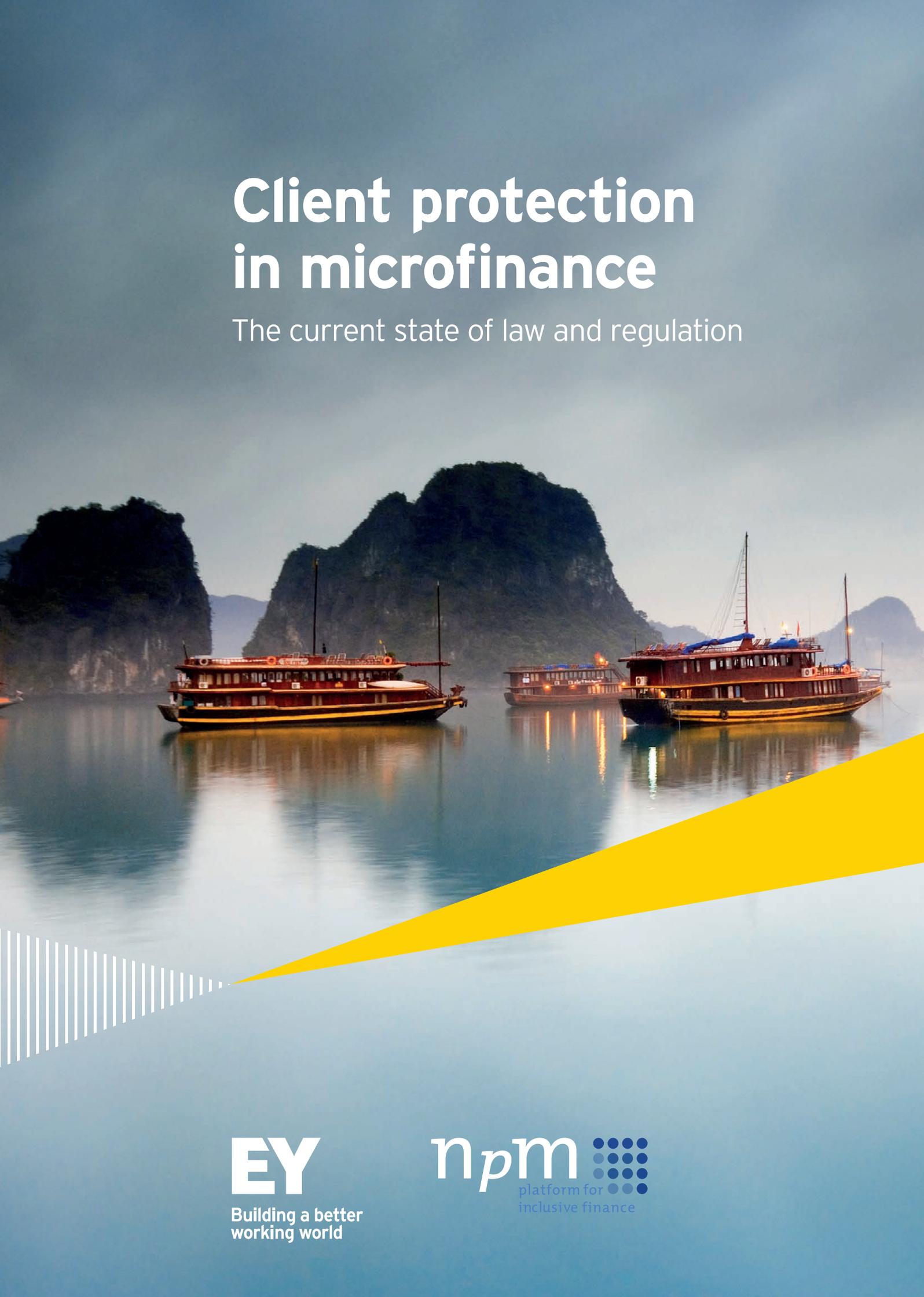


Client protection in microfinance

The current state of law and regulation



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Preface

Microfinance plays a central role in developing populations all over the world. By providing financial services to those who did not have access before, microfinance facilitates entrepreneurship and economic development in general. The sector has grown rapidly, thereby transforming lives in virtually all regions of the world in the past decades.

However, with the growth of the sector, concern over rights of microfinance clients have risen. Client protection has been recognized as an issue that should be addressed by the sector and its regulators, to ensure that microfinance can keep growing in a way that benefits clients.

Both NpM, Platform for Inclusive Finance (NpM), and EY subscribe to the responsible growth of the microfinance sector. NpM wants to facilitate its members in contributing to this goal. For EY, supporting the microfinance sector is a way to give meaning to our commitment to building a better working world.

We also recognize that the full potential of microfinance can only be achieved when clients are sufficiently protected. Law and regulation play an important role in this protection. As a first step to help improve the position of clients, we therefore conducted a study on law and regulation with regard to client protection.

In doing so, we relied upon the help of a great number of people. We are thankful to them all, including the members of NpM for sharing their experiences that served as input for our research. Also, we would like to thank the EY employees who shared their experiences on practical matters in the 12 countries we included in this study. Without their commitment and valuable insights, it would not have been possible to write this report. We invite readers of this report to share their feedback with us.

We hope the results of this study will help the microfinance sector move forward, towards better client protection.

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Executive summary

Microfinance is aimed at improving the lives of the poor populations by making financial products and services available to them. In that sense, microfinance has been welcomed as the 'silver bullet' solution to alleviate poverty. In recent years, however, several crises have drawn attention to the negative impact microfinance can have when not done right. In reaction to this development, attention for client protection has increased.

Key players in the microfinance sector launched the SMART Campaign to improve the protection of their clients. In addition to these types of sector initiatives, the national regulatory landscape also plays an important role in client protection. Therefore, EY, together with NpM, Platform for Inclusive Finance, conducted a study to determine whether law and regulation with regard to client protection have been implemented (in any way shape or form) in 12 countries around the world and whether these rules are enforced. The study focuses on the regulatory and supervisory landscape of the 12 countries in terms of client protection, focusing in particular on the following aspects:

- ▶ Over-indebtedness
- ▶ Responsible pricing
- ▶ Transparency

The results of this study are presented in this paper.

The study found that microfinance institutions that are categorized as banks are more closely regulated than non-bank microfinance institutions. Banks are typically regulated by the local central banks. Given the many shapes and forms of non-bank microfinance institutions, a cluster of different regulators is involved in developing law and regulation. Most notably, microfinance associations and consumer protection agencies are involved in the regulatory process in a consultative role.

Not all countries have specific law and regulation for the

microfinance sector. Roughly half of the 12 countries in scope have some kind of microfinance law, but not all include provisions on client protection. Of the client protection principles mentioned above, laws and regulations on the issue of transparency are most well developed, followed by over-indebtedness. Additionally, many microfinance associations and other organizations (such as consumer protection agencies) that are involved in the sector are educating microfinance clients to increase financial literacy.

Responsible pricing is much less covered by law and regulation, and mostly left to the market. Credit reporting bureaus, important for information sharing between different microfinance institutions, are still developing. Availability of information provided by these credit reporting bureaus, especially to smaller microfinance institutions, is a concern.

Enforcement of law and regulation leaves room for improvement. Not all microfinance institutions, which are under regulatory supervision, are monitored by the local authorities. Additionally, when they are monitored, client protection is not always included in the scope of the monitoring.



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Research question

Microfinance institutions offer small loans and other financial services to micro-entrepreneurs and small business owners, entrepreneurs and other low-income people, that are otherwise excluded from regular financial services. Microfinance is generally considered to play an important role in the economic development of low- and middle-income countries. In the last decade however, the sector has become the subject of increased public scrutiny. This is a result of multiple developments:

- ▶ With the growth of the sector, the landscape of microfinance institutions has become more diverse and complex. The involvement of commercial players has increased, while NGOs and cooperatives also remain active
- ▶ The global financial crises, and the subsequent call for more accountability and transparency in the financial sector, have also affected microfinance
- ▶ In recent years, a serious concern has risen that a significant number of the microfinance clients are over-indebted. For these people, it is suggested, microfinance has become part of the problem instead of part of the solution

Against this background, many countries have developed law and regulation to better protect clients in microfinance. Mirroring the sector itself, the content, maturity and enforcement of these laws and regulations varies between countries.

To determine whether laws and regulations with regard to client protection have been implemented (in any way, shape or form) and whether these rules are enforced, EY and NpM carried out a study in 12 countries during the summer of 2014. The research focused on the regulatory landscape (parties involved in regulating and monitoring the sector), the regulation itself (with a focus on over-indebtedness, responsible pricing, transparency and codes of conduct), enforcement and credit reporting systems that register the loans of individual microfinance clients.

For the purposes of this study, we define a microfinance institution to be an organization that provides financial services to the poor. This very broad definition includes a wide range of providers that vary in their legal structure, mission and methodology. However, all share the common characteristic of providing financial services to clients who are poorer and more vulnerable than traditional bank clients. We have focused on two homogenous groups from a regulatory point of view. They are: deposit-taking microfinance institutions (that generally fall under regulations applicable to regular financial institutions, such as commercial banks) and non-deposit-taking microfinance institutions that often are not regulated or are covered by specific microfinance laws and regulations as explained earlier in the study.



4

The research scope and methodology

The research was a combined effort between EY and NpM. In order to meet the needs of the intended users of this research, an inventory among the members of NpM was completed, to understand the needs of the investors regarding the subject of this research and the required geographical coverage. This inventory was carried out between January and March 2014. Additionally, interviews with renowned experts were held to share knowledge and align with other ongoing studies. Desk research was finally conducted to take note of any other recent studies on law and regulation and client protection within the microfinance sector that may have been conducted recently.¹

Based on the inventory, the interviews and desk research, a set of questions was drafted. In the questionnaire, the focus is on topics that are not currently covered by existing studies.

The questionnaires were sent to the local EY teams in 12 countries. The coordination of the questionnaires was conducted by the EY Microfinance team in the Netherlands. The questionnaires were filled in based on sector knowledge and local expertise in the microfinance sector and the financial sector as a whole. The results of the information and feedback that was received from the EY offices are presented in this research document. The intention is to provide practical insight into what is currently available in the 12 countries.

4.1 Contextual scope

The goal of the study is to determine whether law and regulation with regard to client protection have been implemented (in any way, shape or form) in the selected countries and whether these rules are enforced. To address these issues, the questionnaire includes questions on the content of client protection regulation as such, enforcement, and general trends and concerns in the microfinance sector regarding client protection.

The study focuses on the issues addressed in the client protection principles from the SMART Campaign,² which are widely known in the microfinance sector. Law and regulation regarding over-indebtedness, responsible pricing and transparency get special attention.

For an overview of the research questions included in the questionnaire, refer to section 4.3.

4.2 Geographical scope

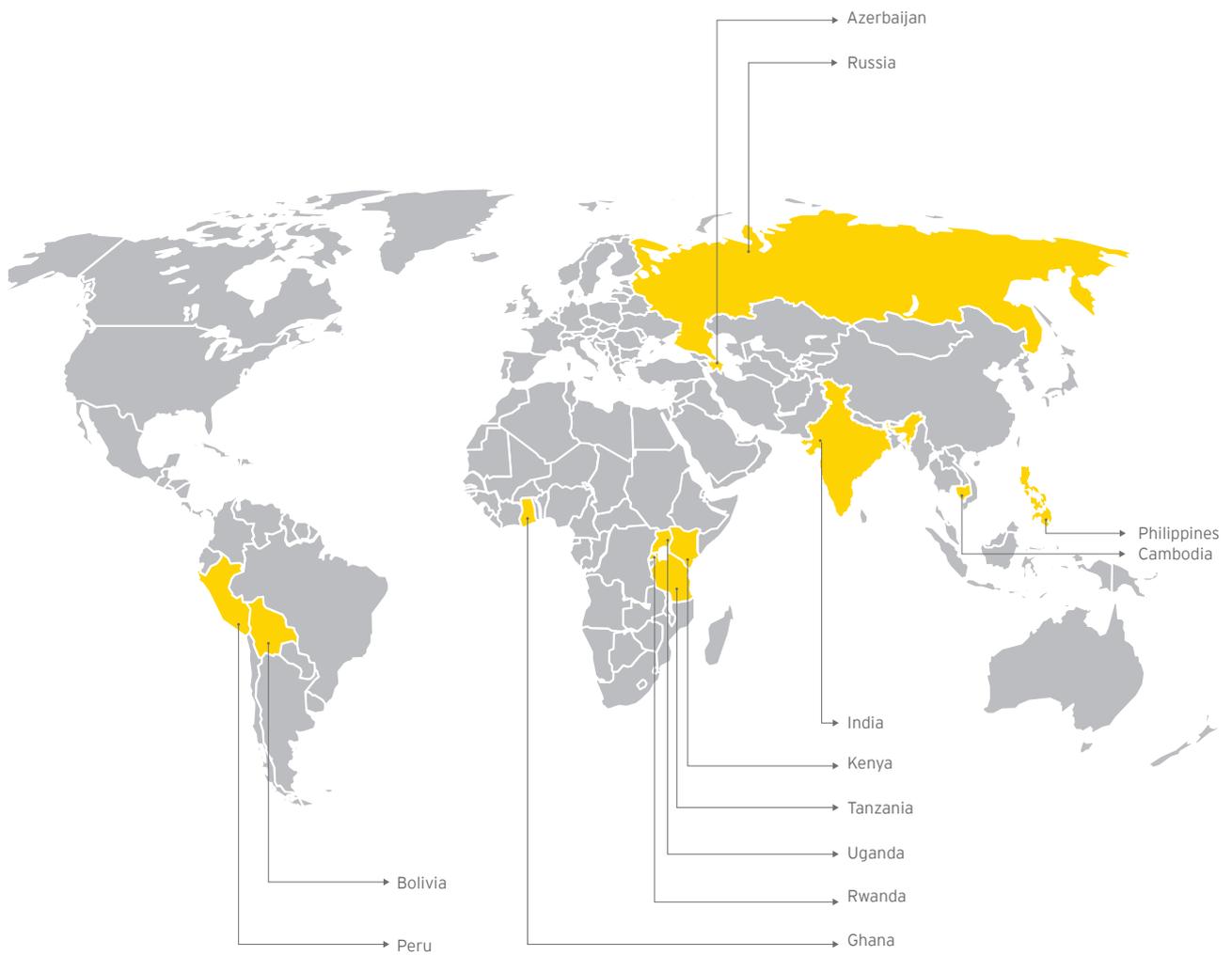
For the purpose of this research paper, the current state of law and regulation regarding client protection in 12 countries has been evaluated. These countries were again selected on the basis of the results of preliminary research, and they represent four different regions with significant microfinance activity.

¹www.inclusivefinanceplatform.nl/about/publications.

²www.smartcampaign.org.



Geographical scope





4.3 Research questions

As indicated earlier, the goal of the study is to determine whether client protection rules have been implemented (in any way, shape or form) in the selected countries and whether these rules are enforced. To address these issues, the questionnaire includes questions on the content of client protection regulation as such, oversight and enforcement, and general trends and concerns in the microfinance sector.

Regulatory framework:

- ▶ Which rules (laws or otherwise) are implemented in your country to protect microfinance clients?
- ▶ How are these rules/laws different for microfinance institutions and regular bank and non-bank financial institutions?
- ▶ Which parties are involved in setting rules/laws concerning client protection in your country and how?
- ▶ What rules (laws or otherwise) have been implemented regarding over-indebtedness towards the client?
- ▶ What rules (laws or otherwise) have been implemented regarding responsible pricing towards the client?
- ▶ What rules (laws or otherwise) have been implemented regarding transparency towards the client?
- ▶ What formal code of conduct is available on the basis of which financial service providers commit to mutually agreed standards within the microfinance sector?

Oversight and enforcement:

- ▶ What oversight and supervisory bodies check compliance with rules set?
- ▶ How is compliance checked and enforced by these bodies/institutions?
- ▶ What type of credit reporting system is in place in your country?

Trends and concerns:

- ▶ What are the major concerns and issues on the three focus client protection principles in microfinance in your country?
- ▶ What are the major trends/developments in the area of client protection in microfinance in your country?

4.4 Report

In this report, the results of this study are aggregated and presented to give an overview of the current state of law and regulation with regard to client protection. Rather than giving a detailed description of country-specific aspects, the aim of the report is to draw a general picture of client protection in the microfinance sector. Where relevant, country-specific examples have been provided to emphasize important developments.



5

Research results

5.1 Specific regulation for microfinance institutions

As the microfinance services grew during the past decades, and in some places became a sector of its own, several countries have started to develop specific laws and regulations for the microfinance sector. In other countries, the sector is covered by the regulatory regime of the regular financial sector.

In general, microfinance institutions can be classified in two groups, the credit-taking microfinance institutions and the non-credit-taking microfinance institutions. A large number of microfinance institutions in the countries covered do not take deposits from clients and are therefore not covered by the regular banking acts because they are not allowed by law. In general, microfinance institutions that do take deposits are covered by the regular national banking laws. These regular banking laws and regulations are more stringent than laws and regulations applicable to non-bank financial institutions.

In recent years, however, some countries have started to differentiate microfinance institutions from the regular financial institutions covered by acts for financial institutions. In these countries, microfinance institutions were previously not covered at all or covered by the regulatory regime of the regular financial sector. This changed when the microfinance sector grew and small scale lending became a sector of its own, with its own set of specific rules and regulations.

Roughly half of the countries in scope have specific regulations for microfinance.³ This does not necessarily mean microfinance clients are better protected in these countries, as these rules and regulations mostly address other areas than client protection (such as capital adequacy and reporting requirements).

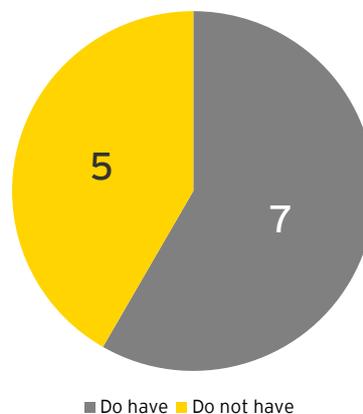
The research has shown that in India, for instance, the Non Banking Financial Company – Micro Finance Institutions Act,

which was put in place on 1 July 2013, sets out a specific set of rules for microfinance institutions, including client protection. In addition to the rules and regulations that also apply to regular financial institutions, this law sets out requirements that are specific for the microfinance sector, such as:

- ▶ A maximum percentage of funds that can be lent for personal use and emergencies
- ▶ A maximum interest rate, based on the cost of funds and the average base rate of the five largest commercial banks
- ▶ A maximum variance for the differential rate of individual loans

Another example of differentiation is Bolivia, where authorities are trying to encourage the growth of the sector by implementing laws and regulations where the microfinance institutions enjoy certain advantages. This allows for the development of new credit granting technologies such as “Bancas Comunes”.⁴

Total number of countries that have specific microfinance regulations



³These countries are: Bolivia, Cambodia, Ghana, India, Kenya, Russia and Uganda.

⁴This is an initiative that has been developed by UNICEF and facilitates granting of small credits by and for local communities. The effort is mainly aimed at keeping interest rates and other fees as low as possible. Many of these Bancas Comunes are based in the poorest region of the country, and all are owned by the local population itself.



5.2 The regulatory landscape

The basis of the regulatory landscape is largely the same in the countries that were studied (we make reference to the overview below). In 11 out of 12 countries in scope, the local central banks play a vital role in the regulatory and supervisory framework of the microfinance sector. As microfinance entails both banking and non-bank activities, other institutions, such as the insurance regulators in Peru, Cambodia and the Philippines, are also involved in regulating the sector. In the Philippines for example, the Insurance Commission regulates and supervises the operations of life cooperative insurance entities to ensure that adequate insurance protection is available to the public at a fair and reasonable cost.

The main difference in regulatory landscapes between countries are the various institutions that are involved in the sector. These include microfinance associations and regular banking associations. These associations are actively involved in developing self-regulation. Consumer protection agencies, which promote consumer rights in the entire economic system, sometimes also contribute to client protection in the microfinance sector.

Microfinance associations play an important role in the regulation and supervision of the sector. The research shows that these organizations are often involved in a consultative capacity in the process of rule setting. In Cambodia, for instance, the National Bank of Cambodia (NBC) consults with the Cambodia Microfinance Association (CMA) before rules, regulations or circulars are published. Currently, the adoption of IFRS in the microfinance sector is being discussed between these two organizations. The CMA also consults with the NBC when it receives signals from its members about issues in the sector that need to be addressed. The same consultative arrangement has been witnessed in Azerbaijan and in Kenya, where there is an arrangement between the Central Bank of Kenya (CBK), the Consumer Federation of Kenya (CFK) and the Association of Microfinance Institutions of Kenya (AMFI).

Although many countries have consumer protection agencies, their involvement in the microfinance sector is not self-evident. Typically, the agencies are not directly involved in developing regulation. They do, however,

support microfinance clients by increasing financial literacy and in helping to resolve conflicts between client and financial institution. An example where the consumer protection agency is involved in the microfinance sector is Peru. INDECOPI, the local consumer protection agency, has the function of protecting consumer rights and is responsible for applying fines in case of violation of consumer protection laws. The authority of this organization includes, but is not limited to, the microfinance sector. In Uganda, by contrast, the role of the Uganda Consumers' Protection Association is to forward customer complaints to the Association of Microfinance Institutions of Uganda who will handle them. In Kenya, the Consumer Federation of Kenya is in regular contact with the regulator (the CBK), but like in Uganda, is not involved in law making.

An overview of the parties involved in setting law and regulation per country:

Azerbaijan	Central Bank of the Republic of Azerbaijan
Bolivia	Autoridad de Supoervisión del Sistema Financiero (ASFI)
Cambodia	National Bank of Cambodia Cambodia Microfinance Association (consultative role)
Ghana	Central Bank of Ghana
India	Reserve Bank of India
Kenya	Central Bank of Kenya Kenya Consumer Protection Advisory Committee (consultative role)
Peru	Central Bank of Peru Superintendencia de Banca, Seguros y AFP (SBS)
Russia	Central Bank of Russia Federal Service for Supervision of Consumer Rights Protection and Human Well-Being (Rosпотребнадзор) Self-regulatory organizations (IUMO Edinstvo, SRO NP MiR)
Philippines	Central Bank of the Philippines Securities and Exchange Commission Insurance Commission (IC)
Rwanda	National Bank of Rwanda
Tanzania	Central Bank of Tanzania
Uganda	Bank of Uganda (central bank) Association of Microfinance Institutions in Uganda (AMFIU) (consultative role)



5.3 Over-indebtedness

The issue of over-indebtedness is generally regarded to be one of the most serious problems of the microfinance sector at the moment. The SMART Campaign, a global initiative to enhance client protection in microfinance, states that “many within the sector have seen an overemphasis on the supply side, which can have the effect of microfinance institutions not adequately knowing their clients’ repayment capacities.”

In microfinance, the global issue of over-indebtedness has surfaced in many countries, such as Nicaragua, Morocco, Ghana, Bosnia and Pakistan, but most prominently in India. In 2010, 200 people in the state of Andhra Pradesh reportedly took their own lives as a result of the pressure put on them to repay their microfinance loans. It appeared that many borrowers had been able to take out loans far above their repayment capabilities. This crisis made many question the “magic bullet” status that previously had been ascribed to the microfinance sector. It showed that when microfinance clients take out more loans than they are capable of repaying, this has a negative social impact. When over-indebtedness is not taken into account, microfinance may counteract its own goal of helping poor communities develop.

Therefore, one of the principles of the SMART Campaign is that: “[p]roviders 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).”

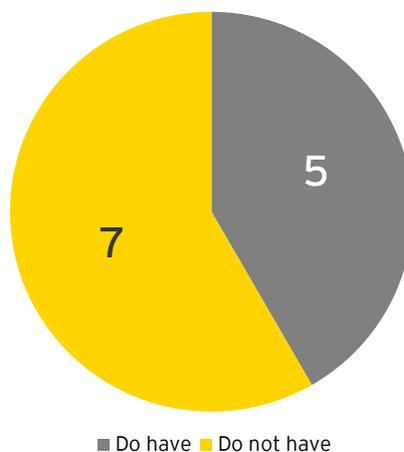
The research showed that less than half of the countries in scope have specific regulation aimed at this principle. The fact that most microfinance institutions are non-deposit taking and thus fall under the non-bank regime, means that they are not covered by the legislation for regular banks on the issue of over-indebtedness. In Cambodia, for instance, microfinance institutions are excluded from the obligation to monitor large exposure to single beneficiaries. This law

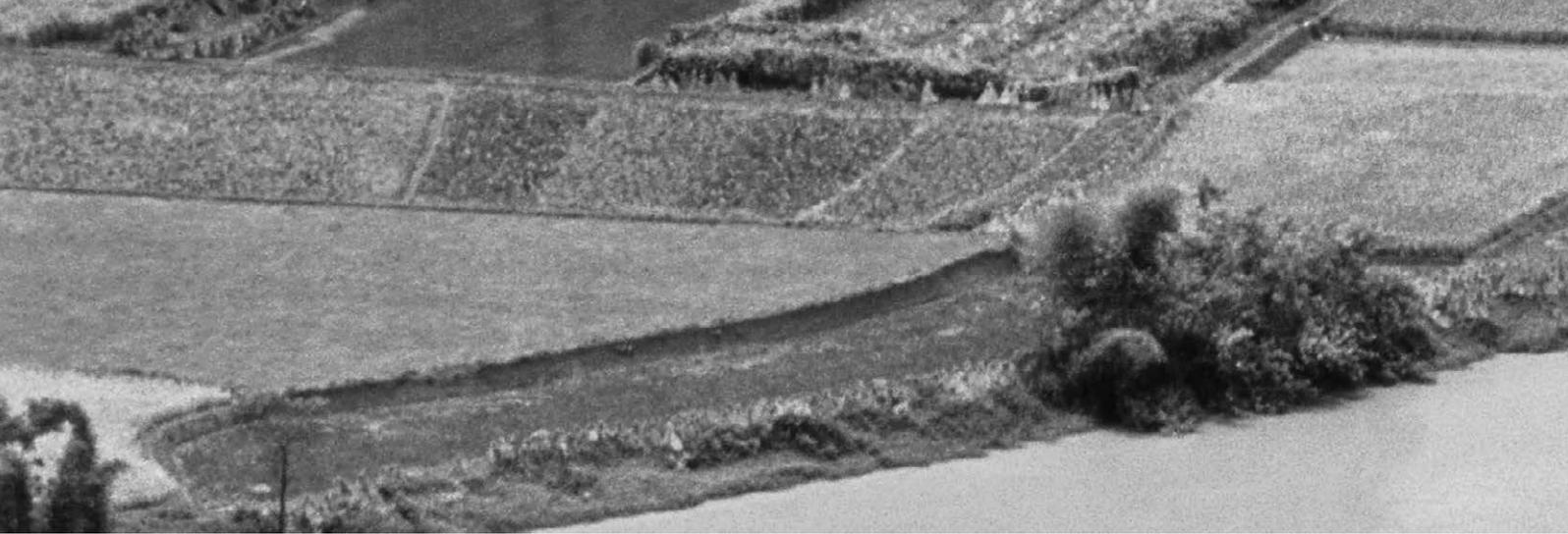
currently only applies to regular banks.

To fill this regulatory gap, regulators in some of the countries researched have developed over-indebtedness regulations specifically for the microfinance sector. Tanzania is one of those countries: the Microfinance Companies and Microcredit Activities Regulations (2004) states that institutions engaged in granting individual microcredits are required to conduct an appraisal of the character, payment history and payment capacity of each client. Therefore each entity has a documented loan appraisal procedure to identify the repayment capabilities of clients.

One of the causes of over-indebtedness is clients taking out loans at multiple microfinance institutions. This may result in a total loan sum that is higher than the client is able to repay. Therefore, information sharing on the credit of microfinance clients between (micro)finance institutions is key to preventing over-indebtedness. The issues surrounding information sharing are discussed in section 5.8 on credit reporting systems.

Total number of countries with specific regulations regarding over-indebtedness





5.4 Responsible pricing

The pricing, terms and conditions of financial products offered to microfinance clients are important factors in increasing the sustainability of the microfinance sector and preventing over-indebtedness. The sector has seen relatively high interest rates compared to the regular financial sector, as a result of the higher risk profile of microfinance as well as the high operational overheads. Given the relatively small loan size, microfinance institutions have relatively high costs per loan compared to players in the regular financial sector. To prevent over-indebtedness and contribute to the sustainability of the sector, it is key that microfinance institutions take into account the personal situation of their clients. This is not limited to the pricing of the financial product, but also includes the repayment conditions and term of the loan. In the SMART Campaign, this is reflected in the principle that:

“[p]ricing, 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.”

Seven out of 12 of the countries included in the study do not have regulation on responsible pricing. In these countries, the emphasis is on the transparency of prices (refer to section 5.5) and the sales process, while price setting itself is left to the market.

In three countries in scope (Peru, Russia and the Philippines), microfinance institutions are covered by regular financial laws and regulations concerning price setting. Cambodia and India have specific price-setting rules for the microfinance sector.

In the rest of the countries, pricesetting is not regulated by law. The National Microfinance Policy of Tanzania states that:

“Pricing is one of the most important determinants of the potential of micro-finance services to become sustainable. Prices should be set by the micro-finance organisations themselves, not by the Government, the Bank of Tanzania or donors because it is only the institution that has the full knowledge of its costs, the market it faces, and its own business strategy that forms the basis for pricing decisions.”

In contrast, India and Russia prescribe limits for interest rates and processing costs that can be transferred to clients.

The Indian NBFC-MFIs regulations determine that:

“[t]he interest rates charged by an NBFC-MFI to its borrowers will be the lower of the following:

- ▶ Cost of funds, plus margin (Cost of funds means interest cost and margin is a mark-up of a maximum of 10 % for large NBFCs-MFI and 12 % for others).
- ▶ The average base rate of the five largest commercial banks by assets multiplied by 2.75”

Further, the “[p]rocessing charges by NBFC-MFIs shall not be more than 1 % of gross loan amount. Processing charges need not be included in the margin cap. Further, NBFC-MFIs shall recover only the actual cost of insurance for group, or livestock, life, health for borrower and spouse.”

India and Russia are unique in this sense, compared to the other countries in scope. In the other countries with regulation on responsible pricing, the regulations are more aimed towards the process and principles of price setting. Article 11 of the Peruvian *Resolución SBS N° 8181 -201* that covers the entire financial sector is a good example of such regulation. It states that:

“[t]he commissions or fees must involve the provision of an agreed service whose value is based on a real and demonstrable cost. Companies must have the underpinnings of the case in order to prove the actual existence of the service and to justify the transfer of such concept to customers, through a fee or expense. In the case of expenses, the amount is recorded as such concept must be documented.”



5.5 Transparency

With the expansion of the microfinance sector, the number and complexity of products have increased. Therefore, transparency about the products offered is crucial for client protection. The SMART Campaign emphasizes the need for 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.”

Out of the three subjects of client protection regulation covered in this study, transparency laws and regulations seem most well-developed. Almost all countries have regulations on the communication and dissemination of information between microfinance institutions and their clients.

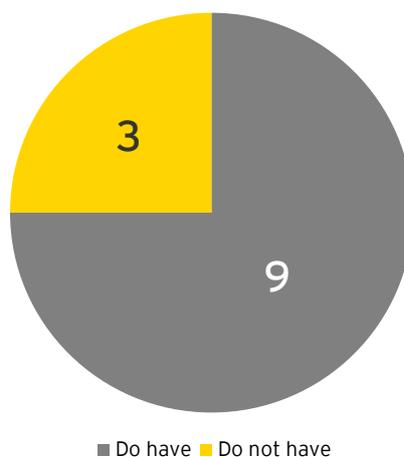
The laws and regulations on transparency typically require financial institutions to provide information on the pricing of products and (additional) costs and expenses involved, in a way that is understandable to microfinance clients. Some countries have more comprehensive requirements that cover aspects, such as advertisement and service offering (Peru) or even the obligation to provide an oral explanation to microfinance clients that are unable to understand the written information (Uganda). The Uganda Financial Consumer Protection Guidelines further state that:

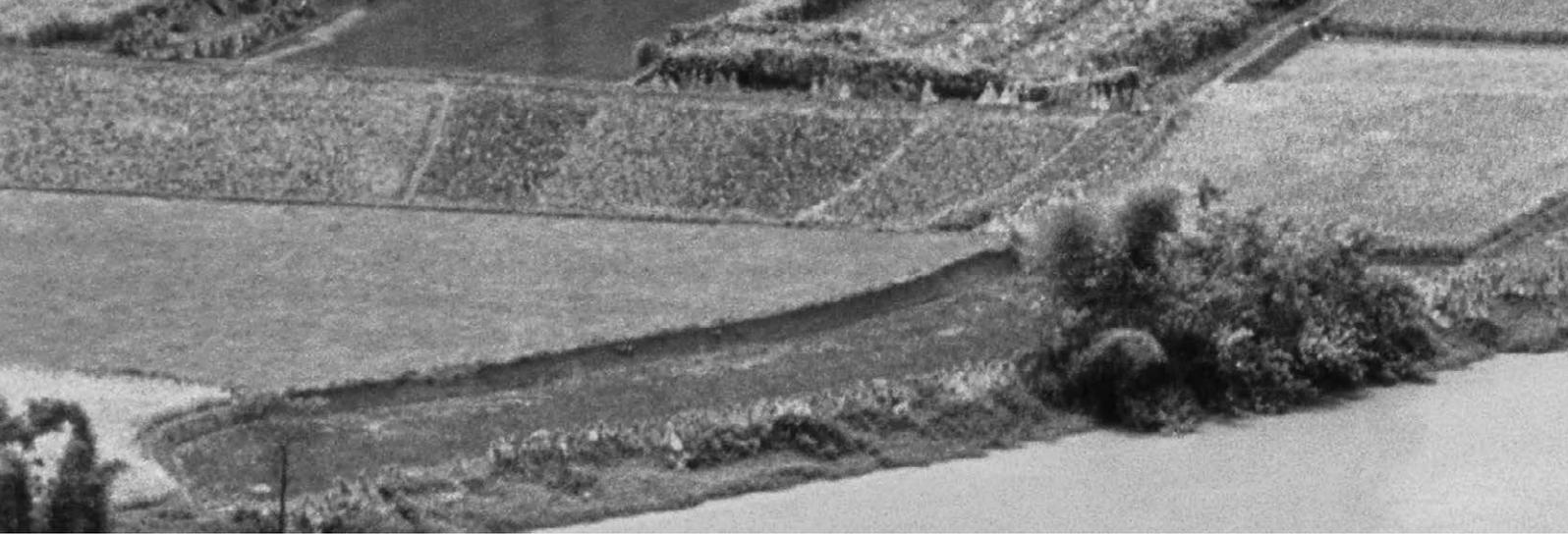
“Disclosure of the name and contact details of the regulator will make a consumer aware that the financial services provider is regulated; and will assist the consumer to be able to contact the regulator if the consumer considers that the financial services provider has failed to comply with its regulatory requirements.”

In Tanzania, microfinance institutions are required to let all microfinance clients sign a legal document, containing information on the terms and conditions of the financial product, to confirm that they understand the terms and conditions of the loan.

In a number of countries, initiatives are taken to enhance the financial literacy of microfinance clients. Both consumer protection agencies and microfinance associations are deploying initiatives in this area. Increased financial literacy could make clients more aware of the implications of their financial decisions and more critical towards the information that is supplied by the microfinance institutions. In Kenya, the regulator, the CBK, is particularly active in this area. It has been carrying out sensitization programs through agricultural shows and colleges. Additional measures undertaken by CBK include requiring the microfinance institutions to set aside funds for customer education in their budgets.

Total number of countries with specific regulations regarding transparency





5.6 Code of Conduct

To gain insight into the type of behavior that is expected of microfinance institutions towards clients, the study looked at the existence and content of codes of conduct that are available or even mandatory in the countries in scope. The study found that in less than half of the countries in scope a formal code of conduct is available on the basis of which financial service providers commit to mutually agreed standards within the microfinance sector.

The codes of conduct in the different countries come in many shapes and forms. In Tanzania, every microfinance institution develops its own code. Bolivian, Indian and Peruvian microfinance institutions are required to adopt the same code of conduct that applies to the regular financial sector.

The codes of conduct in the microfinance sector typically cover aspects such as:

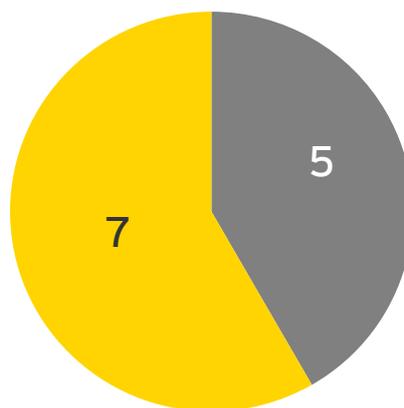
- Regulatory framework and scope
- Respect to the integrity of the market
- Enforcement of banking secrecy
- Conflicts of interest
- Prevention of money laundering
- Use of information
- Respect for competition
- Responsibility of the directors, officers and employees
- Board of ethics

The Microfinance Council of the Philippines does not prescribe a specific code of conduct for its members, but does facilitate information sharing on this topic between the different institutions. Suggested standards are also addressed and discussed in this forum.

An overview of the available codes of conduct per country:

Cambodia	Developed by the Cambodia Microfinance Association
India	Developed by the Reserve Bank of India
Peru	Código de Etica de las empresas del Sistema Financiero (Code of Ethics for Financial Institutions), issued by the Association of Peruvian Banks
Russia	Code of Ethics, issued by the self-regulatory organization SRO NP MiR
Uganda	Developed by the Association of Microfinance Institutions of Uganda

Total number of countries where a formal code of conduct for microfinance sector is available



■ Do have ■ Do not have



5.7 Enforcement and compliance

The impact of the law and regulation on client protection in microfinance largely depends on effective enforcement and monitoring of compliance. Therefore, the study includes an evaluation of the parties involved in enforcement and the monitoring activities.

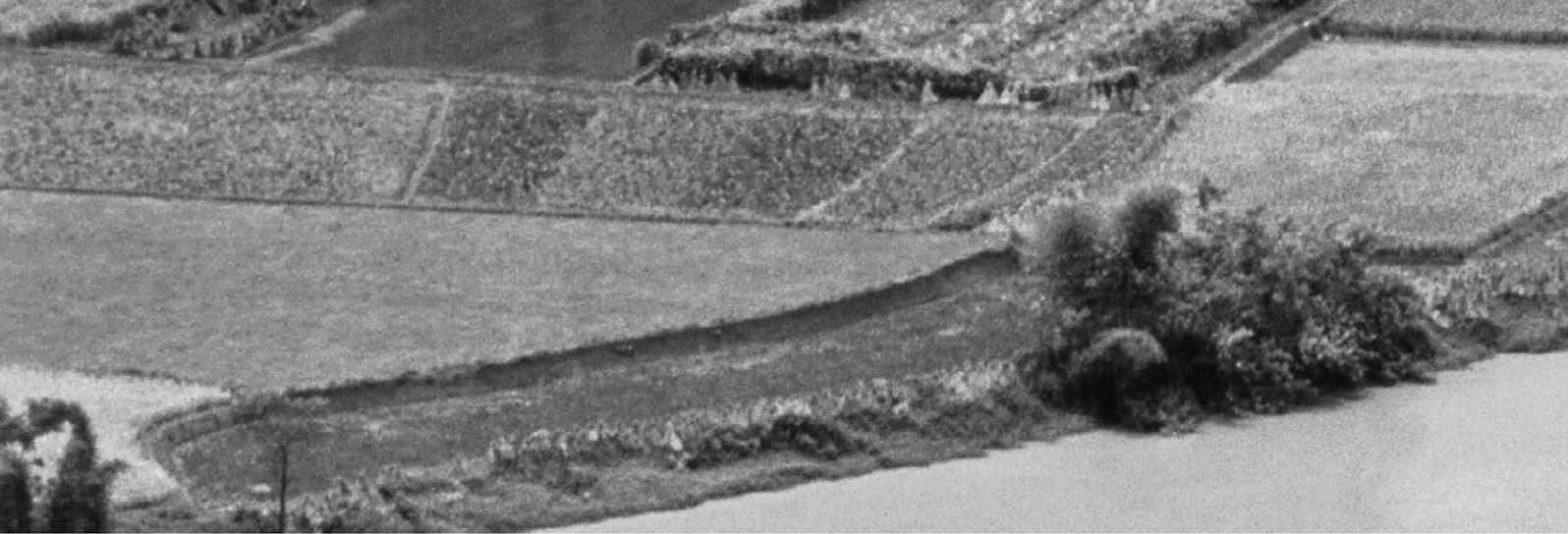
5.7.1 Enforcement and oversight bodies

The study found that the central banks and other regular financial regulators that are mentioned in section 5.2, are the most important enforcement institutions for the microfinance sector. In all countries, microfinance institutions that are under supervision receive regular supervisory visits by the oversight bodies. Other parties involved in the monitoring and auditing of the microfinance sector are external auditors, microfinance associations and special microfinance authorities (such as the Cooperative Development Authority in the Philippines). This means that many different types of authorities are involved in enforcement of laws and regulations, with different levels of monitoring and audit scrutiny.

Where there is no specific microfinance regulation, non-bank microfinance institutions are not always audited. Cambodian non-bank microfinance institutions, for example, are only audited by the tax authorities. In Tanzania, authorities do not carry out reviews on non-bank institutions and thus oversight and compliance with regulations is the responsibility of the board of the institution itself.

Oversight bodies per country:

Azerbaijan	Central Bank of the Republic of Azerbaijan
Bolivia	Autoridad de Supoervisión del Sistema Financiero (ASFI)
Cambodia	National Bank of Cambodia General Department of Taxation
Ghana	Central Bank of Ghana
India	Reserve Bank of India
Kenya	Central Bank of Kenya
Peru	Central Bank of Peru Superintendencia de Banca, Seguros y AFP (SBS) INDECOPI (Consumer Protection Agency) FENACREP (Federación Nacional de Cooperativas de Ahorro y Crédito)
Russia	Central Bank of Russia Self-Regulatory Organization Nonprofit Partnership "Microfinance and Development" (SRO NP MiR) Institution of Financial Ombudsman
Philippines	Central Bank of the Philippines Philippine Deposit Insurance Corporation (PDIC) Cooperative Development Authority (CDA) Insurance Commission (IC)
Rwanda	National Bank of Rwanda
Tanzania	Central Bank of Tanzania
Uganda	Bank of Uganda (central bank) Association of Microfinance Institutions in Uganda (AMFIU)



5.7.2 Enforcement of law and regulation regarding client protection

In cases where regulatory reviews are carried out, the emphasis of the reviews is on financial aspects, such as minimum capital adequacy requirements, liquidity requirements, asset quality, reports on balance sheet, profit and loss and portfolio quality. There are, however, exceptions to this rule. In India, external auditors of microfinance institutions also report on compliance with client protection regulations.

Other parties can also play a role in the enforcement of law and regulation regarding client protection. The Russian Self-Regulatory Organization Nonprofit Partnership “Microfinance and Development” (SRO NP MiR) is involved in customer rights protection, with the participation of the Institution of Financial Ombudsman. Active steps are being taken to ensure smooth arbitration between the microfinance organizations and their clients through this organization. In Peru, the consumer protection agency does not carry out audits, but supports microfinance clients in addressing issues with the institutions and thereby contributes to the enforcement of law and regulation.

5.8 Credit reporting systems by credit bureaus

One of the causes of over-indebtedness of microfinance clients is the lack of information sharing on the credit worthiness of clients between different microfinance institutions. When there is no comprehensive overview of a client’s total outstanding loans, microfinance institutions cannot effectively assess a client’s repayment capabilities.

Seven out of 12 countries have at least one credit bureau in place that is accessible to microfinance institutions, or are in the process of developing one. Credit bureaus administer the credit history of clients of financial institutions and make this information available to financial institutions against a subscription fee. However, not all countries require the microfinance institutions to use these credit reporting systems by law. Cambodia, for instance, does have credit bureaus, but microfinance institutions are not required to use them. Another issue is the accessibility of the information to all microfinance institutions. For microfinance institutions to gain access to the information, subscription (by payment of a specific fee) is necessary. The smaller microfinance institutions often do not have the means to gain access to these systems. This is the case in the Philippines, where such institutions are forced to rely on “on the ground” information, rather than the central register. In Bolivia, there are separate systems for regulated and non-regulated institutions, meaning that it cannot be assured that all relevant credit information of a client is available to microfinance institutions.



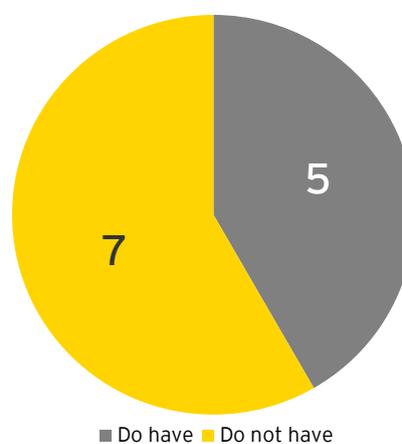
Microfinance institutions in Russia are confronted with similar issues. According to SRO NP MiR, a self-regulatory organization in the Russian microfinance sector, due to the lack of specialized reports for microfinance institutions, microfinance institutions in Russia have to work simultaneously with several credit bureaus. In case of the absence of specialized IT software, this process is quite costly. In 2014, SRO NP MiR, in collaboration with one of the leading Russian credit bureaus, announced a plan to create a specialized credit bureau for microfinance organizations.

In addition, where credit bureaus are in place, it will take time before their full potential in terms of coverage and historical basis is available. The Indian authorities specifically point out this issue in the explanation of the use of credit reporting systems by microfinance institutions:

“Every NBFC-MFI has to be a member of at least one Credit Information Company (CIC) established under the CIC Regulation Act 2005, provide timely and accurate data to the CICs and use the data available with [...], level of indebtedness and sources of borrowing. While the quality and coverage of data with CICs will take some time to become robust, the NBFC-MFIs may rely on self certification from the borrowers and their own local enquiries on these aspects as well as the annual household income.”

Azerbaijan	Centralized Credit Registry (by the Central Bank of the Republic of Azerbaijan)
Bolivia	Central Credit Risk ASFI “CIRC” (for regulated entities) INFOCENTER (for non-regulated entities)
Cambodia	Multiple private credit bureaus
India	Multiple private credit bureaus
Peru	Infocorp (for regulated entities) Certicom (for regulated and non-regulated entities)
Russia	Multiple private credit bureaus
Uganda	Credit Reference Bureau (only available to regulated entities)

Total number of countries that have a credit reporting system





6

Conclusions and outlook

6.1 Conclusions

The rapid expansion of the microfinance sector into different geographies and the establishment and development of many different institutions are noticeable in the laws and regulations that govern this sector.

Microfinance institutions come in many shapes and forms. There are (international) commercial banks involved in the microfinance sector, as well as small, regionally focused cooperatives and NGOs. Effectively regulating and supervising all different types of microfinance institutions, especially the smaller ones with non-bank activities, proves to be challenging. For the purposes of this study, we have focused on two homogenous groups from a regulatory point of view. They are: deposit-taking microfinance institutions (that generally fall under regulation applicable to regular financial institutions such as commercial banks) and non-deposit-taking microfinance institutions that often are not regulated or are covered by specific microfinance regulations.

Roughly half of the countries in scope have **specific regulation for microfinance institutions**. This does not necessarily mean microfinance clients are better protected in these countries, as these rules and regulations do not always specifically address client protection.

Transparency regulation is relatively well developed in most countries. Conversely, price setting is mostly left to the market. **Over-indebtedness** is generally regarded as a serious problem in the microfinance sector. The majority of countries have regulations concerning over-indebtedness, and some have or are developing some sort of credit reporting system, although accessibility of these systems, especially to smaller microfinance institutions remains a concern.

The microfinance sector is still developing, and so is the regulatory landscape. Regulators and other authorities are struggling with the different shapes and sizes of the organizations that populate the microfinance sector.

Our view is that the effective protection of microfinance clients entails more than regulation alone. Enhancing financial literacy among clients and increasing accessibility of credit information to microfinance institutions are key ingredients to reaching this goal. It is encouraging to see that consumer protection agencies and microfinance associations are becoming increasingly active in these fields.

6.2 Outlook

We see this research as the first step in gathering insights on the topic of law and regulation in the microfinance sector. The impact of law and regulation on the microfinance sector has not been covered by the study, but is a logical step for further research. Due to the fact that the sector is still developing and the fact that the regulatory landscape is still evolving, information on impact may not yet be forthcoming. Drawing on the insights of this study, there are a number of areas that could be further researched to help effective client protection in microfinance move forward. These areas include addressing the following questions:

- ▶ What is the impact of law and regulation regarding client protection on the sector?
- ▶ Do countries with more regulation and enforcement in the field of client protection have lower rates of over-indebtedness?
- ▶ The microfinance sector is heavily reliant on self-regulation: what effect does this have on client protection?
- ▶ How does client protection impact investor confidence in microfinance institutions? Does more regulation and enforcement lead to higher investor confidence? Is there a difference between the behavior of institutional investors and other groups of investors (e.g., impact investors) regarding client protection issues?

We encourage further research and information sharing in these areas.

About NpM

NpM, Platform for Inclusive Finance, promotes inclusive finance as a contribution to poverty alleviation in developing countries. The platform, established in 2003, brings together developing organizations, social investors, private foundations and commercial banks from The Netherlands. Together with the Dutch Ministry of Foreign Affairs, the 13 Dutch members share a commitment to expanding access to finance in underserved regions and anticipate the changing need in the sector to grow towards a responsible industry.

The members of NpM are active in over 90 countries. They support organizations that offer financial services to community-based organizations, cooperatives, non-governmental organizations, banks and other financial institutions. The NpM members also support various global initiatives in order for the industry to grow in sustainable and responsible way.

The members of NpM have different fields of expertise and offer a broad range of financial services at each development stage of a microfinance institution.

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