Pakistan Microfinance Network

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MicroNOTE

BRINGING CLIENT TO THE CENTRE:

A consolidated report on client protection practices in Pakistan's microfinance sector

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BACKGROUND AND INTRODUCTION

This collated "State of Practice in Client Protection" report documents and consolidates findings from seventeen Client Protection assessments of Pakistan Microfinance Network's member organizations. These assessments were conducted over a period of three years (2013-2015) under the Client Protection Initiative (CPI).

The Client Protection Initiative (CPI) was a 3-year project funded under State Bank of Pakistan (SBP) Financial Inclusion Program (FIP), which kicked off in January 2013 and ended in March 2015. The project consisted of two components:

Pricing Transparency: promoting responsible and transparency pricing practices among microfinance practitioners (MFPs) in Pakistan. This component was carried out through partnership with Microfinance Transparency (MFT).

Client Protection Monitoring: conducting client protection monitoring through third-party assessments of PMN member MFPs to ensure that these MFPs are complying with global bench-marks for client protection, offering practitioners a client-focused lens with which to view their institutions and to adequately fill any gaps highlighted. This component was carried out through partnership with the Smart Campaign (SC). Overall, nineteen institutional assessments were completed till May, 2015, providing us with a unique opportunity to gauge the compliance levels vis-à-vis client protection principles in Pakistan. Please refer to **Annex 1** for a list of institutions assessed and timelines for assessments completed to date.

For participating MFPs, the assessments provided an opportunity to evaluate their practices in comparison with globally accepted standards of client protection, and seek recommendations for institutional improvements to better comply with the standards. After undergoing an assessment and acting on its results, Kashf Foundation (KF) became the first microfinance institution in Pakistan to achieve Smart Certification. For details of the Kashf's journey to certification please refer to **Box 1.**

Box 1: Kashf Foundation becomes first MFP in Pakistan to get Smart Certified

A third-party Smart Assessment of Kashf Foundation was conducted in 2013 with Kashf's policies and procedures passed with flying colors – a testament to the organization's focus on client centricity and responsible practices. Client protection has always been a conscious decision made by Kashf and institutionalizing it has been a process of exchange and learning from the clients. An international recognition of these standards will help stakeholders, including clients; understand the level of commitment to Kashf's clients and its priority of aligning products, services, and procedures to clients' needs.

What is unique to Kashf is that for all clients, it undertakes a detailed cash-flow analysis of the household's business flows and guides clients on better financial management through tailored trainings to improve savings, budgeting, and debt management. Moreover, Kashf Foundation gathers client feedback through multiple mechanisms including quarterly meetings of the Women Entrepreneurs Council (WEC) (comprised of regionally representative clients and Kashf management), annual client satisfaction surveys, and regularly-held staff discussions. Even before this certification, Kashf Foundation was using an in-house Social Performance Dashboard to monitor and improve institutional compliance to the universal standards for social performance management (USSPM). The Dashboard provided all internal stakeholders with a quick check point for targets and achievements on indicators relevant to our social objectives.

Kashf's core mission and commitment to empower low-income households, especially women, has been the biggest driver of good client protection practices. Ownership, especially at management levels, of consumer protection and transparency sets a good example for the entire institution to follow. The microfinance sector in Pakistan is diverse, including various types of providers like microfinance banks, microfinance institutions, and NGOs, providing micro-credit along with other services. Interventions such as Smart Assessments and Certification play an important role in mainstreaming client protection across the market. Hence, the industry needs more institutions participating in these programs to create positive market pressures on all to treat clients well.

Source: Smart Certification: Kashf Foundation Takes the Lead in Pakistan - http://cfi-blog.org/2015/03/26/smart-certification-kashf-foundation-takes-the-lead-in-pakistan/

This report summarizes the prevalent state of client protection practices in Pakistan and the analysis is organized by each of the seven CPPs, based on a compilation of results by indicator for the 17 Smart Assessments that form part of our data set.

An overview of the methodology of this review is given in section 2; followed by the summary findings on the state of practice in client protection in section 3; section 4 presents detailed analysis by client protection principles. Section 5 offers recommendations, primarily for MFPs, to improve client protection in the sector.

METHODOLOGY

The client protection assessments were carried out along the Smart Campaign's Smart Assessment methodology[1]. The Smart Campaign, established in 2009, is housed within the Centre for Financial Inclusion at Accion International. It has worked on developing a universal set of minimum client protection standards known as the Client Protection Principles (CPPs) for the global microfinance industry. The Client Protection Principles are the minimum standards that clients should expect to receive when doing business with a microfinance institution. These principles include: (i) appropriate product design and delivery, (ii) prevention of over-indebtedness, (iii) transparency, (iv) responsible pricing, (v) fair and respectful treatment of clients, (vi) privacy of client data, and (vii) mechanisms for complaint resolution. **Figure 1** gives additional information on the CPPs.

These principles are a result of the path-breaking work by providers, international networks, and national microfinance associations to develop pro-client codes of conduct and practices[2]. Smart Assessments are designed to assess institutions around these seven principles.

Figure 1: The Smart Campaign's Client Protection Principles (CPPs) and definitions

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 overindebtedness 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.

Source: http://www.smartcampaign.org/about/smart-microfinance-and-the-client-protection-principles

[1] Source: www.smartcampaign.org/about/campaign-mission-a-goalsRetrieved on December 13, 2015.

[2] Source: http://www.smartcampaign.org/about/smart-microfinance-and-the-client-protection-principles , Retrieved on December 30, 2015

MFPs are assessed on these broad CPPs via a set of uniform indicators for each of these principles. Each indicator is scored according to the following criteria:

Score	0	1	2
Meaning	Does not meet the indicator	Partially meets the indictor	Meets the indicator

Each indicator within a CPP is equally weighted for an average score per CPP. In turn, each of the seven CPPs also has an equal weightage. The results for each CPPs provide an overall picture of how well (or not) the institution is doing on minimum standards in each of the seven areas. These indicators are designed so as to incorporate micro-finance operations beyond credit to include savings and insurance services as well. However, the main focus at present remains on the credit products.

This report documents the findings of the 17 Smart Assessments conducted for MFPs in Pakistan between 2013 and 2015, of which five were microfinance banks, four rural support programs and eight microfinance institutions[1]. In terms of the number of clients, these17 MFPs constitute approximately 67 percent of the market and in terms of gross loan portfolio approximately 70 percent. Therefore, it will not be wrong to assume that these results are largely representative of current sector practices of large to mid-sized MFPs. However, these results are not representative of smaller MFPs in the sector as most of the institutions which were reviewed did not fall in this category. Nevertheless, as the standardized assessment methodology enables a reliable comparison of results across institutions, and the institutions assessed cover the majority of the clients in the sector, the findings can be said to impact at least 67 percent of microfinance clients in Pakistan. The data set excludes two earlier assessments conducted at the beginning of the project period, prior to the Smart Campaign's revision of the client protection principles from six to seven principles.

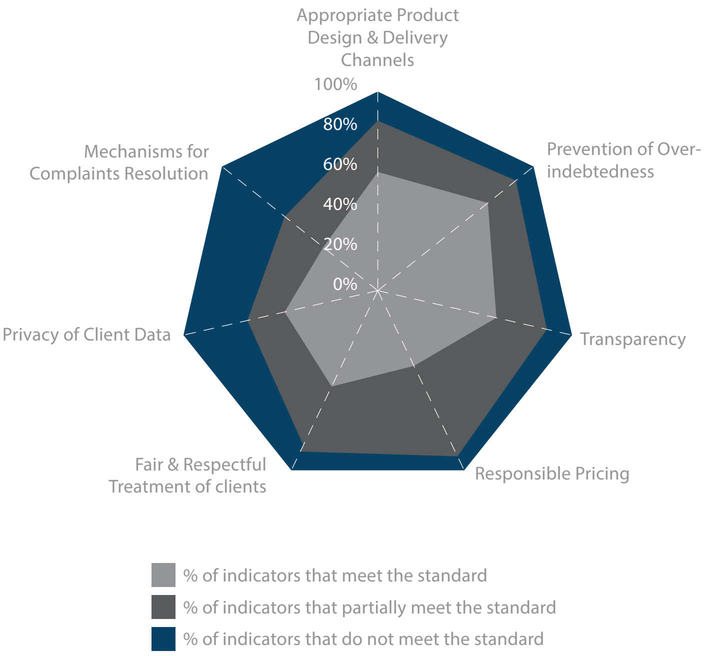
CONSOLIDATED INDUSTRY RESULTS ON CLIENT PROTECTION

This in-depth look at the state of the sector in client protection offers further evidence of the client centric nature of microfinance in Pakistan, while at the same time highlighting the need for greater level of compliance for some of the principles (especially among MFIs). Overall, a positive trend of client-centric processes was witnessed across the assessed MFPs, however, further work needs to be done in each CPP, and in some more than others, to bring the compliance levels at par with the global standards of client protection.

The overall compliance levels on client protection indicators for the sector are given in **Figure 2**; the light grey core denotes the percentage of indicators within each CPP that were fully met; areas in dark grey show the percentage of indicators that were partially met, and areas in blue represent the percentage of minimum standards of practice that were relatively not strong or absent.

[1] These include: Khushhali Bank Limited, The First MicroFinance Bank, FINCA Microfinance Bank, Pak Oman Microfinance Bank, NRSP Microfinance Bank, Kashf Foundation, BRAC Pakistan, National Rural Support Program, Thardeep Rural Development Program and Punjab Rural Support Program, Development Action for Mobilization and Emancipation, Rural Community Development Society,Sindh Rural Support Organization, SAFCO Support Foundation, Jinnah Welfare Society, Farmers Friend Organization, Sungi Development Foundation.

Figure 2: Overall compliance to the CPPs by the Pakistan microfinance sector

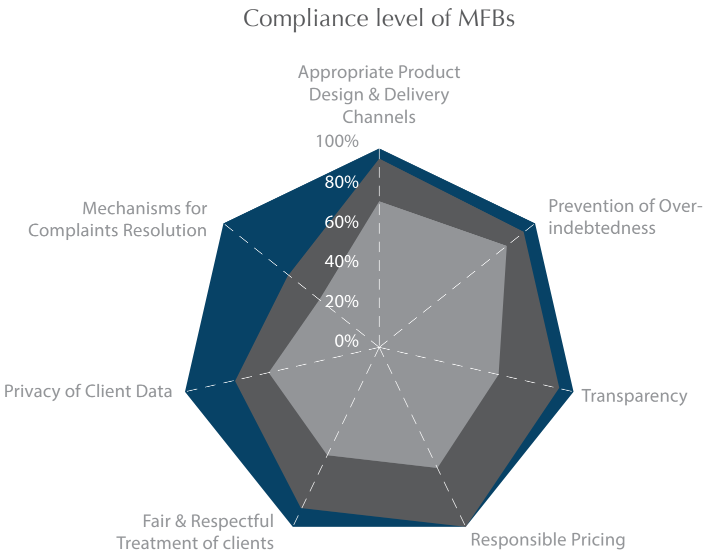


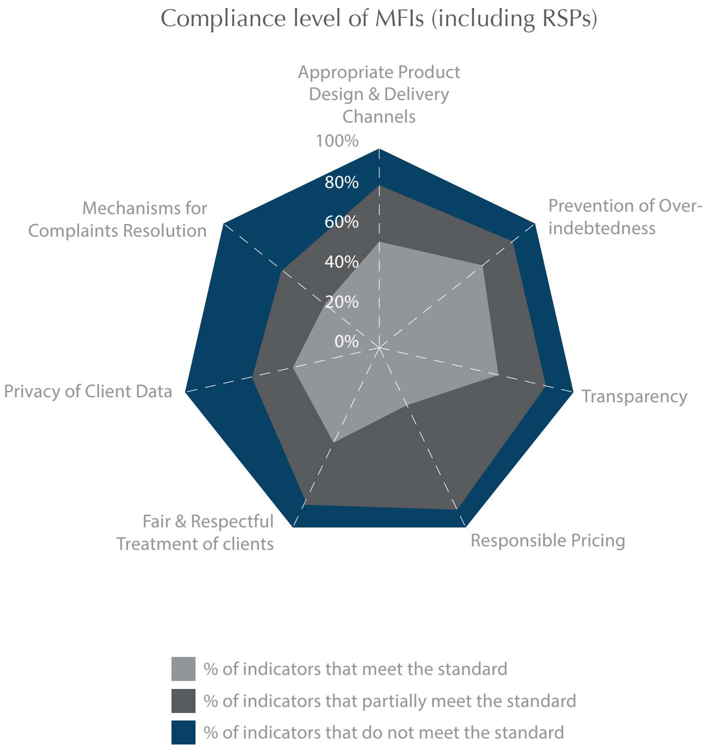
Consolidated findings of this report reemphasize the findings of the initial state of practice report that large-scale MFPs are going strong on the CPPs of (i) *appropriate product design and delivery,* (ii) *prevention of over-indebtedness,* (iii) *transparency*. However, partial compliance on indicators for these principles highlights the need for the majority of peer groups (particularly non-regulated MFIs) to improve practices. Although the wider data set has shown somewhat better results for fair and respectful treatment of clients, there is still significant scope for improvement in practices pertaining to pricing transparency. Lastly, the results relating to the principles of *privacy of client data* and *mechanisms for complaints resolution* reflect a distinct weakness in meeting minimum standards of practice.

Figure 3 presents the consolidated results by peer groups of five microfinance banks (MFBs), eight microfinance institutions (MFIs) and four RSPs that were part of the dataset, respectively. Given the differences in regulatory and legal frameworks they operate under, analysis at the peer group level helps to bring out common strengths and weaknesses, if any, in client protection practice by type of institution[3].

[3] MFBs in Pakistan are set up under the Microfinance Banks Ordinance 2001, and are regulated and supervised by the central bank, the State Bank of Pakistan (SBP), under the Prudential Regulations for Microfinance Banks. MFIs are non-bank, specialized microfinance service providers, the majority of whom are registered under the Companies Ordinance 1984 by the Securities and Exchange Commission of Pakistan (SECP). SECP issued a set of regulations for Non-bank Financial Companies in December, 2015. Operationalization of these regulations is under way.

Figure 3: Summary compliance level of MFBs and MFIs to the CPPs

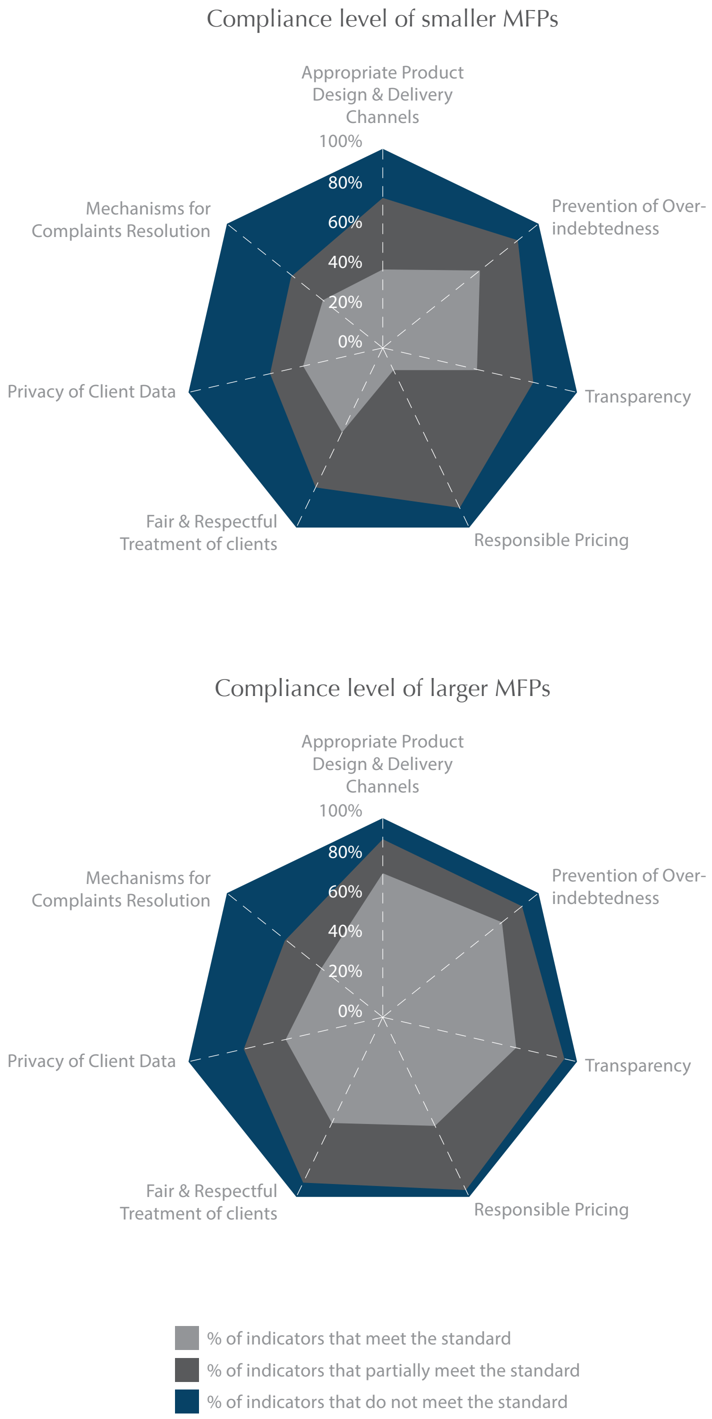




A comparison of two charts yields that MFBs in the dataset are somewhat better at implementing the other six CPPs than MFIs, with the exception of mechanisms for complaints resolution. The difference is most pronounced on the principle of responsible pricing where non-regulated MFIs and RSPs seem to be lagging, as their compliance remains conspicuously partial. MFBs continue to dominate this principle based on their ability to mobilize deposits and achieve scale at a lower cost of operations. Despite the differences between the two peer groups, it is interesting to note that MFIs/RSPs in the dataset performed equally well on the principle of transparency as MFBs, despite not being bound by regulations around disclosure. During the course of the CPI project, both regulated MFBs and non-regulated MFIs and RSPs were involved a voluntary pricing transparency initative in which all product pricing details were disclosed (in 2014 and updated pricing data in 2015). This initaitive has further promoted responsible pricing in the industry. The principle which stood out for weak or absence of practices across both peer groups is the mechanism for complaints resolution and privacy of client data. However, interestingly, MFIs performed better at the principle on mechanisms for complaint resolutions than the MFBs which can be attributed towards their orientation towards social goals more than the other peer group.

Figure 4 adds an additional layer of analysis by segregating the MFP performance along the lines of their size (deduced by their asset base). This helps us understand that compliance levels for client protection prinicples, among other factors, is also positvely correlated to size of the organization i.e large-scale organizations are better at CPP implementations than the smaller ones. It also highlights that the issue of non-compliance among the smaller MFPs can be tackled by providing proper incentives and capacity building support as needed.

Figure 4: Compliance level of MFPs as per their sizes



RESULTS BY PRINCIPLE

This section analyzes and presents the state of practice in client protection, segregating each of the CPPs in detail, to highlight areas of strength and gaps in MFPs' practices.

Areas of strength

The MFPs in our dataset demonstrate relatively robust practices for the principles of appropriate product design and delivery channels, prevention of over-indebtedness and transparency (figure 5). While in the first assessment report, included MFPs performed well on the pricing transparency as well, expansion of the dataset to include more medium sized MFIs led to its relegation to areas of improvement.

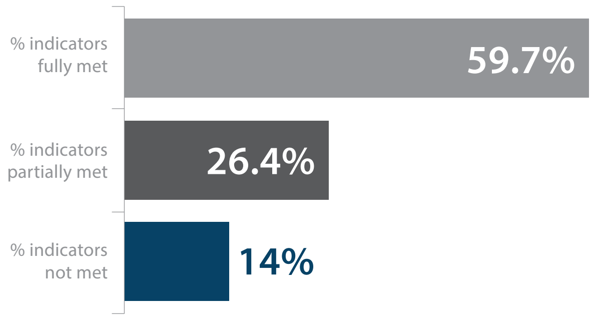
Appropriate Product Design and Delivery Channels

The *appropriate product design and delivery channels* principle dictates that providers should take necessary steps to ensure that their products and delivery channels are designed according to the clients' needs.

The assessed MFPs performed relatively well for this principle as they fully met 59.7 percent of the indicators. Compared to the first state of practice report, in which 70 percent of indicators were fully met under this principle, there is a clear need for improvement among the MFIs to achieve full compliance.

It was observed that though most of the assessed MFPs have some kind of a formal product development process; the need of institutionalized processes for client feedback collection in the product design is there. Additionally, many MFPs are now showing interest in adopting diversified products and PMN is planning to take this discussion forward. Some of the key areas where impetus for product development has been noted are: agricultural value chains, low cost private schools, Shariah-compliant products and micro-clinics.

Figure 5: MFPs' overall compliance level for Appropriate Product Design and Delivery Channels



Prevention of Over-indebtedness

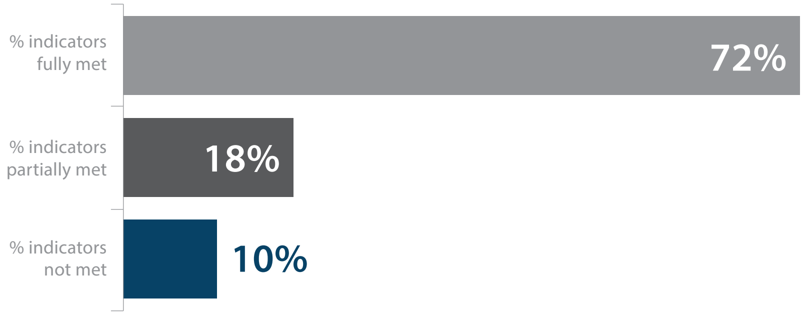
The principle of *prevention of over-indebtedness* gauges the sturdiness of organizational processes in place to prevent client over-indebtedness and participate in market level credit risk management initiatives. The primary elements considered under this principle include(i) the client underwriting process;(ii) loan terms and conditions;(iii) sales techniques; (iv) staff incentives; (v) monitoring systems; and (vi) participation in market initiatives.

On the whole, compliance to this principle was found out to be the highest among the assessed MFPs with 72 percent of the indicators being fully met (see **Figure 6**).

Moreover, the industry was able to maintain a strong percentage of full compliance with the collation of data from more MFPs following the initial state of sector report. In fact, an interesting observation to emerge was that two MFPs fully met each indicator under this principle, showing strong overall practices. It was found that all MFPs in the dataset conduct a reasonable analysis of client repayment capacity.

Despite good performance of the MFPs on this principle, lack of awareness on preventing client over-indebtedness at the MFP Board level was found to be a crosscutting weakness. One possible explanation is that most of MFPs have been unable to clearly define over-indebtedness as it applies to its clients. Consequently, it has been hard to measure, monitor and report on.

Figure 6: MFPs' overall compliance level for Prevention of Over-indebtedness



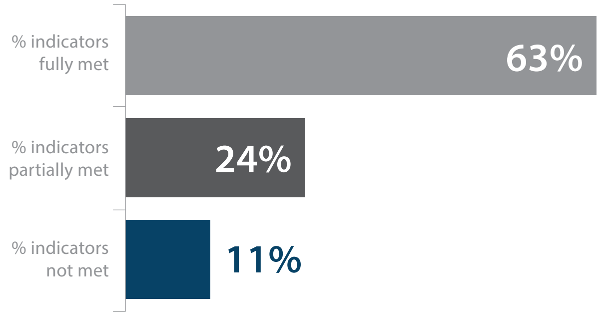
The encouraging results for this principle are an indication of the sector's awareness and relevant efforts to limit burdening the client as well as protecting the sector from delinquencies. Comparing globally, over-indebtedness was not found to be a major concern for the microfinance sector in Pakistan, unlike in regions of Sub-Saharan Africa, and East Asia and the Pacific. High compliance to this principle can partially be attributed to the introduction of Microfinance Credit Information Bureau (MF-CIB), a sector-wide platform to facilitate the sector in managing credit risk and assessing the true credit worthiness of existing and prospective micro-credit clients.

Transparency

The transparency principle highlights the need for transparent information on pricing, terms and conditions of products so that clients can make informed decisions. The primary elements considered within the Transparency principle include: (i) clear use of language; (ii) complete cost and non-cost information; (iii) timely provision of information; and (iv) informing clients of their rights.

On this principal as well, assessed MFPs performed well with 63 percent of the indicators fully met (see **Figure 7**). We found evidence of some robust practices in terms of this principle. For instance, most of the MFPS are employing multiple channels in communicating product terms, including introductory meetings, brochures, posters in branches and websites (for a best practice case study please refer to **Box 2**). Considering the low literacy levels among clients, however, verbal communication was determined to be the most effective channel compared to the rest. Institutions were also found to be giving customers sufficient time to discuss and review the contract terms and conditions prior to signing by verbally communicating the terms at various stages of the loan cycle, in line with the minimum standard requirements for the principle of transparency. Given that half of the MFPs in the dataset are unregulated, good practices in transparency are encouraging. Interestingly, MFIs performed better on this principle than most of the MFBs. None of the assessed MFBs in the dataset scored high on the indicator of using "simple non-technical language in contracts" i.e. MFB contracts were found to be full of complex 'legalese'. Additionally, results gathered showed that MFBs in the dataset are not disclosing complete information on early repayment fees and conditions, late payment penalties, and possible changes to product terms, on loan documentation. This information is rather made part of the contract in fine print so the client is many times unaware of these conditions.

Figure 7: MFPs' overall compliance level for Transparency



Despite tremendous performance of the MFPs under the principle, lack of clear disclosure policies on the total cost of loans by most MFPs constituting the dataset, is a cause of alarm. Moreover, the sector as a whole does not provide hardcopy contracts or summary documents listing terms and conditions of the loan to clients. Absence of a sector-wise standardized pricing disclosure methodology marks another area of improvement. In the past, a lack of regulatory framework for MFIs posed challenges in reaching a consensus regarding and adoption of a standardized pricing disclosure methodology. However, with the issuance of a regulatory framework for Non-Bank Microfinance Companies (NBMFCs), the road forward is less complicated now.

Box 2: Building a culture of transparency at DAMEN

Development Action for Mobilization & Emancipation (DAMEN) employs a multi-channel approach for disclosing key information to clients about the products they are offered, as well as their rights and responsibilities as microfinance clients. DAMEN distributes brochures which entail product information (including pricing details) and how to access DAMEN services. Repayment schedules with the details of service charges are also distributed among existing clients, and field staff conducts regular meetings with client groups to familiarize them on DAMEN's credit policies and update them on any new product information. Print posters on client protection are also displayed the DAMEN Branches. In addition to the print campaign, DAMEN has been running ads on local cable TV channels around Lahore to educate the population (both existing microfinance clients and potential clients) on the services offered by DAMEN as well as several key client protection messages.

Primary Gaps

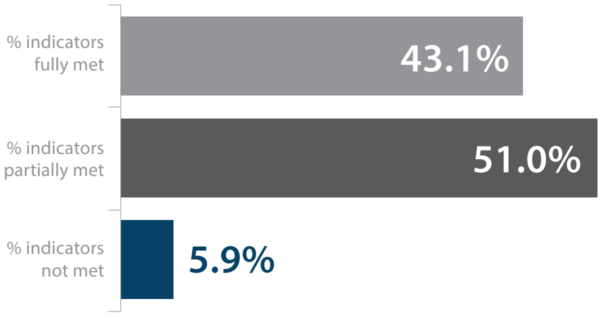
In this sub-section, we look into the principles where the assessed MFPs tend to be lagging. These include *pricing transparency, fair and respectful treatment of clients, privacy of client data* and *mechanisms for complaints resolution*.

Responsible Pricing

While in the initial report, assessed MFPs performed strongly on the *pricing transparency* and it was stated as a strength area of the sector. However, expansion of the dataset to include more medium sized MFIs led to its relegation to areas of improvement.

The *responsible pricing* principle gauges the MFPs' processes to ensure that pricing, terms and conditions of their products are set in a way that is affordable to clients while allowing for financial institutions to be sustainable. It necessitates that MFPs give due consideration to the client's ability to pay, along with a look to institutional operational efficiency and profit levels when determining product prices. The two elements forming the core of this principle include pricing procedures and fees.

Figure 8: MFPs' overall compliance level for Responsible Pricing



The performance of MFPs in the data set remained a little hazy for this princple with less than half (43.1 percent) indicators being fully met (see **Figure 8**). However, the collation of results from both the initial and current state of practice reports indicates a very small percentage (5.9 percent) of indicators not met. It is apparent that most of the MFPS are already there and this compliance gap can been filled with necessary capacity building among the MFPs. There was a marked difference between MFBs and MFIs in terms of this principle with MFIs lagging behind. But this this can be attributed to the lack of regulatory framework for the MFIs, which now hopefully be resolved with the issuance of new SECP regulations.

This principle also evaluates the efficiency of MFPs to gauge how responsibly priced their products. Some MFPs from the dataset were found to be unable to keep their efficiency ratios in line with peers, causing related indicators to be partially met or unmet.

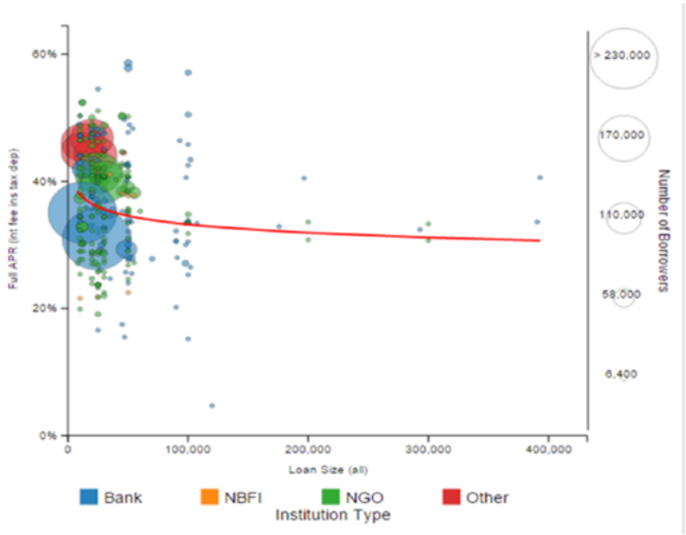
The pricing data collected by PMN in collaboration with MFTranspracy corroborates these findings. According to the 2014 data, while the pricing in Pakistan is low relative to loans of similar scale in other countries (**Figure 9**), the loans with lower prices are advertised with more transparency than the others (**Figure 10**). This necessitates the need to effectively monitor and advocate for responsible pricing in the sector by all major stakeholders.

Figure 9: A comparative analysis of loan prices

Pricing levels in Pakistan relative to other countries	
Country (Data from 2013)	**Range of Full APR on Loan Sizes less than 40% of GNI of the country**
Cambodia	35%
India (2010)	25-50%
India (2013, Post legislation on transparency)	30%
Kenya	25-125%
Pakistan	30-50%
Philippines	50-200%
Tanzania	100-125%
Uganda	50-125%

Transparency levels in Pakistan relative to other countries	
Country (Data from 2013)	**Percentage of clients in Highest Category of Pricing Transparency (76-100)**
Ghana	2%
India (2010)	19%
India (2013, Post legislation on transparency)	98%
Malawi	65%
Mozambique	48%
Pakistan	67%
Rwanda	14%
Tanzania	27%
Uganda	1%
Zambia	26%

Figure 10: Comparison of Annual Percentage Rates (APRs) and loan sizes

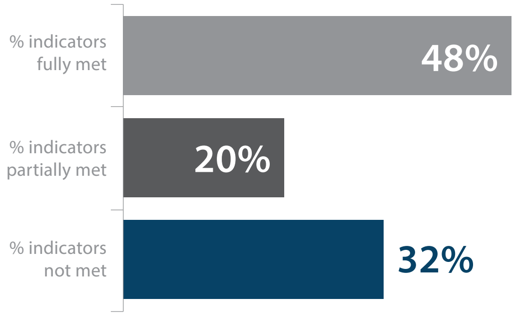


Fair and Respectful Treatment of Clients

In the last few years, the microfinance industry has come under increased scrutiny globally and has been censured for heavy-handed debt collection practices. To improve, monitor and streamline organizations policies pertaining to the treatment of the client, this principle dictates and monitors following elements: (i) commitment to code of ethics; (ii) non-discrimination; (iii) appropriate incentive structure and sales practices; (iv) responsible use of agents; (v) preventing staff corruption; (vi) informing clients of their rights; and (vii) client feedback.

The performance of assessed MFPs remained weak on this principle with only 55 percent of indicators being fully met while 45.5 percent indicators were either partially or not complied to at all (see **Figure 11**). These results are very similar to the initial state of practice results, indicating that the subsequent CPP assessments of MFIs shows their compliance to be at par with regulated MFBs, which is encouraging considering MFIs tend to lack formalization of policies and procedures. Having said that, this finding can be attributed to the comparatively larger, more experienced MFIs, while smaller MFIs and RSPs continue to struggle with meeting full/partial compliance to formal practices.

Figure 11: MFPs' overall compliance level for Fair and Respectful Treatment of Clients



Despite good performance shown by the larger MFBs in terms of this principle, there is room for improvement at mid-sized MFBs. Success of large-scale MFBs' in this principle can be attributed to formalization of policies and procedures, for example, the credit policy manual streamlines and highlights appropriate and acceptable debt collections practices. In the larger MFPs like FINCA, KF and KBL, client protection principles have been inculcated in the human resources manual, internalizing it as a core value to be considered while recruiting employees. For example, staff compatibility with institutional values is verified through background checks, and staff recruitment, training and performance evaluation are aligned with the institution's standards of ethics and treatment towards clients. These practices, however, remain limited to large-scale MFBs only. There is a need to incorporate client protection policies in institutional manuals and train staff accordingly, at both mid-sized MFBs and MFIs alike.

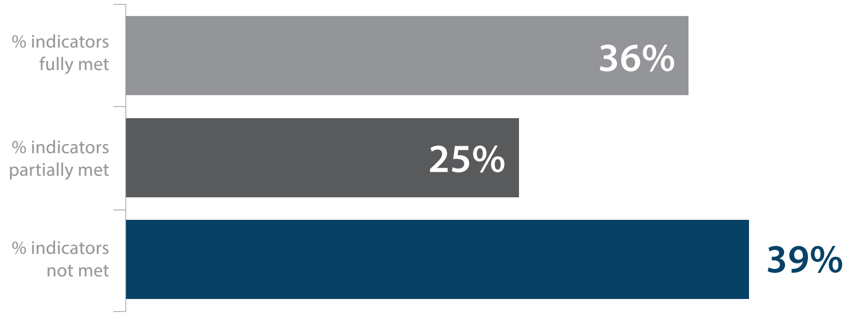
Privacy of Client Data

In order to ensure that privacy of individual client data is respected in accordance with the laws and regulations of individual jurisdictions, this principle covers following standards: (i) existence of complete policy and procedures; (ii) information security protocols; (iii) information provided to clients about their rights and responsibilities; (iv) waivers of privacy rights; (v) safeguarding data that could be used for discriminatory purposes; and (vi) sharing of client data with third parties.

Performance of the assessed MFPs remained weak on this principle with only 48 percent of the indicators being fully met. A significant percentage (32 percent) of the indicators were found unmet due to absent practices (**Figure 12**). Interestingly, not much difference was found between MFBs and MFIs in terms of this principle as both the peer groups showed weak performance, except two organizations. The biggest challenge stems from the fact that the legal jargon used in the agreements is too complex and difficult for microfinance clients to understand. Although the majority of MFPs have privacy clause in the loan contract, on-site evidence suggested that clients are not informed of the importance of this clause.

Low performance of most of the assessed MFPs can also be attributed to a lack of written policies. The importance of written policies guiding the gathering, processing and distribution of client data can hardly be overemphasized as they are pertinent for MFPs in order to curtail the risk of fraud. Moreover, field staff must be trained on these policies and systems.

Figure 12: MFPs' overall compliance level for Privacy of Client Data

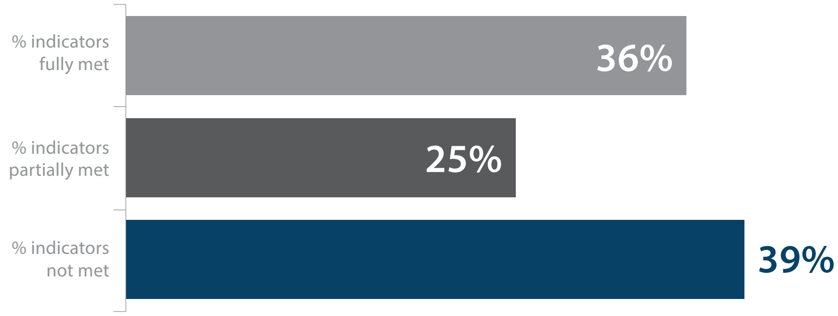


Mechanisms for Complaints Resolution

The principle of mechanism for complaints resolution necessitates the providers to place timely and responsive mechanisms for complaints and problem resolution for their clients and use these mechanisms to resolve individual problems as well as to improve their products and services. The key standards in this principle include: (i) communications with clients about their rights and about how to register complaints, (ii) the mechanics complaints handling process itself (intake, resolution, appeals), (iii) oversight of the complaints process, and (iv) use of complaints to identify broader problems.

Overall, our assessment results depict that much work need to be done on this principle as most of the assessed MFPs showed low performance in this regard. A sizeable 39 percent of the indicators were not met i.e. practices were missing from the institutions altogether as evident in **Figure 13**. Additionally, 25 percent of the indicators were only partially met. Most of the MFPs in the dataset had an ineffective complaint resolution strategy, only using suggestion boxes in branches.

Figure 13: MFPs' overall compliance level for Mechanisms for Complaints Resolution



Despite overall low performance on this principle, a few large-scale MFPs have robust and efficient complaint redressal systems in place and their processes can be considered as best practices and emulated across the sector. Tameer Bank, KBL, FINCA and KF have adopted a multi-channel approach for an effective and independent grievance redressal including traditional complaints boxes, a customer hotline and routine client satisfaction survey calls (For a brief description of Kashf Foundation's complaint handling system, please refer to **Box 3**). To ensure client awareness about the system, not only the information about the mechanism in printed on posters and client passbooks, but the details of the system are also communicated to clients by the field staff at different stages of the loan cycle. Moreover, complaints are also routinely monitored at the head office and cases of mistreatment of clients by staff are dealt with in a systematic and timely manner. Tameer Bank has also implemented Customer Services Unit (CSU) which uses preemptive, outbound calls to clients to enhance client satisfaction.

Box 3: Best Practice in Grievance Redressal Mechanism – Kashf Foundation

Kashf follows a proactive approach in soliciting complaints through a multi-channel customer care systems at branch level through which Kashf clients can effectively communicate their concerns, queries, fears, expectations and complaints. Specialized resources have been allocated to deal with complaints and issues faced by clients while interacting/dealing with Kashf staff. Numerous clients, on an on-going basis, share their feedback through the client complaint cell, complaint/feedback boxes placed in every branch, and personal visits to Kashf's offices. This entire process is supervised by the Compliance Department at Kashf, situated at the Head Office. All queries are centrally dealt with and response timelines are kept to a minimum. Through these channels, Kashf provides complete autonomy to its female clients to get their feedback and ensure that their issues are heard and resolved.

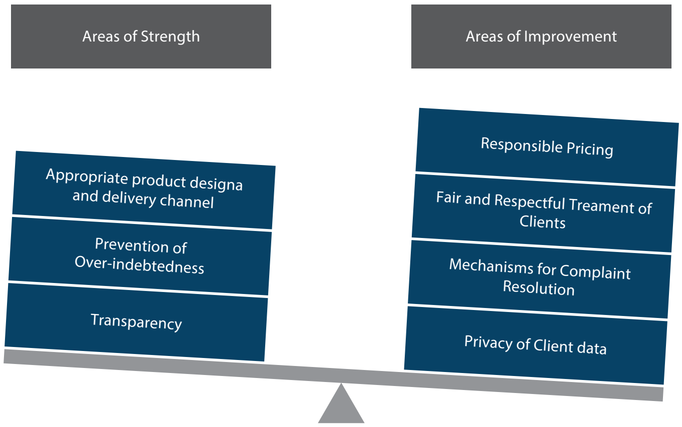
There is plenty of room for improvement for this principle for MFPs in Pakistan. Although MFPs consciously try to collect and resolve complaints through field staff and client interaction, compliance to the minimum standards requires formalization of the policies and procedures already being implemented in the field as well as an adoption of multi-channel approach.

INSIGHTS AND RECOMMENDATIONS

With impetus in growth in the past several years, it is widely recognized that microfinance in this increasingly complex and competitive global environment needs various interventions, one of the most important ones being client protection. This state of practice documents data findings from 17 smart assessments conducted over a period of three years. This report should be treated as a baseline survey to evaluate client protection practices on-ground.

On the whole, the assessment results show positive trends depicting that most of the MFP in the sector are making conscious efforts to bring client at the center of their services. Most of the weak spots identified have to do with the lags in the capacity and lack of formalization of client protection processes rather than the lack of will. As of now, the balance of scales is tipped towards areas of improvement highlighting the need to further the client protection agenda at the sector level (**Figure 14**).

Figure 14: A measure of areas of improvement and areas of strength



This analysis calls for additional efforts in principles of *appropriate product design and delivery mechanisms, avoidance of over-indebtedness and transparency*. There are considerable gaps to be filled for the principles of responsible pricing, *fair and respectful treatment of clients, privacy of client data and mechanisms for complaints resolution*.

1. Mid-sized players need to further formalize their product development mechanisms to better align their products to client needs and to modify them over time based on any changing demands. This can be done by incorporating appropriate research elements into the product development process to ensure client-centric products. While the market for traditional credit products has matured, the opportunity is ripe for MFPs to invest in new and diversified products. PMN, after discussion with important stakeholders has identified the following key areas to forward the discussion of product development: Agricultural value chains, Low cost private schools, Micro-clinincs and Shariah-compliant products.

2. MFPs must formulate and strengthen policies to determine acceptable debt thresholds for clients in order to reinforce avoidance of over-indebtedness. The data from microfinance credit bureau is there to assist MFPs in institutionalizing and streamlining the compliance to this client protection principle. In addition to this, institutions should put systems in place to monitor and review the cases of over-indebtedness among its clients in order to preserve the quality of its portfolio and reduce PAR all the while internalizing the principle of 'do no harm'.

3. At this point, the microfinance industry in Pakistan lacks a standardized pricing disclosure system. There is a need for sector-level efforts to build a consensus upon and adopt standardized disclosures on the annualized percentage rate (APR) interest calculation formula, and to move away from flat interest rate pricing, for enhanced transparency. Since 2013, MFTransparency has been publishing pricing data for the majority of the sector in Pakistan; however, the number of reporting MFPs remains small. Additionally, clients need to be given clearer information about their legal rights and obligations. This can be accomplished through including a short summary of the loan terms and contract stipulations, included on the back of repayment schedules or on passbooks for better awareness and understanding. After the closure of MFTransperancy, PMN has decided to take on the onus of publishing the pricing data on its website from now onwards while advocating for standardization of the policies.

4. As per the first state of sector report, principle of responsible pricing was included as an area of strength, however, an addition of seven MFIs in the datasets, led to its relegation into a weak area of practice. This can be attributed to a lack of sturdy regulatory environment for the MFIs. Now with the issuance of Non-Bank Microfinance Companies (NBMFCs) by SECP, this relegation will hopefully be remedied along with the improvements in other areas. Also oth-

er steps can be taken further improve responsible pricing. One of the ways this can be done is to ensure that institutions are not placing the additional cost of its own inefficiencies onto its clients. This can be monitoring through a strict watch on the efficiency ratio of the institution, setting a realistic target in line with best practice benchmarks for its own peer groups, and instituting a strategy to bring the institution towards greater operational efficiency. This will help the sector towards more responsible and competitive prices.

5. In order to increase compliance with the principle of fair and respectful treatment of clients, formalized policies and procedures are pertinent. Codes of ethics need to be supported further: the acceptable practice of interactions with client streamlined and inculcated in human resource manual. In the events of violation of the code of ethics, clear sanctions and penalties should be included. Moreover, these codes of ethics and policies must become 'living documents' via detailed familiarization of staff on its stipulations and consequences in case of non-compliance.

6. Importance of preserving Client data privacy can hardly be overemphasized. It is not only a a client right, but is also important to uphold to protect against internal and external fraud. To this end, the first step towards strengthening practice on this principle includes putting in place written policies which govern the gathering, processing, distribution and access of client data. To ensure adequate implementation and protect client data, all staff must be trained on client data privacy protocols as defined by institutional policies.

7. While some of the larger MFPs have robust multi-channel formal complaints handling mechanisms in place, grievance redressal mechanism at mid-sized and smaller MFPS remain largely informal and unsophisticated. For most of MFIs, there are no separate departments handling client complaints, which are often routed through Operations departments – highlighting an inherent conflict of interest and inappropriateness of the mechanism in place. With the delinquency pockets witnessed in the past few years in Pakistan, it is pertinent for MFPs to strengthen the complaint resolutions mechanisms. Since MFPs exist to serve their clients, it is necessary for them to create avenues for clients to air their suggestions, concerns and grievances. This is not only important for better operational flow, but also to raise any red flags before problems become systemic or unavoidable, such as delinquency crises, or loss in revenue due to inferior product design. Such problems can be gauged in advance and averted with a well-functioning client complaints handling system that clients are aware of and know how to use.

   In addition to well-functioning complaints handling mechanisms at the MFP level, there is also a need to set up an independent grievance resolution authority at the national level, Currently only clients of microfinance banks (MFBs) have access to an independent, third party complaint resolution mechanism through the State Bank of Pakistan. There is no such platform for clients of non-bank microfinance providers. The absence of such a platform increases the risk of clients approaching politicians and media (or other actors such as lawyers and thugs) in case they have a complaint against their respective service provider. Intervention by these types of players is detrimental for the sector and can lead to delinquency crises as was witnessed in Punjab in 2008-09..

   Moreover, absence of a sector level platform distorts the playing field for bank and non-bank MFPs. In addition, such platforms if available, can raise 'red flags' by bringing to notice any systemic issues before they snowball into sector-wide disasters. Increasing competitiveness in the industry can lead to unhealthy practices and pose reputation risk, and damage the vulnerable population that makes up the microfinance client base.

   The national association of MFPs, Pakistan Microfinance Network, is planning to establish such a system at sector level and various models are under discussion with the industry stakeholders.

Adoption and compliance to CPPs will result in a series of benefits for the MFPs, for example a more agile product development and design system leading to attractive products for clients, strengthening of internal controls, and development of a positive reputation among clients, leading to greater retention. Collectively, the importance that the sector places on protecting clients from harm, and placing clients at the center of its business will also govern how MFPs tackle challenges in advancing financial inclusion and move towards its goals with a sustainable growth trajectory.

While there is much to be accomplished to ensure that the CPPs are met by the majority of MFPs in Pakistan, the foundation is set and ongoing advocacy and efforts by various stakeholders can pave the way for strengthening of the industry in this crucial area. These recommendation can help MFPs in improving their client protection practice to better align their operations with the minimum standards defined by industry consensus through the CPPs. Tools and resources, highlighting best practices in client protection by microfinance practitioners from around the world, are available for MFPs' use and adaptation.[4]

[4] An extensive range of tools and resources relating to each of the CPPs has been developed by the Smart Campaign and available at their website, at the following URL: http://www.smartcampaign.org/tools-a-resources

ANNEX 1: LIST OF SMART ASSESSMENTS CONDUCTED TILL PROJECT END (MARCH, 2015)

#	MFP	Assessment Date
1	Tameer Microfinance Bank Ltd	2013
2	Orix Leasing Ltd. Pakistan	2013
3	First Microfinance Bank (FMFB)	April, 2013
4	Khushhali Bank Limited (KBL)	April, 2013
5	FINCA Microfinance Bank (FINCA)	May, 2013
6	Kashf Foundation (KF)	May, 2013
7	National Rural Support Program (NRSP)	Sept, 2013
8	BRAC Pakistan (BRAC-P)	Sept, 2013
9	Punjab Rural Support Program (PRSP)	Sept, 2013
10	NRSP Bank (NRSP-B)	Sept, 2013
11	Thardeep Rural Development Program (TRDP)	Oct, 2013
12	Pak Oman Microfinance Bank (POMFB)	Nov, 2013
13	Development Action for Mobilization and Emancipation (DAMEN)	Sept, 2014
14	Rural Community Development Society (RCDS)	Sept, 2014
15	Sindh Rural Support Organization (SRSO)	Oct, 2014
16	SAFCO Support Foundation (SSF)	Nov, 2014
17	Jinnah Welfare Society (JWS)	Nov, 2014
18	Farmers Friend Organization (FFO)	Dec, 2014
19	Sungi Development Foundation	May, 2015

Pakistan Microfinance Network

MicroNOTE: Bringing Client to the Centre: A consolidated report on client protection practices in Pakistan's microfinance sector.

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