KEY POINTS

- Microfinance institutions must deliver demand-driven and quality services to clients, where financial consumer protection is critical nationally and globally.
- Differing development stages in microfinance markets in each country require tailored solutions on client protection.
- Advanced technology both diversifies microfinance services and creates new risks, requiring sophisticated client-protection measures and microfinance education.
- More focused training is needed nationally and training for trainers should be strengthened.

MICROFINANCE CLIENT PROTECTION IN ASIA AND THE PACIFIC: LESSONS FROM ADB-SMART CAMPAIGN TRAINING PROGRAMS

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FINANCIAL CONSUMER PROTECTION AS A CRITICAL POLICY AGENDA ON FINANCIAL INCLUSION

Slower economic growth globally and regulatory tightening in finance has complicated access to finance for vulnerable groups, including low-income households and small businesses. Limited financial access for these groups requires diversified financing modalities accessible to them, addressing the balanced development of banking and nonbank finance industries. Microfinance institutions (MFIs), crucially, provide small funds and related services to these groups, helping them to escape poverty and sustain businesses.

The microfinance industry has been growing steadily in Asia and the Pacific, promoting financial inclusion. However, the quality of growth has often been called into question in many countries. This includes issues such as high lending rates, the over-indebtedness of borrowers, and abusive debt collection by financial institutions, undermining poverty reduction and creating financial instability and a more informal finance base. For these reasons, it has become critical to ensure financial consumer protection or microfinance client protection is part of the policy agenda on financial inclusion, nationally and globally.

Recognizing this fact, the Group of Twenty (G20) set up the High-Level Principles on financial consumer protection in 2011, underscoring the importance of advancing financial consumer protection agenda.¹ The principles address ten priorities, as indicated in Table 1.

The Smart Campaign, launched in October 2009 as an initiative of the Center for Financial Inclusion at ACCION International—a New York based not-for-profit corporation—is working with microfinance leaders to provide the tools and resources they need to deliver transparent, respectful, and prudent financial services to all clients. The Smart Campaign is taking a leading role in the development and promotion of the Client Protection Principles in the microfinance industry, which represent a set of core concepts for the treatment of clients. They are operationalized into standards, which are the minimum behaviors from financial institutions that clients should expect. These principles are embedded in the path-breaking work by microfinance service providers, international networks, and national microfinance associations to develop pro-client codes of conduct and practices.

The consensus in the microfinance industry is that financial services providers should adhere to the seven core principles in the second column of Table 1.²

The Smart Campaign has developed global knowledge in supporting microfinance networks to help its members implement a code of conduct through training, monitoring systems, and where needed, certification programs.³ The Smart Campaign and its partners have created and collected a deep body of knowledge and best practice, including over 80 practical tools to support financial institutions in their practices. More than 360 trainings, webinars, and presentations have taken place since 2010, and a cadre of 73 trained assessors and technical consultants has provided tailored support around the globe.

ADB PROJECT ON MICROFINANCE INDUSTRY'S CLIENT PROTECTION PRINCIPLES

In 2015–2016, the Asian Development Bank (ADB) and the Smart Campaign delivered training programs on the Client Protection Principles to six of ADB's developing member countries selected from five ADB regions: Azerbaijan, India, the Kyrgyz Republic, Lao People's Democratic Republic (Lao PDR), Myanmar, and Papua New Guinea.⁴ The primary audience for the training was MFI senior management and staff responsible for implementing the code of conduct. Each program targeted around 30 participants from MFIs so that they could enjoy interactive learning effectively.⁵ The training included the experiential learning

Table 1: Financial Consumer Protection Principles

G20 High-Level Principles on Financial Consumer Protection, 2011	Smart Campaign's Client Protection Principles
<ol style="list-style-type: none"> 1. Legal, regulatory and supervisory framework 2. Role of oversight bodies 3. Equitable and fair treatment of consumers 4. Disclosure and transparency 5. Financial education and awareness 6. Responsible business conduct of financial services providers and authorized agents 7. Protection of consumer assets against fraud and misuse 8. Protection of consumer data and privacy 9. Complaints handling and redress 10. Competition 	<ol style="list-style-type: none"> 1. Appropriate product design and delivery 2. Prevention of over-indebtedness 3. Transparency 4. Responsible pricing 5. Fair and respectful treatment of clients 6. Privacy of client data 7. Mechanisms for complaint resolution

Sources: G20 High-Level Principles on Financial Consumer Protection. 2011. OECD; Smart Campaign website (<http://www.smartcampaign.org/>).

¹ OECD. 2011. G20 High-level Principles on Financial Consumer Protection.

² From the Smart Campaign, <http://www.smartcampaign.org/about/smart-microfinance-and-the-client-protection-principles>

³ In 2013, the Smart Campaign launched the first ever third-party evaluation of client protection practices in MFIs, with the Client Protection Certification program. As of November 2016, more than 185 assessments and 100 certification missions had taken place and 72 MFIs been certified, covering more than 35 million clients.

⁴ TA-8643: Implementation of Microfinance Industry's Client Protection Principles. Training was conducted in (i) Papua New Guinea, Port Moresby, 21–23 October 2015; (ii) India, Mumbai, 2–3 February 2016; (iii) Azerbaijan, Baku, 17–19 February 2016; (iv) Lao PDR, Vientiane, 25–26 February 2016; (v) Myanmar, Yangon on 22 March 2016 and Nay Pyi Taw on 25 March 2016; and (vi) Kyrgyz Republic, Bishkek on 30 March 2016 and Osh on 1 April 2016.

⁵ Number of participants: Azerbaijan 21, India 28, the Kyrgyz Republic 21 (combined two areas), the Lao PDR 30, Myanmar Yangon 112 from 70 institutions, Myanmar Nay Pyi Taw 31, and Papua New Guinea 27. In Myanmar, the country counterpart (Myanmar Micro Finance Association) accommodated strong demand from MFIs for training, providing a large space for that purpose.

method, such as role plays and group exercises, which helped participants understand client protection issues and develop their own solutions. The training program was well received by all participants as a useful tool to enhance broader and higher-level implementation of the Client Protection Principles, creating strong demand for continuous training.

The six countries selected under the ADB project have all prioritized client protection in their microfinance sectors, albeit in different ways. In Azerbaijan, the central bank has promoted microfinance as a poverty reduction tool, while emphasizing consumer protection as a key foundation. The Reserve Bank of India set up the Fair Practice Code in response to the 2010 Andhra Pradesh microfinance crisis and empowered microfinance industry associations to act as self-regulatory organizations. In the Kyrgyz Republic, the government implemented a mid-term Microfinance Development Strategy covering 2011–2015, which included consumer protection. In the Lao PDR, the government has established a taskforce to create a decree on consumer protection to promote sustainable MFI operations. Myanmar enacted the Microfinance Law in 2011 and recently passed regulations that encompass the Client Protection Principles. And in Papua New Guinea, the central bank is responsible for supervising the microfinance industry, with an emphasis on consumer protection, which was supplemented by ADB's Microfinance Expansion Project.

DIFFERENT DEVELOPMENT STAGES OF MICROFINANCE MARKETS BY COUNTRY

Microfinance markets in the six countries are at vastly different stages of development, which requires tailored solutions on client protection by each country.

Microfinance markets can be classified into three development levels, based on four elements: (i) strong microfinance network, (ii) strong operational and managerial capacity of MFIs, (iii) relatively developed microfinance sector in scale, and (iv) regulatory framework on consumer protection. The country accommodating all four elements is a level 1 country, three elements level 2, and one or two elements level 3. Among the six countries, India was categorized level 1, Azerbaijan and the Kyrgyz Republic as level 2, and the Lao PDR, Myanmar, and Papua New Guinea as level 3 (Table 2).

High Maturity Market (Level 1)

In India, the microfinance industry has gone through boom-and-bust cycles, and client protection is not only a part of regulation, but also embedded in the industry's code of conduct.⁷ In Andhra Pradesh, poor governance and low credit discipline in the microfinance industry allowed multiple borrowing among households, with high interest rates, and caused the microfinance crisis in 2010. This outcome highlighted the importance of consumer protection. The state government of Andhra Pradesh passed the Microfinance Ordinance in 2010 to protect microfinance borrowers from abusive debt collection, and the Reserve Bank of India has promoted the Fair Practice Code nationally. Eleven of the largest MFIs in India⁸ have been certified by the Smart Campaign on client protection and many more have been assessed on the implementation of the code of conduct. Strong MFI networks are present in India, represented by Sa-Dhan, with over 200 member microlenders and the Microfinance Institutions Network, with over 40 members. India's microfinance industry is undergoing significant transformation, with large MFIs licensed by the central bank to become small banks or universal banks.⁹ They provide a mix of financial services, including both credit and savings. Rapid digitization in India has

Table 2: Microfinance Market Maturity Level in Selected Countries

Country	Market Maturity Level	Network	MFI Capacity	Sector Development	Regulatory Framework
India	1	✓	✓	✓	✓
Azerbaijan	2	✓	✓	✓	
Kyrgyz Republic	2	✓	✓		✓
Lao PDR	3	✓			✓
Myanmar	3	✓			✓
Papua New Guinea	3	✓			

Lao PDR = Lao People's Democratic Republic.

Source: Authors' construction.

⁶ ADB. Papua New Guinea: Microfinance Expansion Project. Project documents. <https://www.adb.org/projects/44304-013/main>

⁷ Sa-Dhan and Microfinance Institutions Network. 2014. Code of Conduct for Microfinance Institutions in India. <http://mfinindia.org/wp-content/uploads/2014/06/IndustryCodeofConduct.pdf>

⁸ The Smart Certified Financial Institutions in India are Annapurna, Cashpor, Equitas, Fusion, Grameen Koota, SKS, Satin Credit Care, Sonata, Swadhaar, Ujjivan, and Utkarsh.

⁹ Reserve Bank of India. 2014. Guidelines for Licensing of Small Finance Banks in the Private Sector. Press release, Reserve Bank of India. https://www.rbi.org.in/scripts/BS_PressReleaseDisplay.aspx?prid=32614

also raised issues of client protection for digital financial services, including the mobile payment system.

Middle Maturity Market (Level 2)

In Azerbaijan, microfinance was introduced in the mid-1990s as a strategy for addressing the economic requirements of as many as 1,000,000 refugees and internally displaced persons uprooted during the conflict in the late 1980s between Armenia and Azerbaijan over this region. The Azerbaijan Microfinance Association is a strong network consisting of 28 member organizations with explicit committed to client protection. While most association members have endorsed the Smart Campaign, issues remain for small and mid-tier MFIs to adopt the Client Protection Principles, particularly in the area of over-indebtedness. A study on over-indebtedness of microcredit clients indicated that 30% of microcredit households are seriously over-indebted, spending all their disposable income on debt payments, which has a positive correlation with multiple borrowing.¹⁰ It was identified through the training program that the dollarization of microcredit is the primary cause of client over-indebtedness in the country.

In the Kyrgyz Republic, the microfinance sector emerged in 1995 and has grown to encompass more than 200 MFIs, including microcredit companies and agencies registered with the National Bank of the Kyrgyz Republic. The Law on Micro-Finance Organizations was enacted in 2002 to govern MFI activities. The Association of Microfinance Organizations, established in 2005, created a tight network of MFIs. As the microfinance industry has demonstrated its financial viability, commercial banks have begun downscaling their traditional banking and been entering the microfinance market. According to MIX market data, more than 50% of microfinance borrowers in the country raised funds from MFIs certified by the Smart Campaign on client protection. In rural areas, however, many households and small businesses have been raising funds from smaller financial institutions that undermine consumer protection, suggesting the importance of financial education for rural clients and increased endorsement of client protection from local financial institutions and community lending bodies.

Low Maturity Market (Level 3)

In the Lao PDR, the microfinance industry is in the early stage of the development but growing, with more than 60 MFIs licensed by or registered with the central bank, with ACLEDA Lao capturing the major market share. MFIs comprise licensed deposit-taking MFIs, registered nondeposit-taking MFIs, and licensed savings and credit unions. The Decree on Microfinance Institutions was enacted in 2012 to regulate deposit and nondeposit taking MFIs

and microfinance projects. The Lao Microfinance Association has worked with the Smart Campaign to develop a code of conduct based on the Client Protection Principles.

In Myanmar, the microfinance industry is nascent and, hence, awareness of client protection is minimal in the industry. However, the microfinance market has been sharply increasing, with more than 180 MFIs licensed under the Microfinance Law in 2011, requiring effective implementation of recently launched regulations on client protection. The Myanmar Microfinance Association supports networking of MFIs and promotes the Client Protection Principles. Myanmar has experienced interest rate caps and requirements for public disclosure, and has faced the risk of over-indebtedness in some rural areas.

In Papua New Guinea, over four-fifths of the population live in rural areas, and are largely engaged in informal economic activities. Significant challenges in the microfinance sector remain, such as limited infrastructure and resources, a diverse and often geographically remote population, and high levels of financial illiteracy among clients. The Bank of Papua New Guinea supervises the microfinance industry with an emphasis on consumer protection. In the 2014–2015 National Financial Inclusion and Financial Literacy Strategy, the government launched a consumer protection working group. The Centre for Excellence in Financial Inclusion is one of the committed partners of Smart Campaign to promote the financial inclusion agenda in the country. With its focus on advocacy projects, the center has a good relationship with the Bank of Papua New Guinea, one that can be leveraged further to help evolve a framework for the microfinance sector and embed client protection principles in microfinance operations.

TRAINING PROGRAMS TAILORED BY COUNTRY

Consumer protection principles provide guidance and basic rules for all stakeholders of the microfinance industry to comply with. However, market maturity, depth, regulatory environment, and MFI capacity in operations and management differs from country to country. Accordingly, training programs need reflect country context and needs.

India, as a high-maturity microfinance market, has developed a diverse range of microfinance products and services, including savings, insurance, and payments with advanced technology. Given this evolution, training was partly used as a preview of the Smart Standards Version 2.0,¹¹ which included new standards on products such as savings, insurance, and payments. Mindful

¹⁰ Justyna Pytkowska and Sylvia Spannuth. 2016. The Risk of Over Indebtedness of Microcredit Clients in Azerbaijan: Results from a Comprehensive Field Study. Microfinance Centre and Finance in Motion field study. http://mfc.org.pl/mfcwp/wp-content/uploads/2016/04/Research_efse-df_oi-study-azerbaijan_summary-paper.pdf

¹¹ The Smart Campaign. 2016. Client Protection Certification Standards Version 2.0. http://www.smartcampaign.org/storage/documents/Standards_2.0_English_Final.pdf

of the perception gap identified in the microfinance sector, training supported better understanding in MFIs of specific principles, such as over-indebtedness and the grievance redressal mechanism.

More focused training was delivered to MFIs in the middle-maturity microfinance markets, that is, Azerbaijan and the Kyrgyz Republic. In Azerbaijan, training focused on preventing over-indebtedness, given the large number of microcredit households excessively spending disposable incomes on debt repayment.

Training in the Kyrgyz Republic focused on two different groups: small and medium financial institutions, in Bishkek, and the rural community (Jama'at), at Osh. These target groups often undermine client protection in microfinance and needed intensive training in financial consumer protection. The training program also provided a training of trainers to educate Jama'at leaders (community heads) on how their communities protect themselves from harm through knowing and exercising their rights.

Countries with the low maturity market of microfinance have weaker regulation, and the microfinance associations are at the nascent stage of introducing and supporting members in client protection.

In the Lao PDR, training focused on actual practices on seven Client Protection Principles, given that the code of conduct is designed based on these principles, targeting Lao Microfinance Association members. The training helped to expose participants to international best practices around transparency, complaint resolution mechanisms, and over-indebtedness. Training also helped the central bank understand the consumer protection regulatory framework.

In Myanmar, the microfinance market has been growing, with newly created regulations including client protection. Training has helped regulators and MFIs better understand consumer protection from the nascent stage to ensure that the industry is able to incorporate international best practices. Two separate programs were initiated. Training in Yangon targeted MFIs for understanding of client protection, while training at Nay Pyi Taw provided a workshop for microfinance regulators, which addressed a model legal framework on microfinance client protection.

In Papua New Guinea, the primary focus of the training was on basics of the seven Client Protection Principles and its standards and indicators, given the nascent stage of microfinance development in the country.

THE WAY FORWARD

Amid the global economic slowdown, domestic financial sectors are much stricter on risk management, making it much harder for low-income households and small businesses to raise funds from financial institutions. Commercial banks tend to expand their business lines to small retail finance or microfinance in many countries, making a fierce competitive environment in the national microfinance industry. These conditions risk triggering higher lending rates to vulnerable groups and abusive debt collection from them, leading to the resultant over-indebtedness of borrowers and undermining poverty reduction. Financial consumer protection is thus a critical policy agenda in financial inclusion at the national and global levels.

Microfinance consumer protection plays a key role in fair treatment of clients, safeguarding their individual rights, and enhancing corporate governance of MFIs, which ensures sustainability of MFI operations and hence sustainable outreach to vulnerable groups. MFIs should focus on the delivery of demand-driven and quality services to their clients. ADB's 2012 Special Evaluation Study on Microfinance Development Strategy called for increased support to consumer protection to make microfinance demand-side-oriented and more beneficial to borrowers.

Through the implementation process of the ADB-Smart Campaign training programs on client protection in microfinance, it was recognized that six selected countries with different market maturity and depth, regulatory and supervisory environments, and operational and managerial MFI capacity, need tailored solutions on client protection with focused training programs for each country addressing specific national opportunities and threats (Figure 1).

Given fast-moving technology, microfinance instruments and services available for low-income households have been diverse. In addition, a new risk set associated with technology-oriented services for microfinance borrowers—such as cyber risk and money laundering—has emerged, requiring sophisticated microfinance client protection measures and education for MFIs. With the perceived demand of continuous ADB support in MFI client protection, more focused follow-on national training is expected. Regulator workshops and training for trainers on microfinance client protection principles need to be encouraged. These can be provided as part of the ADB microfinance expansion project modeled on the Papua New Guinea project, for instance.

Figure 1: Tailored Solutions on Microfinance Client Protection

FI = financial institution, Lao PDR = Lao People's Democratic Republic, MFI = microfinance institution.

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ADB's vision is an Asia and Pacific region free of poverty. Its mission is to help its developing member countries reduce poverty and improve the quality of life of their people. Despite the region's many successes, it remains home to a large share of the world's poor. ADB is committed to reducing poverty through inclusive economic growth, environmentally sustainable growth, and regional integration.

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