THE CENTER FOR FINANCIAL INCLUSION at ACCION (CFI) was launched in 2008 to help bring about the conditions to achieve full financial inclusion around the world. Constructing a financial inclusion sector that reaches everyone with quality services will require the combined efforts of many actors. CFI contributes to full inclusion by collaborating with sector participants to tackle challenges beyond the scope of any one actor, using a toolkit that moves from thought leadership to action.

www.centerforfinancialinclusion.org

What Is the Low Bar and What Is the High Bar on Client Protection?
Center for Financial Inclusion Advisory Council

Brian Clancy, Chair  
President  
Boston Public Library Foundation

Philip Brown  
Director of Risk  
Citi Microfinance

Paul Christensen  
Senior Lecturer, Finance  
Northwestern University  
Former President, ShoreCap Management

Alex Counts  
President & CEO  
Grameen Foundation

Anthony Goland  
Senior Partner  
McKinsey & Company

Kurt Koenigsfest  
CEO  
BancoSol

Christina Leijonhufvud  
Social Sector Finance  
JP Morgan

Kate McKee  
Senior Advisor for Policy, Poverty and Aid Effectiveness  
Consultative Group to Assist the Poor

Jonathan Morduch  
Professor of Public Policy and Economics  
New York University

David Porteous  
Founder and Director  
Bankable Frontier Associates

Marguerite Robinson  
Institute Fellow Emeritus, HIID  
Harvard University

David Simms  
Board Chair  
Opportunity International Network

Diana Taylor  
Managing Director  
Wolfensohn & Co.

Donald F. Terry  
Morin Center of Boston University Law School

Paul Tregidgo  
Managing Director  
Credit Suisse

Cover Photograph  
Photographer Credit: John Rae for ACCION International.  
Caption: Aziza Ramadhani, fish vendor and client of ACCION partner Akiba Commercial Bank in Moshi Tanzania.
What Is the Low Bar and What Is the High Bar on Client Protection?

Commissioned Workshop Paper
2011 Global Microcredit Summit
Valladolid, Spain
November 2011

Elisabeth Rhyne
Managing Director
Center for Financial Inclusion at ACCION, USA
Contents
I. Introduction 1
II. The X-Axis: Distinguishing Right from Wrong 4
III. The Y-Axis: Principles into Practice 7
IV. The Z-Axis: Advertising, Reporting, Verification, and Certification 10
V. Concluding Note 14
I. Introduction

Financial services have the power to help people improve their lives, sometimes dramatically so. However, if offered carelessly or used improperly, financial services can also cause harm – exacerbated when the recipients are poor and have little formal education. Recognizing this, the global microfinance community has come together around a set of Client Protection Principles (CPPs) as promoted by and embodied in the Smart Campaign. This paper is an opportunity to explore in depth how these principles can become vibrant and meaningful forces in the microfinance industry and even beyond to all providers of financial services to low-income people.

There is no question that a broad array of high-quality financial products can help individuals and families save for the future, pay for school for their children, build small businesses, and cope with unexpected setbacks such as illness or poor crops. However, the operative word is “quality.” Client protection is focused on several dimensions of product and delivery quality. It addresses transparent, respectful, and prudent treatment of clients. Good client protection practices should be especially beneficial for the more vulnerable populations that microfinance serves, such as women, youth, rural dwellers, and the disabled. Strong practices are particularly important for anyone who is becoming a customer for the first time – clients in newly penetrated areas and young people. Lacking in experience, these new clients must be treated especially carefully by providers. As the young move into the workforce, marry, and have children, their own sense of the possible will be influenced by how they experience their interactions with financial institutions.

In 2008 the microfinance community agreed on a set of CPPs very quickly. This was because of the good work that had been done a few years before by microfinance organizations to adopt client protection codes of their own. But it was also because client protection had climbed to the top of the agenda as a result of the subprime mortgage meltdown in the United States and controversies about interest rates and profits in microfinance following the Compartamos IPO. Added to this were concerns about over-indebtedness resulting from rapid growth of multiple microfinance competitors in some areas. It was also easy to agree on the principles, frankly, because most of us have a general sense of fair play that guides us to a commonsense statement about the right way to treat clients.

And that’s what the principles are – a commonsense statement about what we think is fair for clients. They started out heavily focused on credit, because that’s the main product microfinance institutions (MFIs) provide, and because the burning issues – especially interest rates and over-indebtedness – were credit-related. The Smart Campaign worked to evolve the principles early this year in order to encompass all financial services and to add a very important nondiscrimination clause.

While it was relatively straightforward to agree on the principles, and even to evolve them, it has not been easy to ensure that they are thoroughly implemented in all parts of the microfinance industry, and that is the topic this paper examines. The paper tackles the question, “What is the high bar and what is the low bar on client protection?” The answer to this simple question is surprisingly complex and, by examining it in detail, we will have a chance to consider many of the key questions involved in implementing the CPPs.

Setting a useable bar involves finding ways to apply broad moral intuition – the principles – to the complexities of real life. I will look at this question in three dimensions. Each dimension looks at a different aspect of bar-setting, and each implies a spectrum from very poor performance to excellence, and a need to set a bar somewhere on that spectrum to differentiate acceptable and unacceptable practice.

Imagine a three-dimensional chart, the kind used in high school algebra. We start with the x-axis, usually the most fundamental dimension, and label it client treatment. The x-axis is the heart of client protection. On the
**THE CLIENT PROTECTION PRINCIPLES**

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

**PREVENTION OF OVER-INDEBTEDNESS**
Providers will take adequate care in all phases of their credit process to determine that clients have the capacity to repay without becoming over-indebted. In addition, providers will implement and monitor internal systems that support prevention of over-indebtedness and will foster efforts to improve market level credit risk management (such as credit information sharing).

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

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

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

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

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

negative end of the axis are illegal or even criminal acts, like demanding kickbacks or physically harming clients. On the positive end are actions that go well beyond the client protection minimum and stretch into service quality. Every aspect of every client relationship could be placed somewhere along this line.

The y-axis involves implementation processes, policies, and procedures that providers carry out to make sure they treat clients according to the principles. These range from very simple actions any provider can take, like posting rates on branch office walls, to complex processes that are only relevant for large or formal providers, like a toll-free complaints number and telephone call center. On this axis, the appropriate location for the bar depends on the size and type of provider, and on how well policies are followed. It also depends on the market and regulatory environment. Expectations for providers in countries with credit bureaus differ from those for providers with none. When we discuss this dimension we will look at how the Smart Campaign has developed approaches to address the variation in environment and provider status.

The z-axis is about verification. It denotes how an outside observer, especially one with a burning need for assurance, like an investor, regulator, or especially a client, learns whether or not a provider follows acceptable practices. On one end of this spectrum are unverified claims made by promoters, essentially advertisements, while at the other end one might place direct observation of client experience. The discussion of this dimension will allow us to comment on questions about reporting and certification.

The rest of this paper looks in detail at each of these dimensions, and asks where the bar is for each. Before getting into this detail, however, a brief introduction to the Smart Campaign is in order, given that
one of the purposes of this paper is to shed light on the thinking behind some of the Campaign’s main initiatives, particularly certification.

Launched publicly in October 2009 after a year of intensive preparation, and guided by a 28-person Steering Committee and several task forces, the Campaign has created a sturdy base and increasingly strong momentum. Full implementation of responsible finance required that three legs of a stool work together: regulations, to control bad actors and level the playing field for good ones; education for clients so they can become discerning and responsible customers; and application of norms and standards by providers throughout the industry. The Smart Campaign was created as an industry development effort specifically to help providers to hold up their leg of this stool.

Its premise is that the microfinance industry itself, together with its funders, investors and industry associations, can build the norms, values, practices, and standards that make it a pro-client industry. That makes the Campaign not exactly a self-regulatory movement (because it is not a substitute for regulation), but a movement to build commitment and capacity inside the industry, and then to create structures that reinforce the application of the principles. The Smart Campaign is built around the CPPs and seeks to embed the practices that go with them deep within the institutional culture of the microfinance industry. It works through raising awareness about client protection, developing and disseminating best practices, helping MFIs to implement best practices, and creating processes to certify MFIs as pro-client.

The Campaign has already made significant strides, with more than 2,300 endorsers from 130 countries, including more than 700 MFIs with roughly 40 million clients. Endorsement is a first step toward deeper engagement with the CPPs. Subsequent steps include assessment, training, and, ultimately, as we will discuss here, certification.

With this background let’s turn to the question posed. What is the low bar and what is the high bar in client protection?
II. The X-Axis: Distinguishing Right from Wrong

Let’s look at the treatment clients might receive relative to one specific principle, transparency. The principle is this: Providers will communicate clear, sufficient, and timely information, especially on prices, terms, and conditions, in a manner that clients can understand, so that clients can make informed decisions.

At the low end of transparency is deliberate provision of false or misleading information – lying. In the middle is provision of information in a cursory or incomplete manner, not actually misrepresenting the pricing of a product, but perhaps selectively representing it to make it look more attractive (the way teenagers often report to their parents). A better practice is provision of full and complete information multiple times and in multiple ways. This allows the client to learn what she needs to know at the time she is making a decision, and if she doesn’t understand one form of communication, to hear the information in another way. An even better practice might be provision of training on how to understand and compare interest rates.

I think all of us agree that deliberate falsehood or misrepresentation is unacceptable. But that is a very low bar. Moving along, while selective representation may not be reprehensible, and we are sympathetic to the provider’s need to attract clients, we are not generally comfortable seeing a rosy picture when we know that it glosses over relevant information. So perhaps a bar should be placed there. That, in fact, is what the principle states. It uses qualifying words to place the dividing line between clear, sufficient, and timely information and information that is unclear, partial, and late. What about the even better practice of providing training? While we might agree that such training is valuable to clients and therefore applaud organizations that provide it, it would be hard to argue that providers should be required to give formal training of this type.

With these comments, we have divided that x-axis into four segments, imagining a bar separating one from the next. Let’s call the first category Wrong (and possibly criminal). For the second category there is a rich possibility of epithets: dubious, shady, questionable, irregular, suspect, disreputable, unsavory. Let’s go with Unsavory. The third category could be called upright, satisfactory, right, proper, fitting, suitable, or appropriate. I like Fit and Proper. And the last category we will designate Extra Credit, implying that it is above standard expectations.

With these four categories, we now have three bars to set – one between Wrong and Unsavory, one between Unsavory and Fit and Proper, and one between Fit and Proper and Extra Credit. I argue that the CPPs are designed to delineate the bar between Unsavory and Fit and Proper, but first let’s look briefly at the other two bars.

The bar between Wrong and Unsavory is a very important one for regulators. I first learned this from listening to Gabriel Davel, the driving force behind South Africa’s National Credit Regulator, and one of the world’s experts on client protection regulation. Gabriel describes his main concern as regulator as preventing seriously damaging practices, especially deliberate ones. During his years as a regulator, he had to deal with practices such as lenders that required clients to turn over their bank account debit cards so the lenders could get first access to the client’s salary when loan payments came due. This practice was outlawed. More recently in South Africa, some profiteering lenders have offered home mortgages on terms designed to make it easy for them to acquire the homes of defaulters at bargain prices (like subprime mortgages on steroids). Regulators need to be on the lookout for Ponzi schemes, too. Within the past two or three years, major Ponzi schemes have ripped off tens of thousands of people in the Philippines, Benin, Colombia, the United States (Bernie Madoff), and, thinking back a little farther, Armenia and Uganda. No region of the world is exempt.

This means regulators need to devote a great deal of their energy to hunting down players and activities in the Wrong category. This is where enforcement energy must be directed, and laws and regulations may need to reflect a focus on the Wrong, so that they provide clear levers for enforcement to arrest and punish wrongdoers.
Accordingly, with their focus on defining what is clearly unacceptable, regulators may have relatively less focus on defining and supporting the good practices that are Fit and Proper.

When we shift perspective from regulators to providers (and the investors who support them), it’s all about achieving positive practices: the Fit and Proper category. In short, regulation seeks to prevent bad behavior while industry players seek (or should seek) to follow good behavior. There is a potentially large gray and Unsavory area in between.

Unsavory practices are not in alignment with the underlying social mission of microfinance and are inconsistent for providers and investors that wish to maintain their reputation as organizations that contribute to the public good. More fundamentally, the line between Unsavory and Fit and Proper is implicitly derived from the common moral principle of treating others as you would like to be treated. That is why it has universal validity. It applies to all providers, regardless of social mission.

Even Unsavory players recognize that universal validity and cloak themselves with Fit and Proper rhetoric. Another lesson I learned from South Africa: Some years ago, a group of socially motivated microenterprise lenders adopted a client protection code to differentiate themselves from consumer lenders they considered to be Unsavory. Within a few months, the consumer lenders adopted a nearly identical code. They accepted the validity of the moral standard, and wanted its mantle, even if they did not conform in practice. That’s one reason any industry-based campaign to promote client protection has to be vigorous and thorough if it is not to be dismissed as whitewashing.

Returning to the image of the x-axis, the bar between Unsavory and Fit and Proper is at zero, where negative turns into positive, wrong into right. There are things that are only a little bit bad, but they are still negative, and there are things that are only a little good, but they are still positive. A universal truth, and a universal standard.

Turning now to the higher bar, between Fit and Proper and Extra Credit, the names say it all. All providers are expected to provide Fit and Proper treatment, while Extra Credit is a matter of choice. In fact, it is difficult to conceive of items related to the Extra Credit category that would still be considered part of client protection, because the focus of the CPPs is a simple matter of fair treatment and harm avoidance. The principle on transparency demands transparency. Full stop. Providers need to ensure that clients are given full information in a manner they can understand. Clearer than clear, or extra transparency is a concept difficult to imagine. That is why in the formulation above, we turned to financial education, which prepares clients to use transparent information. Financial education provision is not universally acknowledged as a duty of all providers, but rather is still largely thought of as a voluntary responsibility.

Focusing once more on the main bar, between Unsavory and Fit and Proper, just as with other moral dilemmas, it is usually easy to stay on the positive side, but temptation is there to pull you down. Temptation arises when the provider’s interests conflict with the client’s interests, i.e., when there are incentives for negative behavior – especially if one can preserve a positive image while getting away with it. The existence of these temptations is why client protection is difficult. The core incentives to acquire more clients and to make each customer relationship profitable creates derivative incentives for aggressive sales, over-lending, aggressive collections, hidden charges, and so on. Temptations like these exist at the level of institutional policy and among frontline employees, even when the organization has a strong social mission.

That is why the Smart Campaign has found numerous Unsavory practices in common use throughout the microfinance industry. When substandard treatment has become an industry norm, many people in the industry may believe that the treatment is acceptable or at least unavoidable. Changes in norms come gradually. The Smart Campaign can press for higher standards, but providers must first be convinced that they can and should make the change.

Before leaving the x-axis, let’s see how the four-category, three-bar framework would apply to prevention of over-indebtedness. In the Wrong category would be deliberate predatory lending, like
What Is the Low Bar and What Is the High Bar on Client Protection?

I would also include any lending model that deliberately yields high default with revenues made up by penalty charges or confiscation of collateral – a model prevalent in some consumer lending, and often not prohibited by regulators. Unsavory practices might include a failure to adequately take into account existing indebtedness or lending without adequate checking on income (as in no-doc home mortgages during the subprime bubble). Aggressive sales techniques by loan officers that push clients to borrow when they’d rather not might fall into this category, as would the policies that create incentives for loan officers to behave in this way.

In the Fit and Proper category, lending policies would set clear limits on debt service-to-income ratios, making it difficult for loan officers to lend too much. Lenders would caution clients during the loan application process about over-borrowing. Providers operating in the absence of credit bureaus would agree to share information on clients to avoid lending too much to already indebted borrowers. To illustrate extra credit, we might include the offer of savings services to allow financial management needs to be met in a more balanced way than by credit alone; and we again note that financial education could help clients understand how much debt they can sustain.
III. The Y-Axis: Principles into Practice

Financial service providers are not monoliths. They are collections of people operating through hierarchies, teams, policies, and procedures. The actual treatment clients receive from their providers happens on the front lines, and that’s where the final result of client protection codes, policies, and training shows up. Loan officers, tellers, sales representatives, call center operators, and banking agents are the people who determine whether or not a client will receive fair treatment.

In our framework, the y-axis is about how well a provider translates principles into actual client interactions. Even if they adopt the highest principles and even if they are seriously committed to them, institutions cannot transmit their principles into action 100 percent effectively. A “score” or position on the y-axis would evaluate whether the institution has taken the appropriate steps to put the principles into action and how well those steps are working. We can call this “adequate standards of care.” Determining what constitutes adequate is less straightforward than it seems or than we might wish.

Specific standards of care are only now being developed in the microfinance industry. The Smart Campaign has developed an Assessment Guide and a guidance document that embodies the learning and consensus building to date. These standards are still evolving. For example, the standards around credit are much more fully developed than are the standards around other financial products, and the task of applying the principles to various forms of agent banking is still in its early days. In detailing standards, the Smart Campaign looks to see that each of the CPPs is integrated into each of the following aspects of a financial institution’s operations: written policies and procedures, staff training, communications and marketing materials, and monitoring systems, among others.

Let’s illustrate the standards with respect to the client protection principle of data privacy. The key aim of the principle is to ensure that sensitive client data is available only to those who need to see it and that information is shared with others only with permission from the client. The outcome is clear: either the data is protected or it gets into the wrong hands. In order to assess whether an institution takes adequate measures to prevent misuse, a Smart Campaign assessor will look for the following: evidence that the institution has and uses a privacy policy governing how client data can be used; the adequacy of access protections embedded in IT systems; use of client permissions when data, photos, and names are to be shared in any way; and evidence that the institution clearly communicates with clients about their data privacy rights. These practices do not guarantee the desired outcome, but they make it much more likely, and they constitute the adequate standards of care an institution should be expected to take. It should also be evident that even though the standards are as specific as possible, determining whether an institution meets them may require subjective judgment on the part of an external assessor. We will come to that when we take up the z-axis.

Even when standards are clear and ready to apply, their application in a real-life case must be tempered by other considerations, including the size, maturity, and regulatory status of the institution; current industry practice; and the local policy and market environment.

It is harder to draw a clean line to distinguish adequate from inadequate standards of care, and the line may be more subjective than that between Unsavory and Fit and Proper. For example, it is easy to agree that asking clients for a bribe is Unsavory or flat-out Wrong, but it is much more complicated to agree on whether a financial institution has good enough systems to prevent and detect such behavior.

---

In developing its Assessment Guide, the Smart Campaign has created scoring around each dimension of implementation. For example, a key aspect of transparency involves providing full information to customers before they commit to buy a product or take a loan. An adequate standard requires that this information be made available, while a higher standard would be that the customer is offered a “cooling-off period” – a day or two to think before signing.

The Smart Campaign focuses on defining adequate rather than excellent care. Many organizations want to get an “A” from assessors, and therefore grumble when graded “adequate.” However, in the experience of the Smart Campaign, we have found that it takes commitment, planning, and good execution to take adequate care, and institutions that do so should be recognized. I personally believe that if standards are to be raised across the industry, they must rest on a firm definition of what constitutes adequate, acceptable care, applicable to all providers.

There is a myth that surfaces from time to time in discussions about client protection that client protection is a burden for providers, and that compliance is costly. The reason I believe this is myth rather than reality is that client protection is generally not about extraordinary operations. Rather, it is about doing ordinary operations well. This is what is meant by the aim sometimes expressed by the Smart Campaign: to make client protection part of the DNA of microfinance. Policies, systems, training, and operations should be designed to incorporate the CPPs. If that is done, the “extra” costs of client protection will be small. Large extra costs might arise, if by applying the principles the institution reduces prices, offers smaller loans, or loses customers to organizations that oversell, overextend, or mislead clients. That is a more basic x-axis issue, not a y-axis one.

In taking adequate care, small and large providers can generally apply the same standards. However, the complexity of the systems they use to apply the standards will differ, and regulated financial institutions may face different legal requirements. Consider complaints resolution. Complaints resolution for a small institution may involve simply a way for clients to seek resolution first from some branch staff member other than their own account representative, and then to appeal to a higher-level staff member if problems remain unresolved. No dedicated staff member is needed, although to score well on this principle even a small institution would need to make the complaints pathway well understood to clients and staff, and would need to record and review the complaints received. Large institutions will develop more elaborate systems, such as customer care representatives, complaints hotlines, or call centers. We have seen many initiatives in this area by MFIs since the Smart Campaign began. Regulated institutions may face more specific requirements. For example, in Peru, providers are required to have on-site client protection officers in their branches who report directly to the banking superintendency’s client ombudsman.

This example raises the issue of local regulatory and market environment. The global CPPs, which form an industry-based voluntary code of conduct, are not intended to supersede the legal and regulatory requirements applicable to a given institution. This has not been a major issue for the Smart Campaign to date, as most client protection laws and regulations are aimed at the same goals as the CPPs. While instances of specific differences in standards do arise, most have been minor, except in a few countries where regulators see client protection regulation as a way to “clamp down” on microfinance. This is unfortunate, often politically motivated, and can lead to an adversarial relationship, rather than a relationship based on recognized alignment of interests among providers and regulators to create an orderly marketplace that benefits clients.

The more frequent challenge in many countries is likely to be absence of regulations or lack of enforcement. Similarly, the market context may not support the application of the principles. An important example of this would be the absence of credit bureaus as a means of checking on client indebtedness. It would be unrealistic to insist upon checking with a credit bureau as a requirement for prevention of over-indebtedness and therefore to give a low score to every provider in countries lacking credit bureaus. Instead, assessors will look for compensating measures an institution is taking to determine the debt levels of loan applicants.
The Smart Campaign has noted some problem areas where practices that are less than ideal are in widespread use in the microfinance industry.

- **Loan officer incentive policies that reward both growth and portfolio quality.** The conventional wisdom has been that as long as growth incentives were tempered with portfolio quality incentives, over-indebtedness would be avoided. However, now emerging from South Asia is the concern that while such incentives may reduce over-indebtedness, aggressive collections practices may be an important byproduct. And it is even possible that these practices fail to prevent over-indebtedness. Stuart Rutherford noted recently, in CGAP’s blog series on over-indebtedness, that the heavy emphasis on 100 percent on-time repayment in Bangladesh pushes some clients to borrow from a second lender to pay off the first, thus beginning a debt bicycling chain. One solution may be to rethink loan officer incentives altogether, as ProCredit did when it decided to eliminate them.

- **The use of paid commission agents, such as borrower group leaders, to form new groups or bring in new customers.** While it can be acceptable and properly managed, the use of such agents to achieve rapid scale is often associated with subsequent collapse or overlending.

- **Overcharging for credit life insurance.** High charges for credit life insurance are used by a number of MFIs to make up for low loan interest revenues. This enables lenders to report low interest rates to clients and regulators, while making up the revenues through highly profitable credit life charges, classified as insurance rather than credit. In a few cases, nearly all the profits of the institution are derived from credit life charges. This occurs most often when institutions are under political or regulatory pressure to keep interest rates low.

- **“Flat” interest rates.** While quoting rates in flat rather than declining balance terms began innocently enough as a way to simplify both calculation and communication about interest rates, it is increasingly clear that it is a suboptimal practice. The industry should be working to move to other practices as soon as possible.

These practices are found among MFIs with a wide range of social missions. Because most of them have traditionally been seen as standard industry practice, they are not easy to change and require the industry to revise its norms and standards over time. This may be of particular importance in the area of preventing over-indebtedness. The Smart Campaign has found that most MFIs that provide individual loans take adequate care in assessing their clients’ capacity to repay. However, as multiple borrowing becomes more frequent, and as we learn more about the client experience of over-indebtedness, it may become necessary to raise the standard of care.3

In the meantime, the question is how to “grade” practices such as these that fall below the bar but are widespread. The Smart Campaign has taken the position that it cannot get too far ahead of the industry on any given issue. The aim of the Campaign is not to designate large swathes of the industry as Unsavory, but to incentivize improved performance. The Campaign will press toward upgraded standards at a deliberate and reasonable pace.

3. For a discussion of how clients experience over-indebtedness, see Jessica Schicks, “Over-Indebtedness of Microborrowers in Ghana.” Smart Campaign, Center for Financial Inclusion, November 2011.
IV. The Z-Axis: Advertising, Reporting, Verification, and Certification

It should be clear by now that the standards of practice for implementing the CPPs can be complex. But what about actual outcomes? How do we know if clients are actually being protected? Equally important, how can clients know whether they are selecting a provider with a good track record in client protection? How can investors and regulators know? And how can providers themselves know?

If you believed everything providers tell clients about how client-friendly they are, you’d think they all apply the CPPs all the time. When we first began to develop the Smart Campaign, we often heard MFIs say “We don’t need to work on client protection because we’re already doing a good job.” The self-interest of such a statement is obvious, and that’s why it is not convincing. It gets close to zero on the z-axis. (Below zero would be patently incorrect information.)

In fact, many MFIs are convinced that they do a good job of protecting clients. We saw this recently by comparing opinions about the need for improved client protection coming out of the Center for Financial Inclusion’s recent survey, “Opportunities and Obstacles to Financial Inclusion.”4 Respondents from investor and support organizations ranked inadequate client protection as the 7th and 5th most important obstacle to financial inclusion, respectively. MFIs and other financial service providers ranked it 29th. This dramatic difference shows that while investors and support organizations worry that providers may not be protecting clients well enough, providers are generally satisfied with their own performance. Investors and other support organizations are no longer content with simple assertions from providers.

The Smart Campaign invited providers to endorse the CPPs, and about 500 MFIs, including the majority of the largest, have done so. Endorsement does constitute one step forward. It signals a commitment to good practices, and it invites observers to ask providers whether their practices are aligned with the principles they have endorsed. However, as an important disclaimer on www.smartcampaign.org notes, when a provider endorses the Campaign, that does not mean the reverse is true. Endorsing the Campaign is still an unverified claim.

The next step forward is self-reporting. The Smart Campaign worked with the MIX and the Social Performance Task Force to include questions about each of the CPPs in the Social Performance Report the MIX began piloting in 2009. Several hundred institutions have provided this information. While this again signals commitment, and the willingness of so many institutions to provide this reporting is cause for confidence about the industry’s intentions, the information is still unlikely to sway a skeptic. The MIX report only includes a few questions about client protection. Moreover, the nature of questions limits how informative the responses can be. Many providers simply tick the “yes” box for each item (and appropriately so for questions that are not very discriminating). The fact that these questions yield little useful information is not for lack of thought on the part of the designers. It is that good client protection performance cannot be boiled down into handful of questions.

The next step for an MFI might be a self-assessment, such as the Getting Started Questionnaire, a 40-question assessment designed to get providers talking inside their organizations about their strengths and weaknesses.5 The Smart Campaign has collected more than 125 such questionnaires. In the recently published report, “Implementing Client Protection in Microfinance: The State of the Practice, 2011,” the Campaign compared self-reported Getting Started scores with scores given by external raters and found that self-scoring was con-

5. See: http://www.smartcampaign.org/tools-a-resources/2/41
sistently highly positive and well above third-party scoring.

We must conclude that when it comes to client protection practices, there is no substitute for third-party verification. Only an external, impartial observer can offer a bias-free (or mostly bias-free) opinion, and only after a reasonably thorough investigation. That is why the Smart Campaign, in cooperation with the specialized microfinance rating agencies and other players, is spending 2011 developing a certification system for client protection.

In January 2011, the Smart Campaign Steering Committee agreed to launch a certification program by the end of the year. At that time, it agreed to proceed on the following basis. The certification should be external—it cannot only rely on self-reporting; should mean the same thing across the world; and should require regular re-certification. The Certification Task Force, created in July 2010, aims to define a certification process that will differentiate MFIs that have responsible practices from those that do not. In addition to increased transparency, the certification process will provide necessary standards for MFIs to improve their practices. Methodologies already exist to assess client protection practices (Smart Assessments and client protection evaluations conducted by social raters and social auditors). The certification process builds on the existing methodologies.

Certification aims to recognize real achievement in client protection and provide an incentive for MFIs to improve their practices. Meeting standards of fair treatment at a level that merits certification requires significant commitment and attention. The fact that an MFI has responsible practices should not be taken for granted, but rather celebrated as a true achievement.

In order to be credible, an effective certification process requires the following elements:

- Consensus about core principles
- Clearly defined standards of practice
- Agreed-upon methodology for assessing standards, including scoring systems
- Trained entities to carry out the certification who are recognized by stakeholders as legitimate certifiers
- Recognized communication about the certification, e.g., a brand and a means of dissemination of results, so that decisions can be based on the results
- A means of financing the certification that does not bias the results.

It takes a great deal of work to assemble all these elements, as the Smart Campaign has been doing throughout 2011. The good news is that the industry has principles (the x-axis, pretty firm) and practice standards (the y-axis, usable though still evolving) to provide a basis for certification. The Certification Task Force has been deeply engaged in the remaining questions. Fortunately, it is not building from nothing. From the beginning, it had a strong head start on the assessment methodology and on trained certifiers.

The assessment methodology has come from two sources: first, the Beyond Codes project. Beyond Codes was an action research precursor to the Smart Campaign that carried out test assessments on 14 MFIs in 5 countries, using that experience to distill an assessment methodology based around the CPPs. That methodology resulted in the Assessment Guide, the Getting Started Questionnaire, and the MIX Social Performance Report section on client protection. At the same time, the four specialized microfinance rating agencies, Planet Rating, M-CRIL, Microfinanza, and MicroRate, were each deepening their own expertise in assessing the application of the CPPs. In addition, CGAP had developed an investor toolkit with recommendations on incorporating client protection into investor due diligence assessments. The Smart Campaign brought the key experts from all these experiences together in a series of workshops to hammer out a single methodology that could be the basis for industry-wide certification.

Beyond Codes and the specialized rating agencies are also the starting point for a cadre of trained certifiers. The Smart Campaign has developed an assessor training program from Beyond Codes materials and has trained about a dozen people to conduct assessments. The rating agencies also have experienced raters on their staffs.

The Smart Campaign’s Certification program is proceeding under two key working premises:
• **License to certify.** The Campaign will license organizations (not individuals) as certifiers to provide a Smart Campaign certification to MFIs (if the MFI passes, of course). The first organizations licensed are expected to be the specialized rating agencies; however, others (such as specialized consulting firms) may be licensed in the future.

• **Modular approach.** The certification methodology on client protection will be modular, which means that it could be used in conjunction with various assessment products, such as a financial rating with a client protection module, a social rating (client protection is already addressed in these; the Smart module would be applied going forward), or a stand-alone client protection assessment.

As the process of stakeholder consultation on certification moves forward, important questions and challenges arise. One of these is: what are the differences among certification, verification, and assessment? Some observers have argued that verification by investors as part of due diligence might be a better approach than actual certification. This challenge speaks to the potential demand for certification. Verification by an investor’s due diligence team is a private assessment that would be used only by the investor and by the MFI only insofar as it seeks investment from the given investor. In contrast, certification would be public and could satisfy many audiences at once, including investors, regulators, associations, and even (drum roll) clients. We expect that as certification becomes more established, an increasing number of MFIs will seek to be certified. To date, assessments have been learning tools for the Campaign and MFI management, not reported publicly. Once certification is available, assessments will play a role in preparing MFIs for certification.

Another question is how to bring the cost of conducting a certification to a feasible level so that many providers can receive certification, while at the same time creating a viable business model for the certifiers. The first assessments were expensive by microfinance industry standards, involving two-person teams working on-site for a week and then preparing thorough reports thereafter. An effective certification process will need to be more streamlined, especially if it is to be done in conjunction with financial and social ratings.

In order to streamline, the Certification Task Force at first considered the possibility of three levels of certification: 1) a paper/electronic review that would address policies, training materials, and written procedures; 2) an on-site review to see how well policies are applied in the field; and 3) a client survey to see whether the treatment clients actually receive lives up to the principles. Policies and procedures are an important first step, and an assessment of these would be inexpensive as it would not involve travel or extensive interviews. However, paper verification alone is not seen as satisfactory because it is so easy to put codes of conduct in place but not to uphold them. The certification process is proceeding with the assumption that a paper review – verification of intent – is the opening step. But formal certification would require on-site visits, because, as noted above, client protection happens on the front lines, and it is common to find wonderful paper policies that are unrecognized and unimplemented by front line staff.

The greater challenge is how to find ways to check with clients to verify client outcomes. The Smart Campaign Steering Committee strongly believes that clients’ experience must be an essential test of client protection. The Campaign is searching for creative ways to obtain a reading from clients, such as focus groups, review of complaints information, and small-sample surveys, ways that do not make certification prohibitively expensive.

One item on the list of necessary conditions above is a means of financing that does not bias results. The proposal is for the “licensed certifiers” (meaning at first the specialized rating agencies), to offer certification as a part of their product line, charging prices that cover their costs. It is expected that MFIs will pay to be certified in some cases and that in other cases investors will pay to have their investees certified.

In the wake of the mainstream rating agencies’ lack of warnings before the financial sector crisis of 2008, the system in which the rated pay to be rated has come under criticism. It is quite difficult to conceive of a fully unbiased system of payment, how-
ever. Moreover, the Campaign sought to build upon a system that already has high credibility within the industry with the potential to become at least partly self-sustaining in a relatively short time and that could cover a significant number of institutions within the first years in order to create a critical mass of certified MFIs. The specialized microfinance rating agencies fulfill these conditions and have worked on the task force with good will to apply their expertise to the challenge of defining a certification methodology. It might be noted that the “State of the Practice” report has found the rating agencies to be tougher graders than either the Smart Campaign assessors or the investor due diligence teams.

Smart Campaign certification is expected to come on-stream in early 2012, which will be a pilot year. This will be a major milestone for the microfinance industry. Over time, certification will become a solid basis for incentivizing and building sound client protection practices throughout the microfinance industry. We know that it will be used immediately by investors, and we hope regulators will also find it valuable. Ultimately, certification could lead to branding that clients recognize and look for, though this goal is still some years off. We would like to reach the point at which clients have the opportunity to choose institutions that they can be sure will treat them well.
V. Concluding Note

We started working on what is now the Smart Campaign two years ago. When I look back, I see that we have made enormous progress. At first we heard a lot of statements like, “We aren’t convinced of the business case for client protection.” No one says that today. But there is still a long way to go before client protections are robust enough to prevent future problems in avoiding over-indebtedness or increasing pricing transparency.

If the Smart Campaign’s targets for endorsements and ultimately for certifications are reached, the face of the microfinance industry will change in profound ways. The organizations that explicitly implement the Campaign protocols will influence others that have not participated. As norms and practices for protecting clients are created throughout the industry, it will become harder for players paying only lip service to the CPPs to operate in the industry. We also hope (and we intend to pursue this hope actively) that the CPPs and the structures that uphold them will be relevant for all providers of financial services to the poor.

On a personal note, as the daughter of two sociologists, I believe that social change comes from building shared norms and values, and getting responsible finance embedded in the DNA of the industry really involves social change. I’d like to see the day when everyone working in microfinance considers responsibility to clients an integral part of their identity as microfinance professionals, and what’s more, that each person has the know-how and capacity to apply the CPPs in their daily work.
Center for Financial Inclusion Advisory Council

Brian Clancy, Chair
President
Boston Public Library Foundation

Philip Brown
Director of Risk
Citi Microfinance

Paul Christensen
Senior Lecturer, Finance
Northwestern University
Former President, ShoreCap Management

Alex Counts
President & CEO
Grameen Foundation

Anthony Goland
Senior Partner
McKinsey & Company

Kurt Koenigsfest
CEO
BancoSol

Christina Leijonhufvud
Social Sector Finance
JP Morgan

Kate McKee
Senior Advisor for Policy, Poverty and Aid Effectiveness
Consultative Group to Assist the Poor

Jonathan Morduch
Professor of Public Policy and Economics
New York University

David Porteous
Founder and Director
Bankable Frontier Associates

Marguerite Robinson
Institute Fellow Emeritus, HiID
Harvard University

David Simms
Board Chair
Opportunity International Network

Diana Taylor
Managing Director
Wolfensohn & Co.

Donald F. Terry
Morin Center of Boston University Law School

Paul Tregidgo
Managing Director
Credit Suisse
THE CENTER FOR FINANCIAL INCLUSION at ACCION (CFI) was launched in 2008 to help bring about the conditions to achieve full financial inclusion around the world. Constructing a financial inclusion sector that reaches everyone with quality services will require the combined efforts of many actors. CFI contributes to full inclusion by collaborating with sector participants to tackle challenges beyond the scope of any one actor, using a toolkit that moves from thought leadership to action.

www.centerforfinancialinclusion.org

What Is the Low Bar and What Is the High Bar on Client Protection?