, 3) the products and 4) incentives, responsibilities and compliance.

**Level of Organizational Awareness:** Management sets organizational culture and direction.

Management is aware of the potential for over-lending, regularly obtains information on client over-indebtedness and is responding appropriately to risks.

## Tips for analyzing this indicator

Consider the following questions as a guide:

- Where and how often does management obtain data on client over-indebtedness?
- How often has management communicated to staff that over-lending or over-indebtedness might be a problem?
- Are credit products and sales practices reviewed for their potential to cause over-indebtedness or repayment stress? What information is regularly reviewed, and how often?
- Are discussions held about over-selling or mis-selling products? (e.g. loans that are too large, selling products that may be more expensive than others on offer, lending to people who can not afford to repay, incentive systems that push growth without regard to quality)
- How has management shown commitment to adjust procedures, review incentive programs, change operations or begin training programs to address the potential for over-lending?
- What discussions about over-indebtedness have been held at the Board level?

## Policies and procedures

This group of indicators is designed to assess rules that must be followed to limit the potential of over-indebtedness.

- During the loan approval process borrower repayment capacity and loan affordability is assessed.
- The loan approval process does not rely solely on guarantees (whether peer guarantees, co-signers or collateral) as a substitute for assessment of repayment capacity.
- Credit approval policies give decision makers explicit guidance regarding borrower debt thresholds and acceptable levels of debt from other sources.
- The loan approval process requires checking a Credit Registry or Credit Bureau for borrower current debt levels and repayment history. When not available, the financial institution maintains and checks internal records and when possible, consults with competitors for the same.

The financial institution avoids increasing debt levels of borrowers who are already indebted beyond their capacity to repay, avoiding re-financing the loan at a higher amount, and adhering to clear policies and procedures for debt re-structuring.

### **Tips for analyzing these indicators**

Consider the following questions:

- What guidance about assessing repayment capacity is in the credit manual?
- Is there guidance in the credit manual about acceptable debt thresholds or levels of debt from other sources?
  - Are assessments of borrower repayment capacity during the loan application process generally thought to be conservative or optimistic by decision makers?
  - Are assessments of repayment capacity based on current household income/business performance? Do they include a cushion to allow clients to absorb future shocks?
  - Does the policy require a check with the credit registry or credit bureau, if one exists. If no credit bureau or registry is consulted, how does the institution gain knowledge about multiple loans from other sources?
- Are loans approved based on a guarantee, even if borrower repayment capacity is doubtful or unknown?
- How are loan officers trained to assess repayment capacity?
- If the organization has group lending products, how are groups trained to assess repayment capacity?
- Are loan applications reviewed for compliance with the procedures?
- Does the credit manual provide specific rules about re-financing loans at higher amounts when clients experience repayment difficulty?
- Is there a standard protocol for debt re-structuring, for example, specific conditions under which a loan can be renegotiated; clear steps to follow to renegotiate the loan; a meeting required in the branch office or official place of business? Is a new contract signed?

### **Products**

The financial institution offers multiple loan products or flexible ones that address different business and family needs. The organization ensures product suitability<sup>1</sup> through careful product design and testing with the target market.

### **Tips for analyzing this indicator**

Consider the following questions:

- Can your organization regularly provide information on portfolio quality (PAR and write-off) by credit product? What are the trends?
- What other information is collected on credit product performance? For example, increasing calls of guarantees, client exits due to repayment difficulties, decreasing savings due to borrower's concern that they may be seized for loan repayment.
- How is this information used to revise products?
- Has the organization ever modified a product based on its potential to lead clients into over-indebtedness?

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<sup>1</sup> Loan product suitability means the product features suit the cash flow of the business or household and the circumstances of the borrower. Product features include the loan term, size, price, the nature and amount of the guarantee, installment payment intervals and amounts, and pre-payment policies/penalties).

<b>Reality Check Exercise:</b>				
Borrowers complain about:	This trend is:			
	Increasing	Decreasing	Stable	Unknown
a. Inability to find a guarantee/guarantor				
b. Loan application denied				
c. Savings are used to pay installments				
d. Loans are too small				
e. Loans are too big				
f. Cash flow: Installment payments are difficult to meet				
g. Pre-payment penalties are high				
h. No one has complained				

If you answered “increasing” to a, c, d, e, f and g, you have identified red flags. These are signs that products may not be well suited to borrowers. If you answered “increasing” to b you may be making prudent decisions. If you answered “stable” or “unknown” to h, you may have very little idea about how your credit products are suited to borrowers’ businesses. As one organization noted, “no one complains, but this doesn’t mean all is well, it just means no one tells us.... we don’t make much of an effort to find out.”

**Incentives, responsibilities and compliance**

This section of the assessment is critical to understanding what the organization rewards and how incentives and rewards are regularly checked for reducing the potential of over-indebtedness.

- The credit decision making procedure and supervision function promote sales and force accountability for the quality of the loan.
- Incentives and productivity targets reward risk management. Productivity targets and incentive systems value portfolio quality at least as highly as other factors, such as disbursement or customer growth. Growth is rewarded only if portfolio quality is high.
- Internal audits check household debt exposure, lending practices that violate procedures including unauthorized re-financing, multiple borrowers or co-signers per household and other practices that could increase indebtedness.

**Tips for analyzing these indicators**

For this series of indicators, consider the following questions:

- Who is responsible for the quality of the loan? Is there joint responsibility between the sales force and the decision-makers?
- What are the penalties for low portfolio quality?
- What are the incentives for high portfolio quality?
- When was the incentive system designed or calibrated? Many incentive systems were designed during a period of growth, or favorable economic conditions. They may require review in light of current market conditions.
- How often are productivity targets and incentives reviewed? What information informs the review and analysis?
- How does internal audit check procedures with respect to preventing over-indebtedness?

**Exercise: Your Incentive System: What is rewarded – growth or quality?**

- Does the formula include a factor for portfolio quality?
- Is the factor for portfolio quality weighted at least as high as growth?
- Is the factor for portfolio quality weighted higher?

## Guidance on interpreting findings

Each group of indicators must be taken into account when interpreting findings. To judge how well your organization prevents over-indebtedness you must look for interactions among indicators. For example, inadequate loan evaluations, product rigidity, high volume targets, incentives that reward growth over quality, and high competition in a saturated market can drive client over-indebtedness systemically.

### Take note of the following red flags when you judge performance.

- No one in the organization but the loan officers and collections agents recognizes that over-lending is a potential problem.
- An incentive system that promotes growth over quality.
- A loan decision-making process that does not assess borrower repayment capacity
- Reliance on guarantees as a substitute for assessing borrower repayment capacity
- A loan approval process that does not hold both the loan officer and the decision makers responsible for the quality of the loan.
- A one-size-fits-all credit product regardless of the nature of the borrower's economic activity and cash flow.
- Re-financing debt for borrowers who experience repayment difficulties.
- A context where clients are known to borrow from several organizations, and/or the existence of political concern and client or media reports of client over-indebtedness and aggressive collections practices.

### Yellow flags include:

- Group lending methodologies that require continual borrowing, often at higher amounts, to retain group membership and access.
- Systems that cannot regularly state the PAR by product and loan officer.
- No means of information sharing among lending institutions

### Summary: Drawing Conclusions and Planning Next Steps

After this review you should be able to answer the following summary questions: Is over-indebtedness of borrowers a concern within your organization and within your context? Is your organization responding well, adequately or appropriately?

You can now go to the tool in Appendix 1 and fill in your summary information.

#### Box 4: Highlights: Preventing Over-indebtedness

Examples of good practices:

***The Entry Pass:*** The organization's loan officer incentive system uses portfolio quality indicators as the entry pass for a bonus. Portfolio quality is rewarded above growth or at least as much as growth. Revision of the incentive system was based on analysis of the increasing trends in delinquency, competitor analysis and review of market conditions.

***Internal Audit Digs in to Debt:*** The internal audit department checks two groups of borrowers at the branch level: 1) a mixed group of borrowers who are delinquent and those who are not, and 2) a group of borrowers who are delinquent. The analysis considers compliance with loan underwriting procedures and identifies weakness or violations that may have occurred. The IA reviews specific practices that have lead to over-indebtedness, and management has acted to review products and procedures.

*Cont'd.*

*Cont'd.*

Examples of practices that make the institution and the industry vulnerable:

**Market Dominance:** In efforts to gain market dominance, this institution advertises and lends in larger amounts to any borrower from another MF institution.

**Debt Spiral:** The MFI has one product, originally designed for small retail operations with weekly cash flows. Without further analysis the product is extended to farmers who have a seasonal cash flow and require higher initial loan amounts. The farmers borrow the remaining amount from another MFI that offers exactly the same product and terms. The farmers cannot meet the weekly installment payments required by either MFI. They borrow from the moneylender to make the payments.

## ***Principle 2: Transparent Pricing.***

### **Definition**

Customers are able to make sound decisions about the benefits, costs and risks of financial products and services, when they are provided transparent information in a form that they can understand. A financial institution measures up to this principle by ensuring that complete information is made available to customers in clear language that is not misleading and that the customer is able to understand.

### **Getting started**

The evidence is found in written information: advertisements and promotional material; loan contracts; information given to the customer before, during and after the sale; product descriptions, including terms and pricing information; formula or guidelines provided by banking authorities for product pricing; and requirements on publishing financial statements.

Written information is complemented by interviews with all staff that interact face-to-face with customers.

Observing customer/front line staff interactions, orientation/educational sessions or conversations between staff and customers provide valuable insights for assessing this principle.

Observing new staff orientation sessions provides good information for assessing several of the indicators. Interviews with new staff or staff trainers, and examining the curriculum will provide information to analyze several indicators.

<b>People</b>	<b>Paper</b>	<b>Process</b>
Marketing Dept	Loan contracts	APR calculations
New Account Officers, Tellers	Product Descriptions	Observation
Loan Officers	Product Prices	Exercises
Internal Audit	Statements of account balances/receipts	Interviews
	Training Curricula	
	Advertisements	Document review

## Analysis

The analysis focuses on three aspects of how the organization ensures transparency: 1) general disclosure practices 2) transparency in pricing and terms and 3) clarity of communications with customers.

### General Disclosure Practices:

- Senior management creates a culture of transparency within the organization and develops systems, controls and incentives to support it.
- The organization submits audited financial statements to the appropriate authorities, membership, and interested parties, and publishes such information in the media.

### Tips for analyzing these indicators

For this series of indicators, consider the following questions as a guide:

- How often has management communicated to staff about transparency and communications with customers?
- Has there ever been any discussion with management that customers may not understand the information provided to them about the products?
- Are products and sales practices reviewed for their potential to confuse or mislead customers? For hidden fees or over complexity? What information is regularly reviewed, and how often?
- Has the organization changed the way it presents product pricing in response to customer feedback, ethical concerns or market conduct rules?
- How is staff trained to communicate product pricing, terms and conditions with clients?
- What board level discussions have been held about transparency and communications with customers?
- Are audited financial statements submitted to the authorities? Where are they published?

### Guidance on interpreting findings

This section of the assessment relies on your judgment about the culture of transparency within the organization and how well organizational systems respond.

- To meet a minimum standard, management and the board should demonstrate a level of awareness about transparent communication with clients and communicate its importance regularly with staff. Training staff on how to clearly communicate with clients and publishing financial information are also minimum standards.
- Good practices include testing marketing material with the target audience to ensure that customers understand it, and revising marketing material accordingly; as well as training staff on how to test clients on their understanding of product prices, terms and conditions.

### Transparent pricing, terms and conditions

- Prices, terms and conditions of financial products are fully disclosed to the customer, including interest charges, insurance premiums, minimum balances required on savings and transaction accounts, all fees, penalties, and whether any of those can change over time.
- There are no punitive or hidden fees, and there is a minimum of complexity.
- The financial institution follows truth-in-lending laws and required APR or effective interest rate calculation formulae. In the absence of such industry-wide requirements, information is provided that shows the total amount that the client pays for the loan.
- Linked products with no “opt-out,” such as mandatory savings and loan insurance, are included in the price of the loan.
- Third party fees are disclosed, for example, bank service fees for disbursements and installment payments, ATM fees or electronic fees.

### Tips for analyzing these indicators

For this series of indicators, you need to gather information on product pricing and make some key calculations.

Obtain product descriptions, prices, terms and conditions. Gather product marketing material.

How are interest rates on credit and savings products calculated?

- Obtain the official pricing formula used for calculation of the APR in your country. If there is no standard official formula, use an APR calculator. (See the Resource section for an APR calculator.)
- Fill in the table below, using the most popular products offered by your institution.

Product	Our Quoted Rate	APR using formula
Credit product 1	36% annual; flat method	70%
Credit product 2		

- Answer these questions:
  - How does the interest rate quoted by your organization compare with the APR?
  - What does your formula include and what does it leave out?
  - Are products with no-opt-out (such as mandatory savings and insurance) included in your pricing formula?
  - Are there additional 3<sup>rd</sup> party fees a customer must pay? Common examples include transaction fees or service fees for handling payments or disbursement fees, or exchange rate conversions, ATM and mobile banking fees.

**Guidance on interpreting findings:** To meet minimum standards: the quoted rate should match the APR, linked products with no opt out should be included in the pricing formula and 3<sup>rd</sup> party fees should be fully disclosed to the client prior to sale.

### Clarity of communications with customers, prior to sale, at the point of sale and after sale:

- Efforts are made to ensure that customers with low levels of financial literacy understand the product, the terms of the contract, their rights and responsibilities.
- Prices and terms of products are published, enabling customers to compare various offers.
- Advertisements and marketing campaigns clearly communicate complete and accurate descriptions of the product or service. Advertisements reflect the product that the customer can reasonably expect to receive and the full price that the customer can expect to pay.
- Clear and complete verbal or written explanations about the product benefits, costs and risks and customer obligations are provided at the point of sale.
- Loan contracts show the amortization schedule that separates principal, interest, fees and defines the amount, number and due dates of installment payments.
- Contracts include costs related to linked products, fees and conditions for early repayment, late payments and contract termination.
- Interest rates on savings, fees for account maintenance, minimum balances required, and terms and costs of transaction accounts are provided.
- Prices, terms, risks and consequences of not meeting contractual obligations are discussed in language that the customer can understand. Any fine print is minimized, put in plain language, and fully revealed.
- Communications addresses client literacy limitations (e.g., contracts are read out loud, materials are available in local languages).

- Customers are given adequate time to review the terms and conditions of the product and have an opportunity to ask questions and receive information prior to signing contracts.
- The client regularly receives clear and accurate information regarding the account.
- Balances are correct, recorded regularly and investigated for discrepancies in a timely manner.
- Promises of future benefits, discounts and privileges are kept.

**Tips for analyzing these indicators**

Revisit your product descriptions and marketing material and answer the following questions:

1. Compare – is what we know about the products clearly reflected in the marketing material? What does the marketing material leave out? Is there any evidence that this information has the potential to confuse customers or mislead them? Does the information promise anything that the product cannot deliver?
2. How was the marketing material tested for client understanding? What was revised based on this research?
3. Do you advertise your interest rate on credit and savings products? Does the product information include fees, commissions and conditions of the product, such as loan size or minimum balances required to qualify for the advertised rate?
4. When is the client informed of 3<sup>rd</sup> party fees and fees for linked products with no-opt out?
5. Review standard loan contracts used in your organization and check the following:

<b>Meeting Minimum Standards</b>		
<i>Does the contract include:</i>	Yes	No
The APR or interest rate following the formula required by the authorities		
An amortization schedule		
The amortization schedule clearly separates principal, interest and fees by amount		
The amortization schedule lists the number of installment payments and indicates the date that they are due		
Requirements and fees related to linked products		
Late payment fees and timing, other penalties		
Fees and conditions for early repayment of the loan		
Information about whether any of these conditions can change overtime		

6. Review savings and transaction account information.

<b>Meeting Minimum Standards</b>		
<i>Does information provided to the customer prior to sale include:</i>	Yes	No
Interest rates on savings, following APR formula		
Fees for account maintenance		
Minimum balances required		
Terms and fees for transaction accounts		
Penalties for withdrawal of savings before maturity date		
Information about whether any of these conditions can change overtime		

**You may also consider:** Analyze how well your organization ensures customers understand the prices, terms and requirements of your products and services. Consider the following exercises:

**Exercise 1: Understanding loan contracts**

1. Read the loan contracts. Do you understand them?

2. Is there any evidence that the contract has the potential to confuse or mislead the customer?
3. Ask a front line staff member experienced in communicating to customers to explain the contract to you. Do you have any questions or does something seem unclear?
4. What methods did the staff member use to ensure you understood the contract before you signed?

**Exercise 2: The Most Common Questions.** Fill in the table below with loan officers and accounts staff.

What are the most common questions customers have about a product or service? (consider loans, savings, insurance, remittances, ATMs, mobile banking)	How has your organization addressed these questions in customer orientation or product information?	What do you do when you know the customer doesn't understand the product terms or price?
Loans		
Savings		
Insurance		
Remittances		
e-banking		

### Reality Check

<i>Customers complain about:</i>	Check all that apply
Not knowing when their installment payment is due.	
Late fees are charged in excess of what they expected.	
Late fees are charged earlier than expected.	
The loan amount applied for is not the same amount as received.	
The loan amount in the contract is not the same amount as received.	
They regret having made such a quick decision.	
The interest rate is higher than the one expected.	
Savings has been blocked or seized to pay a late installment.	
They did not understand their responsibility for delinquent members of the group.	
Charges to the account for making a deposit, withdraw or receiving a transfer.	
The bank charged a fee they did not know about for account balance inquires.	
They did not know there would be a charge for paying off the loan early.	
They did not know the interest rate would change during the contract period.	
They did not know how much they would have to pay in interest and fees.	
They do not know what their unpaid loan balance is.	
They do not know how much is in their account.	
Expectations of a lower interest rate or larger amount on a repeat loan were not met.	
No one has complained.	

**Guidance on interpreting findings:** To meet minimum standards, you should have checked “yes” in all boxes in both “Meeting minimum standards” tables (above). Good practices include the extra effort an organization makes to ensure that clients understand prices, terms and conditions of products, such as reading contracts aloud, and customer orientation or financial literacy programs.

If any of the items are checked in the Reality Check table, you should review how well you organization communicates with customers. These are red flags ---signs that improvements are needed in what is communicated and the way it is communicated to customers.

## Fair and Forthright Conversion

For credit unions, fair and forthright conversion is a critical consumer protection issue. Protecting the membership during a credit union conversion requires all members to be informed and guaranteed voting rights in the by-laws. Indicators of good practice are:

- a. An established notification process and voting standards in the by-laws.
- b. A clause in the by-laws that stipulates that at least 30% of the members must vote on such a conversion and the motion passing with 75% voting in favor
- c. A policy that all existing members are informed about the opportunity and the right to become shareholders.
- d. A policy that any remaining net capital of the credit union will be donated to another cooperative or development agency for the purpose of education on cooperatives or help in starting new cooperatives.

Review the by-laws and policies to see if all of these provisions are included. Indicate where they fall below the good practice standard.

## Summary: Drawing Conclusions and Planning Next Steps

After this review you should be able to answer the following summary question: How well do we ensure that complete information is made available to customers in clear language that is not misleading and that the customer is able to understand?

You can now go to the tool in Appendix 1 and fill in your summary information.

### Box 5: Highlights: Ensuring Transparency

An example of a good practice:

***It only takes a minute:*** This organization requires all loan officers to read contracts together with the borrowers prior to signing. They use a Q&A point list for each provision to ensure that the customer understands and agrees to the terms. The contracts use clear language which is not obfuscated by legal terms.

Examples of weak practices:

***Wait a minute!*** The institution deducts a fee at the time of loan disbursement. Borrowers are confused (and annoyed) because the amount of the loan that the organization said it had approved is not the same amount that the borrower received.

***Wait a minute! Part 2:*** Effective interest rates are calculated following the banking authority formula which the contract includes. The contract also includes another APR which is what the institution actually earns. What the borrowers are told is that they pay 3% a month (the nominal rate). This rate does not appear in the contract.

Examples of practices that make the institution vulnerable:

***Where did all my money go?*** Borrowers' mandatory savings accounts can be blocked by the institution if the borrower is one day late with an installment payment. Voluntary savings accounts can also be blocked and seized. These terms are in the contracts, but loan officers do not ensure that customers understand this important provision prior to borrowing. The number and amount of voluntary savings accounts has declined.

***The extra mile matters:*** No one told a new mobile banking customer that there would be a charge for each account balance inquiry. The account holder checked the balance, and it went down. He checked it again in disbelief. This process continued until the account was nearly drained.

### ***Principle 3: Appropriate Collections Practices***

#### **Definition**

Debt collection practices test the institution’s commitment to treating customers with respect and dignity. Appropriate debt collection practices do not mean loan forgiveness or laxity about punctual repayment. A financial institution measures up to this principle by maintaining high standards of ethical behavior even when clients fail to meet their contractual commitments.

#### **Getting started**

Matching written policy and procedures with organization-wide practice is the most challenging aspect of analyzing this principle.

Few people like to talk about debt collection, even though it is a routine action in the normal course of a lender’s business. There are others who do like to talk about debt collection practices; find them. They may be experienced loan officers, designated debt collection officers and the legal department.

Based on experience to date in the project, the term “appropriate” may cause confusion, since it is a value laden term. There are several warm-up exercises that may help you clarify what is appropriate in the context.

<b>People</b>	<b>Paper</b>	<b>Process</b>
Loan Officers	Code of Ethics	Group Exercise
Collections Agents	Credit Manual	Document review
Legal Department	Training Curricula	Interviews
Internal Audit	Loan Contracts	

This exercise will help you introduce the topic of appropriate collections practices.

**Exercise: Part 1: What is appropriate and what is not?** Hold a discussion with staff members who are most involved in collections. The objective of this discussion is to clarify what is considered appropriate, what is considered inappropriate and what is illegal in the context.

#### **Box 6: What is appropriate?**

Here are some stories that illustrate the topic:

**Visits:** Is it okay to visit the borrower’s home? At 3PM in the afternoon, at 1AM in the morning? Can a collections officer sit in front of a borrower’s house? How long? A story: A loan officer visited the borrower’s house and place of business to collect a late payment. The borrower said that her husband was coming from a nearby town with the payment. The loan officer asked is it okay to wait. Yes. The loan officer waited until 9PM that evening. If she had made the initial visit at 9PM, she conceded that would have been inappropriate (it would have appeared as a threat); but she was invited to stay until the husband arrived, which he never did.

**Postings:** Can a list of delinquent borrowers be posted in public? Can it be published in the newspaper? Is that considered unreasonable public harassment or embarrassment? In some contexts only government or court authorities are permitted to publish debtor information, in other contexts there may be no convention.

*Cont’d.*

*Cont'd.*

**Visits:** Visiting a place of employment is generally shunned, but it is important to consider the context. For example, when a loan officer arrived at factory gate, he phoned from the gate and the client went to meet the loan officer on an established break. This was acceptable, since the client was not embarrassed in front of her co-workers and the break time was her own. In other contexts visiting the place of employment, or even making a call may not be considered appropriate.

**A kind offer:** The loan officer visits a borrower's farm. The farmer says she doesn't have the money, but has two lambs that she was intending to take to market and sell. The loan officer says I'll take you there now. The farmer agreed and sold the lambs to the butcher, paying the delinquent loan balance with the proceeds. Is this considered seizing assets, or a kind offer to pay transportation costs to the market? The organization was horrified at this behavior and sanctioned the loan officer. The reason: "For us, this is not an acceptable practice." The organization identified what they considered an "inappropriate" collections practice.

### **Exercise: Part 2: What collections techniques are most effective?**

As a wrap-up on "what is appropriate", ask collections staff the following questions:

- What collections techniques are used by the most effective and experienced staff?
- What do they do first when approaching a delinquent client?
- What is never done and why?

### **Analysis**

The analysis focuses on three aspects of how the organization follows appropriate collections practices: 1) codes of ethics for collections agents, 2) policies and procedures for collections staff, and 3) borrower interactions.

### **Codes of Ethics**

Examine the code and check all statements that are included:

- The code of ethics requires all clients to be treated with dignity and respect, even when they fail to meet their contractual commitments.
- The code forbids subjecting a borrower to abusive language or threats by collection agents
- The code forbids harassing borrowers at their place of work or worship, or at unreasonable times of the day or night.
- The code forbids forcible entry to borrowers' dwellings and seizing property without court order or in violation of the law.
- If the institution uses 3<sup>rd</sup> party debt collectors, these agents are expected to follow the same codes of ethical practice as the institution.

### **Guidance on interpreting findings**

You should have checked all the boxes to meet minimum standards for this set of indicators.

### **Policies and procedures**

The indicators addressing policies and procedures for collections staff are:

- Debt collection practices and procedures are clearly outlined in a staff book of rules or credit procedure manual.
- Specific step-by-step procedures and time frames are outlined for late payment recovery and how to proceed when borrowers are in default.
- Collections staff receive training in acceptable debt collections practices and loan recovery procedures.

- Practices and procedures are followed widely in the organization and monitored by the internal audit department. Violations are sanctioned.
- There is recognition that accurate analysis of a borrower's repayment capacity is a first step to preventing delinquency, and the organization may hold some responsibility for borrowers' failure.

### **Tips for analyzing these indicators**

For this series of indicators, consider the following questions:

- Does the institution have a clear and detailed written procedure in the credit manual or other operational guide that all collections agents are expected to follow?
- Read the manual. Does the manual provide specific step-by-step procedures and time frames for late payment recovery and how to proceed when borrowers are in default?
- How are collections agents trained? Examine the training curriculum on collections. Does the training include examples of appropriate practices and ones that are not? Does it include examples of techniques used by the most effective collections staff?
- Are specialized collections agents assigned within the institution? Are they supported by the legal department?
- What are sanctions for inappropriate behavior, and rewards for appropriate behavior? Are these clearly defined?
- How does the incentive system promote appropriate behavior?
- How does the organization monitor collections staff behavior and how regularly?
- Does the internal audit department investigate appropriate collections practices in the normal course of their audits?

### **Guidance on interpreting findings**

You should have checked the first four boxes to meet minimum standard for this set of indicators. Checking the last box shows an organization's good intent to minimize the number of extra-ordinary collections measures. To meet a good practice level, the organization would show that procedures are designed to support this intent, and consistently followed throughout the organization.

### **Borrower Interactions**

The indicators in this section focus on transparency and protection of borrowers' assets.

- Debt collection practices are revealed to the borrower at time of sale. Loan contracts include clauses on late repayment and default, and what the borrower should expect in these cases.
- The institution has a policy on acceptable pledges of collateral, including not accepting collateral that will deprive borrowers of their basic survival capacity.
- Re-scheduling policies prevent automatic debt extensions.
- The institution and the borrower negotiate reasonable repayment plans prior to beginning procedures to confiscate assets that are pledged as collateral.
- Re-scheduling procedures follow written protocol and negotiations are held in an official place of business, such as the branch office. A new contract is signed.

### **Tips for analyzing these indicators**

For this series of indicators, you might want to consider the following questions as a guide:

- Are there any legal conventions about accepting or seizing collateral that would deprive a borrower of survival capacity? Does the organization follow them or have its own policy?
- Can the organization legally seize pledged collateral, or must it rely on court proceedings to settle claims from the sale of assets?
- Is the court claims process effective, speedy and balanced between borrower and creditor?

Get an idea of what incentives the court system provides for your organization. For example, quick efficient, reliable court proceedings for debt collection may provide incentives for the organization to have a standard, legalistic approach to debt collections; the absence of one may provide an incentive to work with delinquent/defaulting borrowers to prudently re-schedule debt, or resort to ad hoc practices that may violate the organization's ethical code.

**Guidance on interpreting findings:** You should have checked the first three boxes to meet minimum standards for this set of indicators. If, in addition, you checked the last two boxes, you can consider the organization's borrower interactions above the minimum for this set of indicators. To interpret whether your organization approaches good practices, you should look for consistency in behavior and enforcement throughout the organization.

### **Summary: Drawing Conclusions and Planning Next Steps**

After this review you should be able to answer the following summary question: How well does your organization consistently maintain high standards of ethical behavior even when clients fail to meet their contractual commitments?

You can now go to the tool in Appendix 1 and fill in your summary information.

#### **Box 7: Highlights – Appropriate Collections Practices**

**Software Reduces Perceived Harassment:** One organization instituted specialized collections software that tracks the patterns of late payments. The system revealed that some clients are always 5-10 days late, but always repay, while some clients slip more deeply towards default. The organization's collections procedures give priority to the unusual patterns, providing for a more efficient operation and reducing unnecessary collections visits that may be perceived as harassment.

**Change in attitude:** Debt collectors are rarely viewed as the borrower's friend. A client and staff survey of collections practices within the organization revealed significant complaints with collections agents and their practices. The collections department was reorganized under the legal department. Collections agents are expected to view their job as "a new face, another opportunity to pay" and the organization provides training on ethical dilemmas that collections agents will likely face, using cases from experience. A second survey, undertaken one year later, shows almost no complaints with collections. This example shows how an organization's good intent is put into practice through specialization, clear procedures, staff preparation for the job, and regular monitoring for consistency throughout the organization.

### **Principle 4: Ethical Staff Behavior**

#### **Definition**

Treating customers with respect and dignity is a fundamental consumer protection principle. A financial institution measures up to this principle by creating a corporate culture that values high ethical standards among staff and ensuring safeguards are in place to prevent, detect and correct corruption or mistreatment of clients.

#### **Getting started**

This principle is similar to principle 3 on appropriate collections practices, which tests staff ethical behavior under difficult circumstances. By far, principle 4 is the most complex principle to assess from an

objective perspective. It is a challenge to know how widely ethical behavior is practiced in the organization, even though there may be strong evidence based on individual incidences.

The analysis of the other principles is essential for the analysis of this one. For example, if an organization says it treats clients with respect, the analyst should see how the institution protects client data, and asks for consent to use it.

People	Paper	Process
CEO	Code of Ethics	Document review
Board	Staff Rules	Interviews
Human Resource Dept	Anti-corruption Policy	
Staff Ethics Committees	Training Curricula	
Complaints Dept	Incentive Policies	
Internal Audit	Performance Review Formats	

## Analysis

### Guidance on interpreting findings

The key to assessing this principle is to compare your organization’s practices to high standards of promoting ethical behavior.

Judge your findings by comparing high standards to your own practices:

- A code is considered a high standard when senior management, the Board and staff committees on ethics are involved in the design and approval of the code, the code is distributed to all staff, and regularly monitored for compliance.
- A code of ethics (or staff rule book) is considered a high standard if it explicitly details the elements of the code, actions that constitute violations, and the corresponding sanctions.
- A requirement for all staff to sign the code and be re-certified annually is considered a high standard.
- A process in place that encourages staff to be vigilant about violations of the code, provides information about how to report violations, and requires unbiased and timely review of reports is considered a high standard.
- A training program in job specific ethical dilemmas based on real cases is considered a high standard.
- An internal audit processes that looks for ethical violations combined with an internal mechanism that resolves problems is considered a high standard.

The analysis focuses on three aspects of how the organization promotes staff ethical behavior: 1) codes of ethics and organizational values, 2) policies and rules, and 3) staff recruitment, training and review procedures.

### Codes of Ethics and Organizational Values

The indicators in this cluster focus on organizational values. The indicators are:

- Senior management creates a culture which values and rewards high standards of ethical behavior and customer service.
- Staff are aware that the image of the institution depends on the behavior of all staff. Staff recognize that their own behavior and reputations are linked to the reputation of the institution.

### Tips for analyzing these indicators

These indicators, which are fundamental for the analysis of this principle, are difficult to verify in an objective way. They can be sensitive. The focus of these indicators is on ethical behavior, not customer service. Ethical behavior differs from customer service, although there is over-lap. Customer service includes being friendly, efficient, professional and responsive to clients; having a clean, safe place for

customers to transact business. Ethics is about values and behavior – like being fair, honest, respectful, respecting confidentiality – as well as not lying to, cheating, stealing from, verbally or physically abusing, asking favors from, harassing, or threatening clients.

How has management created a corporate culture which values and rewards high standards of ethical behavior and customer service?

**Consider the following:**

In staff interviews:

- Ask who is rewarded and for what?
- Dig into the institution’s legends and legendary behavior, but avoid slogans unless there is proof that the organization puts this slogan into practice on a regular basis.
- Note stories about staff reprimands or firings because of unethical or corrupt practices. This is evidence that the organization takes ethics seriously, but not evidence that such reprimands take place systematically or as often as they should. This evidence does provide an idea about what is important in the organization, because it is recalled by staff.

How aware are staff that the image of the institution depends on the behavior of all staff and that staff recognize that their behavior and reputations are linked to the reputation of the institution?

**Consider the following:**

Listen to as many staff members as possible, detecting why it’s important for them to behave in a certain way. Listen for consistent statements of values in all staff interviews. It’s the repetition that counts. Then answer: “The most repeated staff value is: \_\_\_\_\_.”

Interview questions that are helpful are:

- What do you think your organization is known for among your peers and with your customers?
- When you consider an organization’s reputation, what counts? How do you think your organization’s reputation compares to others?
- What does senior management (or your boss) expect of you? (Not, what kind of ethical behavior does your boss expect of you?) Does the response to the question include an example of ethical behavior in the top two or three answers?

**Policies and Rules**

The indicators in this cluster focus on policies and rules for staff. The indicators are:

- A code of business ethics, code of conduct or other guidelines spell out organizational values and the standards of professional ethics expected of all staff. The code of ethics has been reviewed and approved by the Board and is included in staff rule books or administrative policies.
- Staff rules include provisions on what is considered acceptable and unacceptable behavior. Provisions describe reprimands and the actions that can result in termination of employment for violations.
- Anti-corruption policies and procedures are in place, provided to each staff member and enforced by decision-makers.

**Tips for analyzing these indicators:** These indicators call for concrete supporting evidence. Interviews with internal audit, human resources and senior management will complement the analysis, providing insights into how routine systems support organizational culture.

Review the documents and check the following:

	Yes	No
Is there a written Code of Ethics?		
Has it been officially approved by the Board?		
Does all staff have to sign the Code?		
Are staff certified and re-certified in the Code?		
Is the Code of Ethics included in the Staff Book of Rules?		
Does the Staff Book of Rules include provisions on acceptable and unacceptable behavior?		
Are the reprimands and actions that can result in termination of employment clearly stated?		
Is there an anti-corruption policy?		
Does it discuss topics that prohibit staff from conducting business for private gain?		
Does it include topics such as fraud, bribes, kickbacks, favors, gifts, abuse of authority, coercion, sexual harassment, conflicts of interest (real and perceived), nepotism, favoritism, unauthorized use of information?		
Is there evidence that internal audit and complaints are used to turn up instances of unethical behavior and fraud?		

**Interpreting findings:** If you answer “no” to any of these questions, you have identified weaknesses that your organization should address.

### Staff Recruitment, Training and Review

The indicators in this cluster focus on recruitment, training and review. The indicators are:

- Hiring procedures assess new employees for compatibility with organizational values and ethics.
- New staff receive orientation on the practicalities of following codes of conduct and refresher courses include customer service standards.
- Managers and supervisors are tasked with detecting corruption and client mistreatment in the normal course of business.
- Managers and supervisors review ethical behavior, professional conduct and the quality of interaction with customers as part of staff performance evaluations.
- Internal audit is tasked with detecting corruption and violations of procedures as a part of the risk management of the organization, independently reporting to the Board and making recommendations for management action.

**Tips for analyzing these indicators:** These indicators call for concrete supporting evidence. Interviews with internal audit, human resources and senior management will complement the analysis, providing insights into how staff training, professional development and systems are set up to prevent detect and correct corruption and client mistreatment.

Review the documents and check the following:

	Yes	No
Are new recruits tested for compatibility with organizational values?		
Does the staff training program have a dedicated curriculum on ethics?		
Are job-specific ethical dilemmas included in staff training programs?		
Is there a mechanism in place to report staff ethical violations?		
Is there an Ethics Committee that reviews violations?		
Do complaints about client mistreatment reach senior management?		
Does the internal audit department monitor violations, their review and resolution?		
Do staff performance reviews include a section on ethics?		
Does the incentive system specifically reward ethical behavior?		

**Interpreting findings:** If you answer “no” to any of these questions, you have identified weaknesses that your organization should address.

**Summary: Drawing Conclusions and Planning Next Steps**

After this review you should be able to answer the following summary question: How well has your organization created a corporate culture that values high ethical standards among staff and ensured that safeguards are in place to prevent, detect and correct corruption or mistreatment of clients?

You can now go to the tool in Appendix 1 and fill in your summary information.

**Box 8: Highlights – Staff Ethics**

*A bonus for ethics!!* This organization awards an additional monthly bonus to staff members who meet 30 out of 50 criteria for ethics and customer service. The incentive program is popular.

*Know Your Job (KYJ):* This organization developed a comprehensive ethics training program that includes job-specific ethical dilemmas. The modules are based on experience of what ethical choices others have found in the job.

*Real-Time:* This organization developed an anti-corruption and fraud prevention training program, which uses real cases that have occurred.

**Principle 5: Mechanisms for Redress of Grievances.**

**Definition**

Customers should have the opportunity to communicate problems, complain when things go wrong and expect timely resolution for their complaints. A financial institution measures up to this principle by having in place and actively using mechanisms for collecting, responding to in a timely manner, and resolving problems for their clients.

**Getting started**

Each of these indicators can be assessed from written documentation, interviews, or demonstrations of systems.

People	Paper	Process
Staff Designated to Handle Complaints	Complaints Policy	Observation
Customer Service Dept	Complaints monitoring system	Document review
Internal Audit	Customer Surveys	Interviews

**Analysis**

The keys to assessing this principle are:

- 1) Understanding the process from beginning to end; and
- 2) Assessing the quality of complaints handling and resolution.

**Guidance on interpreting findings**

Judge your findings according to the following:

- The existence of a mechanism. (A minimum standard)
- The accessibility of the system to customers. (A better standard)
- The resolution of complaints in an unbiased, timely manner. (A good practice)
- Whether the organization tracks and uses the information it receives about complaints and client feedback to review and improve products or procedures. (A good practice)

The analysis focuses on the complaints mechanism, its accessibility and responsiveness to clients, and the information monitoring system. Check the boxes below, for which you can answer “yes”.

- A written policy is in place, which requires customer complaints to be taken seriously, investigated and resolved in a timely manner. (A good practice)
- A ready mechanism to handle customer complaints, problems and feedback is in place and accessible to customers. (A minimum standard) See tips below.
- Customers are informed of their right to complain and know how to submit a complaint to the appropriate person. (A good practice)
- Staff is trained to handle complaints and refer them to the appropriate person for investigation and resolution. (A good practice)
- Specialized personnel are designated to handle customer complaints and problem solving. (A good practice)
- Complaints are fully investigated and decisions are made consistently and without bias. (A good practice)
- Internal audit or other monitoring systems check that complaints are resolved satisfactorily (A good practice.)
- Complaint information is used to improve products, sales techniques and other interactions with customers. (A good practice)
- Customers have the opportunity to seek independent third party recourse in the event that they cannot resolve the problem with a financial institution, such as an ombudsman or mediator with the power to make binding decisions. (A good practice, which depends on the context)

### **Tips for analyzing this principle**

Suggestion boxes placed in a branch office are poor substitutes for a ready and responsive complaints handling mechanism.

Customer satisfaction surveys are important supporting documentation for assessing this principle, but a customer satisfaction survey is not the same thing as a complaints handling and resolution system.

### **You may also consider:**

At times it can be difficult to talk about complaints --why should we solicit complaints from a satisfied customer base? Oddly, a complaints handling and resolution mechanism is one of the consumer protection practices that can have a dramatic effect on improving business, customer satisfaction and the organization’s image. Savvy organizations use the mechanism to keep in touch with their customers and their problems, fix things that go wrong, and prevent complaints (and their lack of resolution) from reaching an impasse and involving external actors, or moving to the press or political arena.

If the institution receives no complaints or feedback, this is a sign that the system may not be robust or well understood by customers. It can also be an indicator that all clients are perfectly happy with the service, or that most clients don’t know what a legitimate complaint is. In many contexts clients do not feel empowered to complain and have no frame of reference or expectation of effective complaints handling. If there are no complaints, you should know why.

## Summary: Drawing Conclusions and Planning Next Steps

After this review you should be able to answer the following summary question: Does your organization have in place a robust mechanism for collecting, responding in a timely manner, and resolving problems for their clients?

You can now go to the tool in Appendix 1 and fill in your summary information.

### Box 9: Highlights – Complaints Mechanism and Resolution

**Transparency and Complaints:** This organization includes call center information on the first page of all contracts. The organization also includes the hotline for the government consumer protection financial services agency on the same page.

**Compliance, Transparency and Complaints Part 2:** This organization requires the Internal Audit department to check to see that clients have been informed about the complaints hotline and their *obligation* to complain if things go wrong.

**Blind Spot:** This organization undertakes a detailed customer satisfaction survey every six months to provide information for staff performance reviews. However, the information is not used to revise products and procedures, which clients find problematic.

## Principle 6: Privacy of client data

### Definition

Customers have the right to expect that their personal and financial information will not be revealed to those who are not authorized to see it. A financial institution measures up to this principle by respecting the privacy of client data, ensuring the integrity and security of client information, and seeking the client's permission to share information with outside parties prior to doing so.

### Getting started

The assessment of this straight forward principle relies on concrete evidence which is available from a few sources. Each of these indicators can be assessed from written documentation, interviews, or demonstrations of systems.

People	Paper	Process
IT Department	Privacy Policy	Document review
Marketing Department	Credit Bureau Requirements	Observation
Internal Audit	Client Consent Forms	

### Analysis

The key to assessing this principle is to compare your organization's practices to good practices of protecting client data.

### Guidance on interpreting findings

Judge your findings according to whether your organization does the following:

- Secures client information from unauthorized use – a fundamental protection
- Informs customers about how their information will be used – a minimum standard

- Seeks client’s written consent before sharing information – a good practice
- Helps clients review and correct their information – a good practice
- Makes an extra effort to help customers safeguard their information outside the institution – a good practice.

The analysis focuses on two aspects of how the organization safeguards the privacy of client data: 1) systems that safeguard client information, and 2) interactions with customers regarding consent, corrections and assistance.

Check the box, if you can answer “yes.”

**Systems**

- A written privacy policy is in place which governs the gathering, processing, use and distribution of client information.
- Systems are in place and staff are trained to protect the confidentiality, security, accuracy and integrity of customers’ personal and financial information.
- The IT system is secure and password protected with various levels of authorized access to information and access to data modification adjusted to the tasks and needs of the user.
- Internal audit reviews security of locations and electronic systems where client data is stored

**Guidance on interpreting findings:** All of the boxes above should be checked to meet the minimum standard.

**Interactions with Customers**

- Customers know how their information will be used. (A minimum standard)
- Staff explains how client data will be used and seeks client permission for use. (A good practice)
- Clients have the option of not having their information shared. (See tips, below.)
- The organization ensures the accuracy of information shared and requests customer consent for use of data in a Credit Registry or Bureau. (See tips, below.)
- Customers are given the opportunity to correct their information, and the financial institution provides assistance in this regard. (A good practice)
- Customer consent is required for use of information in promotions, marketing material and other public information. Clients are asked to express their written agreement for use of their personal information, such as pictures, business, personal stories in the organization’s publications, promotional material, and any information shared with an external audience. (A good practice)
- The organization offers information, orientation or educational sessions to clients on how to safeguard access codes or PIN numbers. (A good practice)

**Tips for analyzing this principle**

Laws and regulations regarding customer data sharing in credit bureaus differ by country. In some countries, financial institutions are required to share customer data with the bureau or registry. They must seek consent from the customer before submitting data. In other countries, no customer consent is required for submitting client data to credit bureaus or registries; however, the financial institution must obtain written customer consent to access the data. In either of these cases, if customers want a loan, they do not have the option of not having their information shared.

**Summary: Drawing Conclusions and Planning Next Steps**

After this review you should be able to answer the following summary question: How well does the organization respect the privacy of client data, ensure the integrity and security of client information, and seek the client’s permission to share information with outside parties prior to doing so?

You can now go to the tool in Appendix 1 and fill in your summary information.

**Box 10: Highlights – Privacy and Security of Client Data**

**Bankers into Social Workers:** With the advent of new technology that leads to the loss of direct contact between the teller and the customer, one organization finds staff turning into family counselors, in addition to being bankers. Husbands, wives and children know or can guess account access codes and PIN numbers. When the customer checks the balance and finds it low, she accuses the organization of stealing the funds. Only the security video system reveals the real culprit. The institution has made an extra effort to train clients about how to safeguard this information.

**Fair pricing**

**Definition**

The Beyond Codes project currently defines fair pricing as pricing policy that demonstrates the institution’s commitment to a mutually beneficial relationship between the institution and the customer. A financial institution can measure up to this principle by offering quality services for the price it charges, demonstrating its competitiveness in the marketplace, and favoring a long-term beneficial relationship with the customer over short-term profit maximization.

**Getting started**

While controversial, this principle can be analyzed in a somewhat straight forward manner. The evidence can be assessed from written documentation, financial information and industry level benchmarking data from similar competitors.

There are a number of indicators that rely on the organization’s own perceptions about what is “fair” and the decision-making criteria for new products based on “fairness”. You might consider a short kick-off meeting to discuss what fair pricing means to your organization and within your context.

Complete your assessment of Principle 2 “Transparency” before assessing Fair Pricing, since that information will be helpful here.

People	Paper	Process
Finance Dept	Product Information	Financial Calculations
Decision Makers	Financial Ratios	Interviews
	Industry Benchmarking	Kick off Exercise
	Information from assessment of Transparent Pricing	

**Analysis**

The analysis focuses on demonstrating the organization’s commitment to a mutually beneficial relationship in two areas: 1) the efficiency, profitability and competitiveness of the institution in its context, and 2) how benefits of institutional growth are passed on to customers, allowing them to improve their wellbeing.

**Efficiency, profitability and competitiveness**

This section focuses on several key institutional ratios and industry analysis. The indicators are:

- Prices are not subsidized and are market oriented.
- Prices are competitive within the country context.

The financial institution does not charge customers for its own inefficiency, as demonstrated by a comparison of efficiency and profitability ratios of similar competitors.

**Tips for analyzing these indicators**

Fair pricing is different from “low prices” or reliance on subsidies. Commercial enterprises are concerned that their customers benefit from their products, otherwise, their customer base decreases with the perceived decrease in the value of the services. Over reliance on subsidies distorts the market and leads to organizational vulnerability.

To assess these indicators on institutional operations and growth, follow these five steps:

**Step 1:** Examine profitability ratios adjusted for subsidies.

Ratio	Positive or Negative?
AROA	
AROE	
FSS	

**Interpreting Findings** Your organization is assessed positively for a positive AROA, AROE or financial self-sufficiency ratio above 100%.

**Step 2:** Use industry information, to identify the range of prices. Position your organization within the range.

**Example:** In a lending operation, portfolio yield can be used as one proxy for effective interest rates.

- Use the most recent data to calculate the median portfolio yield for the industry. Use network or association data, or data from the banking authorities.
- Calculate your organization’s portfolio yield.
- Assess the position. This example shows that the organization is positioned in mid-range, with 14 organizations posting a higher portfolio yield, and 17 organizations posting a lower portfolio yield.

EXAMPLE:				
Median Portfolio yield	Number of organizations	Yield Range	Your organization’s portfolio yield	Number of organizations above and below
35.7%	31	10.2% - 59.1%	36.5%	14 > 17 <

- Compare AROA or FSS data for the range of institutions in the sample. In this example, of the 17 organizations posting a lower portfolio yield, 5 posted a negative AROA, as well as financial self-sufficiency ratios less than 100%.

The analysis reveals that the organization’s effective interest rates are mid-range. When organizations that are not profitable without subsidies are removed from the analysis, the organization’s yield falls below the median, indicating that by industry benchmarks in the context, the prices are reasonable.

**Step 3:** Continue the analysis by comparing data for organizations offering similar lending products. Compare average loan size to portfolio yield and efficiency ratios. The theory is that smaller average loans are more costly to administer than larger loans, and a higher portfolio yield can be justified as fair to cover costs.

Use benchmarking information with similar organizations in similar contexts and peer groups.

**Example:** This example shows a comparison among five MFIs that offer the same product and the largest loan sizes in the market. Each MFI has the same NBFIL legal charter, works with a similar customer base and uses similar loan delivery technologies:

EXAMPLE:	MFI 1	MFI 2	MFI 3	<i>Our MFI</i>	MFI 4
Average loan amount	370	320	300	<b>300</b>	390
Adjusted return on equity	13.0%	23.2%	42.2%	<b>22.7%</b>	13.4%
Yield on portfolio	20.4%	28.3%	30.1%	<b>19.2%</b>	19.0%
Operational efficiency	15.6%	23.4%	22.1%	<b>14.6%</b>	15.2%

Analysis: Segmenting the industry by average loan size, of the five organizations with the highest average loan sizes in the market, “Our MFI” portfolio yield is one of the lowest. Efficiency ratios are favorable, indicating that clients do not pay for “Our MFI” inefficiency. AROE indicates profitability in the mid-range, indicating prices are not subsidized and reasonable returns are generated.

**Step 4:** Answer the following summary question on interest rates and pricing policy:

- Does your organization use technical criteria to evaluate interest rate and pricing policy?

**Interpreting Findings** Your organization is assessed positively when interest rates cover costs -- including a reasonable return-- the organization is managed in an efficient way and uses technical criteria to evaluate pricing policy.

**Caution:** make sure that you compare organizations in similar peer groups --age, legal charter and those that offer similar products! It is not “fair” to select a sample that tips the bias in favor of your organization. In addition, consider yield gap analysis to ensure a lower portfolio yield is not a reflection of significant delinquency or other factors.

### Benefits Passed on to Customers

This section focuses on how benefits of institutional growth are passed on to customers, allowing them to benefit. The indicators are:

- The financial institution passes the benefits of efficient operations on to customers, as demonstrated by lowering prices based on technical analysis, or offering new products and services that suit customer financial needs.
- Checks and balances exist to prevent the sale of more costly products than others that are available and more suited to a customer’s needs.
- Pre-payment penalties or account closure fees are not excessive. Practices in place do not prevent a customer from changing to another product or provider.

### Guidance on Interpreting Findings

1. **Re-visit transparency.** At a minimum, fair pricing is consistently practiced transparent pricing in a form the customer can understand. The hypothesis: when a customer understands the full price, terms and conditions of a product, even though that product may be more expensive, there is perceived value, unless the customer has no other choice. This would argue for fair pricing being seen more often in competitive environments where choices are available.

Revisit your analysis of Principle 2 on Transparency. How did you assess the organization’s performance on consistently practicing transparent pricing? If your analysis of transparency revealed

weaknesses and red flags, your assessment of fair pricing must reflect this. A good practices assessment on ensuring transparency is the “entry pass” for a positive assessment on fair pricing.

2. **Passing Benefits to Customers.** Have prices been lowered based on a technical analysis? Has the organization invested in developing new products based on customer feedback or adjusted products to better suit customer financial needs?

List the products here, and note why the product was developed, and if organizational benefit and customer benefit was considered in the product development process. If customer benefit was considered in the design of the product, assess your organization positively.

Product	Why Developed?	Organizational benefit considered?	Customer benefit considered?
Credit			
Savings			
Insurance			
Other:			

3. **Checks and Balances.** Fair pricing also includes the notion that more expensive products are not sold to customers who could benefit by other products that are available at a lower price. The incentive system and the product line are key factors for analyzing this indicator. If an organization has only one product with one price, this indicator does not apply. When a variety of products exist, with different terms and prices, the incentives play a key role in determining which products are sold.

Consider this example: The incentive system rewards portfolio size and return. A shorter term loan is available and suits the customer’s retail financing needs to purchase inventory that will be sold within 3 months. The borrower intends to repay the loan in full at this time. The loan officer incentive system promotes selling a larger loan, over a longer period. The portfolio size increases, the loan is more expensive to the borrower, and a pre-payment penalty requires the borrower to repay 5% of the outstanding principal.

If more expensive products are sold to customers because of the incentive system or other institutional priorities the organization is assessed negatively.

4. **Pre-payment penalties.** must be examined when looking at fair pricing. Excessive ones prevent a customer from seeking a better deal elsewhere or through a different product that may become available. Pre-payment penalties should be examined based on what is reasonable considering the organization’s cost of opening new accounts and loan origination, which are often higher than maintenance, and comparisons in the context.

An organization that charges pre-payment penalties is not necessarily assessed negatively. If these fees make up a large percentage of the organizations income, there is a big red flag, since the loan terms that the organization offers do not consistently appear to meet borrowers’ financial needs.

5. **Fair pricing covers other products** such as: insurance, savings, transaction accounts and remittances. Products should be examined for timeliness and barriers to submitting reasonable claims, account maintenance fees, conditions for minimum balances, account activity and exchange rates on remittances.

## Summary: Drawing Conclusions and Planning Next Steps

After this review you should be able to answer the following summary question: How well does your organization demonstrate commitment to establishing a mutually beneficial relationship between the institution and the customer?

You can now go to the tool in Appendix 1 and fill in your summary information.

### **Box 11: Highlights – Fair Pricing**

***No Penalties for Prompt Repayment!*** The bank does not charge pre-payment penalties on any loan product.

***Prices Fall:*** No up-front fees or commissions are charged for the loan. This is a recent practice. When fees were eliminated, the monthly interest rate did not increase to compensate for them.

***Discounts Prevail:*** A non-bank institution offers group deals on savings accounts through established agreements with local banks, allowing groups to pool their savings and avoid charges for not maintaining minimum balances, which can be significant. The organization has negotiated agreements with local banks and convenience store outlets to cover installment payment fees that are often charged by 3<sup>rd</sup> parties for the credit transaction.

***Promises Kept:*** One organization values establishing long-term business relationships with customers over short-term profit-maximization as demonstrated by interest rate discounts, flexible terms and guarantee requirements that are offered to repeat customers as part of customer loyalty initiatives.

**Appendix 1: Summary Assessment**

*Instructions: Check the box to the left to indicate that you had enough information to analyze this indicator well. Check the boxes at the right to show the extent to which your self-assessment of your practices support this indicator.*

<b>Principle 1: Prevent over-indebtedness.</b> A financial institution measures up to this principle by carefully establishing the borrower’s ability to afford the loan and repay it. Clients should be able to handle debt service payments without sacrificing their basic quality of life.	Good	Adequate	Weak	Unknown
Management is aware of the potential for over-lending, regularly obtains information on client over indebtedness and is responding appropriately to risks.				
Management regularly monitors product performance, lending sales practices, approval procedures, and incentive programs to reduce the risk of over-selling and mis-selling and adjusts operations and training programs accordingly.				
The loan approval process requires borrower repayment capacity and loan affordability to be assessed. The loan approval process does not rely solely on guarantees (whether peer guarantees, co-signers or collateral) as a substitute for sound risk management.				
Credit approval policies give decision makers explicit guidance regarding borrower debt thresholds and acceptable levels of debt from other sources.				
When available, the financial institution checks a Credit Registry or Credit Bureau for borrower current debt levels and repayment history. When not available, the financial institution maintains and checks internal records and, when possible, consults with competitors for same.				
The financial institution avoids increasing debt levels of borrowers who are already indebted beyond their capacity to repay, avoiding re-financing the loan at a higher amount, and adhering to a standard protocol for debt re-structuring.				
The financial institution offers multiple loan products or flexible ones that address different business and family needs. The organization ensures product suitability through careful product design and testing with the target market.				
The credit decision making procedure and supervision function promote sales force or loan officer accountability for the quality of the loan.				

<i>Principle 1 continued...</i>	Good	Adequate	Weak	Unknown
<p>Incentives and productivity targets reward risk management. Productivity targets and incentive systems value portfolio quality at least as highly as other factors, such as disbursement or customer growth. Growth is rewarded only if portfolio quality is high.</p>				
<p>Internal audits check household debt exposure, lending practices that violate procedures including unauthorized re-financing, multiple borrowers or co-signers per household, and other practices that could increase indebtedness.</p>				

## Results – Principle 1

Overall Assessment for Principle 1:  Good  Adequate  Weak

List the main strengths that have surfaced from your analysis. Highlight some of your “best practices” that would benefit other institutions.

Our main strengths are:	Highlight strong practices that you think would benefit other institutions:

List practices that you would like to improve. Provide a statement of the reasons why. Identify actions to address this issue.

Our adequate practices	Reasons:	Pilot to Improve

List the main vulnerabilities that have surfaced from your analysis. Provide a statement of evidence or reasons these are problems. Identify actions to address this issue.

Our main vulnerabilities are:	Evidence:	Potential Pilot to Change or Begin

<b>Principle 2: Transparent Pricing.</b> A financial institution measures up to this principle by ensuring that complete information is made available to customers in clear language that is not misleading and that the customer is able to understand.	Good	Adequate	Weak	Unknown
Senior management creates a culture of transparency within the organization and develops systems, controls and incentives to support it.				
Prices, terms and conditions of financial products are fully disclosed to the customer, including interest charges, insurance premiums, minimum balances required on savings and transaction accounts, all fees, penalties, and whether those can change over time.				
Reasonable efforts are made to ensure customers with low levels of financial literacy understand the product, the terms of the contract, and their rights and responsibilities.				
The organization submits audited financial statements to the appropriate authorities, membership, and interested parties, and publishes such information in the media.				
<b>Prior to sale:</b> Prices and terms of products are published, enabling customers to compare various offers.				
<ul style="list-style-type: none"> <li>• The financial institution follows truth-in-lending laws and required APR or effective interest rate calculation formulae. In the absence of such industry-wide requirements, information is provided that shows the total amount that the client pays for the loan.</li> </ul>				
<ul style="list-style-type: none"> <li>• Advertisements and marketing campaigns clearly communicate complete and accurate descriptions of the product or service. Advertisements reflect the product that the customer can reasonably expect to receive and the full price that the customer can expect to pay.</li> </ul>				
<ul style="list-style-type: none"> <li>• Linked products with no “opt-out,” such as mandatory savings and loan insurance, are included in the price of the loan.</li> </ul>				
<ul style="list-style-type: none"> <li>• Third party fees are disclosed, for example, bank fees that service disbursements and installment payments, ATM fees or electronic fees.</li> </ul>				
<b>At the point of sale:</b> Clear and complete verbal or written explanations about the product benefits, costs and risks and customer obligations are provided at the point of sale.				

	Good	Adequate	Weak	Unknown
<b><i>Principle 2 continued...</i></b>				
<ul style="list-style-type: none"> <li>• Loan contracts show the amortization schedule that separates principal, interest, fees and define the amount, and number and due dates of installment payments. Contracts include costs related to linked products, fees and conditions for early repayment, late payments, and contract termination.</li> </ul>				
<ul style="list-style-type: none"> <li>• Interest rates on savings, fees for account maintenance, minimum balances required, and terms and costs of transaction accounts are provided.</li> </ul>				
<ul style="list-style-type: none"> <li>• Prices, terms, risks and consequences of not meeting contractual obligations are discussed in language that the customer can understand. Any fine print is fully revealed and explored and customer questions are encouraged.</li> </ul>				
<ul style="list-style-type: none"> <li>• Communications addresses client literacy limitations (e.g., reading contracts out loud, materials in local languages)</li> </ul>				
<ul style="list-style-type: none"> <li>• Customers are given adequate time to review the terms and conditions of the product and have an opportunity to ask questions and receive information prior to signing contracts.</li> </ul>				
<b><i>After the point of sale:</i></b>				
<ul style="list-style-type: none"> <li>• The client regularly receives clear and accurate information regarding the account.</li> </ul>				
<ul style="list-style-type: none"> <li>• Balances are correct, recorded regularly, and investigated for discrepancies in a timely manner.</li> </ul>				
<ul style="list-style-type: none"> <li>• Promises of future benefits, discounts, and privileges are kept.</li> </ul>				

**Results – Principle 2**

Overall Assessment for Principle 2:  Good  Adequate  Weak

List the main strengths that have surfaced from your analysis. Highlight some of your “best practices” that would benefit other institutions.

Our main strengths are:	Highlight strong practices that you think would benefit other institutions:

List practices that you would like to improve. Provide a statement of the reasons why. Identify actions to address this issue.

Our adequate practices	Reasons:	Pilot to Improve

List the main vulnerabilities that have surfaced from your analysis. Provide a statement of evidence or reasons these are problems. Identify actions to address this issue.

Our main vulnerabilities are:	Evidence:	Potential Pilot to Change or Begin

<b>Principle 3: Appropriate Collections Practices.</b> A financial institution measures up to this principle by maintaining high standards of ethical behavior even when clients fail to meet their contractual commitments.	<b>Good</b>	<b>Adequate</b>	<b>Weak</b>	<b>Unknown</b>
The code of ethics requires all clients to be treated with dignity and respect, even when they fail to meet their contractual commitments.				
The code forbids subjecting a borrower to abusive language or threats by collection agents.				
The code forbids harassing borrowers at their place of work or worship, or at unreasonable times of the day or night.				
The code forbids forcible entry to borrowers' dwellings and seizing property without court order or in violation of the law.				
If the institution uses 3 <sup>rd</sup> party debt collectors, these agents are expected to follow the same codes of ethical practice as the institution.				
There is recognition that accurate analysis of a borrower's repayment capacity is a first step to preventing delinquency, and the organization may hold some responsibility for borrowers' failure.				
Debt collection practices and procedures are clearly outlined in a staff book of rules or credit procedure manual.				
Specific step-by-step procedures and time frames are outlined for late payment recovery and how to proceed when borrowers are in default.				
Collections staff receive training in acceptable debt collections practices and loan recovery procedures.				
Practices and procedures are followed widely in the organization and monitored by the internal audit department. Violations are sanctioned.				
Debt collection practices are revealed to the borrower at time of sale. Loan contracts include clauses on late repayment and default, and what the borrower should expect in these cases.				
The institution has a policy on acceptable pledges of collateral, including not accepting collateral that will deprive borrowers of their basic survival capacity.				

<i>Principle 3 continued...</i>	Good	Adequate	Weak	Unknown
<p>The institution and the borrower negotiate reasonable repayment plans prior to beginning procedures to confiscate assets that are pledged as collateral. Re-scheduling policies prevent automatic debt extensions. Re-scheduling procedures follow written protocol and negotiations are held in an official place of business, such as the branch office.</p>				

**Results – Principle 3**

Overall Assessment for Principle 3:  Good  Adequate  Weak

List the main strengths that have surfaced from your analysis. Highlight some of your “best practices” that would benefit other institutions.

Our main strengths are:	Highlight strong practices that you think would benefit other institutions:

List practices that you would like to improve. Provide a statement of the reasons why. Identify actions to address this issue.

Our adequate practices	Reasons:	Pilot to Improve

List the main vulnerabilities that have surfaced from your analysis. Provide a statement of evidence or reasons these are problems. Identify actions to address this issue.

Our main vulnerabilities are:	Evidence:	Potential Pilot to Change or Begin

<b>Principle 4: Ethical Staff Behavior</b> A financial institution measures up to this principle by creating a corporate culture that values high ethical standards among staff and ensuring safeguards are in place to prevent, detect, and correct corruption or mistreatment of clients.	Good	Adequate	Weak	Unknown
Senior management creates a corporate culture which values and rewards high standards of ethical behavior and customer service.				
Staff is aware that the image of the institution depends on the behavior of all staff. Staff recognizes that their own behavior and reputations are linked to the reputation of the institution.				
A code of business ethics, code of conduct, or other guidelines spell out organizational values and the standards of professional ethics expected of all staff. The code of ethics has been reviewed and approved by the Board and is included in staff rule books or administrative policies.				
Staff rules include provisions on what is considered acceptable and unacceptable behavior. Provisions describe reprimands and actions that can result in termination of employment.				
Anti-corruption policies and procedures are in place, provided to each staff member and enforced by decision-makers.				
Hiring procedures assess new employees for compatibility with organizational values and ethics.				
New staff receives orientation on the practicalities of following codes of conduct and refresher courses include customer service standards.				
Managers and supervisors are tasked with detecting corruption and client mistreatment in the normal course of business.				
Managers and supervisors review ethical behavior, professional conduct and the quality of interaction with customers as part of staff performance evaluations .				
Internal audit is tasked with detecting corruption and violations of procedures as a part of the risk management of the organization, independently reporting to the Board and making recommendations for management action.				

**Results – Principle 4**

Overall Assessment for Principle 4:  Good  Adequate  Weak

List the main strengths that have surfaced from your analysis. Highlight some of your “best practices” that would benefit other institutions.

Our main strengths are:	Highlight strong practices that you think would benefit other institutions:

List practices that you would like to improve. Provide a statement of the reasons why. Identify actions to address this issue.

Our adequate practices	Reasons:	Pilot to Improve

List the main vulnerabilities that have surfaced from your analysis. Provide a statement of evidence or reasons these are problems. Identify actions to address this issue.

Our main vulnerabilities are:	Evidence:	Potential Pilot to Change or Begin

<b>Principle 5: Mechanisms for Complaints Handling and Resolution.</b> A financial institution measures up to this principle by having a mechanism for collecting, responding in a timely manner, and resolving problems for their clients.	<b>Good</b>	<b>Adequate</b>	<b>Weak</b>	<b>Unknown</b>
A written policy requires customer complaints to be taken seriously, investigated and resolved in a timely manner.				
A ready mechanism to handle customer complaints, problems, and feedback is in place and accessible to customers.				
Customers are informed of their right to complain and know how to submit a complaint to the appropriate person.				
Staff is trained to handle complaints and refer them to the appropriate person for investigation and resolution.				
Specialized personnel are designated to handle customer complaints and problem solving.				
Complaints are fully investigated and decisions are made consistently and without bias.				
Internal audit or other monitoring systems check that complaints are resolved satisfactorily.				
Complaints information is used to improve products, sales techniques, and other interactions with customers.				
Customers have the opportunity to seek independent third party recourse in the event that they cannot resolve the problem with a financial institution, such as an ombudsman or mediator with the power to make binding decisions.				

**Results – Principle 5**

Overall Assessment for Principle 5:  Good  Adequate  Weak

List the main strengths that have surfaced from your analysis. Highlight some of your “best practices” that would benefit other institutions.

Our main strengths are:	Highlight strong practices that you think would benefit other institutions:

List practices that you would like to improve. Provide a statement of the reasons why. Identify actions to address this issue.

Our adequate practices	Reasons:	Pilot to Improve

List the main vulnerabilities that have surfaced from your analysis. Provide a statement of evidence or reasons these are problems. Identify actions to address this issue.

Our main vulnerabilities are:	Evidence:	Potential Pilot to Change or Begin

<b>Principle 6: Privacy of client data.</b> A financial institution measures up to this principle by respecting the privacy of client data, ensuring the integrity and security of client information, and seeking the client’s permission to share information with outside parties prior to doing so.	Good	Adequate	Weak	Unknown
A written privacy policy is in place which governs the gathering, processing, use, and distribution of client information.				
Systems are in place and staff trained to protect the confidentiality, security, accuracy, and integrity of customers’ personal and financial information.				
The IT system is secure and password protected with various levels of authorized access to information and access to data modification adjusted to the tasks and needs of the user.				
Internal audit reviews security of locations and electronic systems where client data is stored.				
Customers know how their information will be used.				
Staff explains how client data will be used and seeks client permission for use.				
Clients have the option of not having their information shared.				
The organization ensures the accuracy of information shared and requests customer consent for use of data in a Credit Registry or Bureau. .				
Customers are given the opportunity to correct their information, and the financial institution provides assistance in this regard.				
Customer consent is required for use of information in promotions, marketing material and other public information. Clients are asked to express their written agreement for use of their personal information, such as pictures and business and personal stories in the organization’s publications, promotional material, and any information shared with external audience.				
The organization offers information, orientation, or educational sessions to clients on how to safeguard access codes or PIN numbers.				

**Results – Principle 6**

Overall Assessment for Principle 6:  Good  Adequate  Weak

List the main strengths that have surfaced from your analysis. Highlight some of your “best practices” that would benefit other institutions.

Our main strengths are:	Highlight strong practices that you think would benefit other institutions:

List practices that you would like to improve. Provide a statement of the reasons why. Identify actions to address this issue.

Our adequate practices	Reasons:	Pilot to Improve

List the main vulnerabilities that have surfaced from your analysis. Provide a statement of evidence or reasons these are problems. Identify actions to address this issue.

Our main vulnerabilities are:	Evidence:	Potential Pilot to Change or Begin

<b>Principle: Fair Pricing.</b> A financial institution can measure up to this principle by offering quality services for the price, demonstrating its competitiveness in the marketplace, and favoring a long-term beneficial relationship with the customer over short-term profit maximization.	Good	Adequate	Weak	Unknown
Prices are not subsidized and are market oriented.				
Prices are competitive within the country context.				
The financial institution does not charge customers for its own inefficiency, as demonstrated by a comparison of efficiency and profitability ratios of similar competitors.				
The institution consistently practices transparent pricing.				
The institution earns a reasonable rate of return to support operations and grow, while allowing the customer to do the same.				
The financial institution passes the benefits of efficient operations on to customers, as demonstrated by lowering prices based on technical analysis, or offering new products and services that suit customer financial needs.				
Checks and balances exist to prevent the sale of more costly products than others that are available and more suited to a customer's needs.				
Pre-payment penalties or account closure fees are not excessive such that they prevent a customer from changing to another product or provider.				
Fair pricing covers insurance, savings, transaction accounts and remittances. Consider such factors as: insurance barriers to submitting reasonable claims in a timely manner, safety of savings accounts and fee structure and whether they can be blocked or confiscated by the institution, fee structure for transaction accounts, and pricing of exchange rates on remittances.				

## Results – Fair Pricing

Overall Assessment for Fair Pricing:  Good  Adequate  Weak

List the main strengths that have surfaced from your analysis. Highlight some of your “best practices” that would benefit other institutions.

Our main strengths are:	Highlight strong practices that you think would benefit other institutions:

List practices that you would like to improve. Provide a statement of the reasons why. Identify actions to address this issue.

Our adequate practices	Reasons:	Pilot to Improve

List the main vulnerabilities that have surfaced from your analysis. Provide a statement of evidence or reasons these are problems. Identify actions to address this issue.

Our main vulnerabilities are:	Evidence:	Potential Pilot to Change or Begin

## Appendix 2: Quick Staff Survey

Check all that apply

1. What does your institution do to avoid client over-indebtedness?
  - Written credit policies give decision makers guidance regarding borrower debt thresholds and acceptable levels of debt from other sources.
  - The credit underwriting process includes an evaluation of client ability to repay the loan.
  - The credit underwriting process includes checks on client credit history and existing debt.
  - Loan product options are flexible enough to fit client business and/or household needs.
  - The institution does not rely solely on guarantees for repayment.
  - Staff training includes over-indebtedness prevention.
  - Incentives and productivity targets are weighted to reward loan officers for portfolio quality.
  - Clients receive training/guidance on evaluating their own debt capacity.
  - Management regularly obtains information about debt levels among its clients.
  - Risk management systems monitor potential indebtedness consequences of lending practices/products.
  - Other: \_\_\_\_\_
  
2. How does your institution ensure transparent communication with clients about prices, terms and conditions?
  - Contracts/information use plain language and provide full disclosure of prices, terms and conditions
  - Product prices (interest rates, fees) are published, displayed and provided to clients
  - Format for information on interest rates (incl. fees, commissions) or other products allows comparison with other providers, e.g. annual percentage rates for loans.
  - Penalty and pre-payment fees are disclosed before loan contracts are signed.
  - Amortization schedule in loan contracts separates principal, interest, fees, and shows number, amount and due dates of installments.
  - Requirements and costs related to linked/tied products (e.g. savings, insurance) are disclosed.
  - Staff trained to communicate product pricing, terms and conditions with clients
  - Communications addresses client literacy limitations (e.g. contracts are read out loud, materials are made available in local languages).
  - Clients have an opportunity to ask questions and receive information prior to signing contracts.
  - Clients receive transaction receipts and regular, clear, accurate account statements.
  - The institution offers financial literacy courses.
  - Other: \_\_\_\_\_
  
3. How does your institution ensure appropriate collections practices are followed?
  - A code of acceptable and unacceptable debt collection practices is in place.
  - Debt collection procedures and time frames are clearly outlined in a staff book of rules.
  - Collections staff receive training in acceptable practices and follow them.
  - Collections guidelines specify certain places and times that are off limits for debt collection.
  - Incentives for collections staff reward appropriate, and sanction inappropriate collections practices.
  - Loan contracts explain what the borrower should expect in case of late repayment or default.
  - Efforts are made to negotiate reasonable repayment plans prior to seizing assets.
  - The institution has a policy on acceptable pledges of collateral including unacceptable collateral that would deprive borrowers of their basic survival capacity.
  - The institution monitors staff and any third party debt collections agents to ensure compliance with acceptable practices.
  - The institution provides debt counseling services.
  - Other: \_\_\_\_\_

4. How does your organization ensure staff ethical codes of conduct are consistently followed?
- A Board-approved code of ethics defines organizational values and ethical standards expected for staff.
  - Staff rules describe acceptable/unacceptable behavior, reprimands and violations that can result in employment termination
  - Hiring procedures assess employees for compatibility with organizational values and ethics.
  - Staff training includes testing on the practicalities of following codes of conduct in general and is also tailored to ethical dilemmas for particular positions.
  - All staff sign annual pledges to follow ethical codes.
  - Anti-corruption policies are in place, provided to each staff member and enforced by decision-makers.
  - Scope of anti-corruption policies includes fraud, bribes, kickbacks, favors, gifts, prohibition on conducting business for private gain, abuse of authority, coercion, conflicts of interest, nepotism, favoritism, unauthorized use of information, and other sensitive topics.
  - Staff performance evaluations review ethical behavior and quality of interaction with clients.
  - Internal audit for risk management detects corruption and code violations
  - Other: \_\_\_\_\_
5. Does your institution have policies and procedures in place for complaint resolution and client problem solving?
- A written policy requires customer complaints are taken seriously, investigated and resolved in an unbiased and timely manner.
  - A system is in place to receive and resolve individual client complaints.
  - Staff is trained to refer complaints to those responsible for handling and resolving them.
  - Specialized personnel are designated to handle customer complaints and problem solving.
  - Customers are informed of their right to complain and know how to submit a complaint.
  - Complaints and their resolution are tracked and used to improve products, sales techniques and customer interactions
  - Internal audit or other monitoring systems check that complaints are resolved satisfactorily
  - Mechanisms in place:
    - Suggestion boxes in each place of business
    - Hotline or call center with toll free access
    - Independent third party resolution, such as ombudsman or mediator
    - Other: \_\_\_\_\_
6. How does the institution safeguard privacy of clients' data?
- A written policy and procedures regarding treatment of client personal data are in place.
  - Staff is trained on the organization's policy and procedures.
  - Internal audit reviews security of locations and electronic systems where client data is stored.
  - The IT system is secure and password protected.
  - Staff explains to clients how their data will be used.
  - Client consent is required prior to sharing data outside the institution.
  - Clients may review and correct their information.
  - Clients are provided assistance to review and correct information.
  - Clients are instructed on how to safeguard access codes and PIN numbers.
  - Other: \_\_\_\_\_

## **Resources**

Power point on CP Principles

Mix Market Survey

Reference to APR Calculators

Websites

- Campaign for Client Protection: [www.campaignforclientprotection.org](http://www.campaignforclientprotection.org)
- CGAP: [www.cgap.org](http://www.cgap.org)
- MIX: [www.themix.org](http://www.themix.org), [www.mixmarket.org](http://www.mixmarket.org)
- Microfinance Transparency: [www.mftransparency.org](http://www.mftransparency.org)
- Financial Education
- Microfinance Gateway Resource Center on Regulation and Supervision:  
<http://www.microfinancegateway.org/p/site/m/template.rc/1.11.48251/1.26.9208/>

Other Information