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Keeping clients first  
in microfinance

**Smart Lending: Client Protection in the Group Lending Process:  
An Overview of Client Protection Practices in Group Lending for Financial Institutions**

## Introduction

“Smart Lending: Client Protection in the Group Lending Process”<sup>1</sup> is a tool for financial institutions (FIs) that want to incorporate client protection practices into their group lending process. As group lending continues to be one of the most popular methodologies for delivering financial services throughout the world, this tool should prove useful to scores of financial service providers. The tool is applicable to a wide range of credit methodologies, and can be adapted for use by FIs employing village banking methodology, Grameen-style “group of groups” methodology, and other forms of group lending.

**Section I** provides guidelines for FIs on group loan product design and staff training. Appropriate product design and adequate staff training do not apply to a specific **phase** of the group lending process, rather, they provide a foundation for client protection throughout the entire process.

**Section II** divides the group lending process into five key phases and identifies good client protection practice for each phase. The five phases are: (1) Client Recruitment and Group Preparation, (2) Loan Application, (3) Evaluation and Loan Approval, (4) Disbursement, (5) Customer Service and Collections.

For each phase, the tool identifies distinct “**service points**”—points of interaction between the client and the institution. For each service point, the tool:

- demonstrates how an FI can incorporate **adequate effort** in client protection in their policies, and practices; and
- identifies which **Client Protection Principles** apply.

The **Annex** provides recommendations for the use of **client protection tools** that could help FIs improve their client protection practices at each service point. The tools listed are available for download on the Smart Campaign’s website, [www.smartcampaign.org](http://www.smartcampaign.org)

Note: Most of the guidance provided in this tool corresponds with the Smart Campaign’s certification program, which is a benchmark for standards of care. Where the guidance refers to standards or practice that are beyond the certification level, it is noted.<sup>2</sup>

**The Client Protection Principles** (short form listed below, for complete description, see [www.smartcampaign.org](http://www.smartcampaign.org))

1. Appropriate Product Design and Delivery
2. Prevention of Over-indebtedness
3. Transparency
4. Responsible Pricing
5. Ethical Staff Behavior
6. Privacy of Client Data
7. Mechanisms for Complaint Resolution

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<sup>1</sup> Authored by Leah Wardle, with: Accion India, Hema Bansal, Amit Gupta, Ujjivan, Grameen Koota, Victoria White, Isabelle Barres, and Alexandra Rizzi.

<sup>2</sup> To view a complete list of the Smart Campaign Certification Standards, see the Smart Campaign website: <http://smartcampaign.org/certification/certification-standards>

## **Section 1: Client Protection for Product Design and Staff Training**

The guidelines in this section do not apply to a specific phase of the group lending process, rather, they provide a foundation for client protection throughout the entire process.

### **CLIENT PROTECTION FOR PRODUCT DESIGN<sup>3</sup>**

FIs should carefully design group loan products that meet clients' needs and do not unintentionally harm clients. This means that FIs do not offer products that produce negative value for the clients. In practical terms, institutions should evaluate client demand for products and services, client satisfaction, and the reasons for client drop out. This client feedback provides important insights for designing appropriate products, and allows FIs to understand how clients experience the products, and whether the products are producing positive or negative value for clients.

Complaints information is another source of information on clients' experience with the institution's products and services. Through regular analysis of complaints data, FIs can determine how to make operational enhancements that will improve their institutions' products and services. In the same way, FIs should use this information to correct mistakes, omissions, and activities that may be harmful to the client.

It is important that FIs offer multiple or flexible loan products that address different business and family needs. Though group loans are often less flexible than individual loans, institutions should offer enough flexibility that clients are not harmed by purchasing a rigid product that is not suitable to their business type and income flow, for example.

Finally, FIs should price their products so that they are affordable to clients. Practically, this means that the FI offers market-based, non-discriminatory pricing and has efficiency ratios that are aligned with peers, so that inefficiencies are not passed on to clients in the form of higher prices. Additionally, fees charged to clients should not be excessive, including prepayment penalties, account closure fees, transaction fees, and other charges.

### **CLIENT PROTECTION FOR STAFF TRAINING<sup>4</sup>**

In addition to appropriate product design, proper staff training is essential to ensure client protection practices throughout the group lending process. FIs should train staff both during orientation, and through ongoing refresher trainings. Essential training topics can be divided into three categories: 1) ethical staff behavior, 2) complaints handling, and 3) data handling.

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<sup>3</sup> Client Protection Principle that applies: Appropriate Product Design and Delivery

<sup>4</sup> Client Protection Principles that apply: Fair and Ethical Treatment of Clients, Mechanisms for Complaint Resolution, Privacy of Client Data

**1) Ethical staff behavior—policies and training**

Financial institutions should clearly spell out, in a Board-approved Code of Conduct, the organizational values and standards of professional conduct that are expected of all staff, including appropriate and inappropriate collections practices. Moreover, staff should sign in agreement of the Code and receive training on the Code and collections policies. Initial training should include a review of the Code of Conduct and a discussion with staff on the situations where the compliance with the Code might be a challenge. All staff involved in collections (loan officers, collections staff, third-party collections agents, and branch managers) should receive additional training in acceptable debt collections practices and loan recovery procedures.

To reinforce training, staff should be required to regularly pass a Code of Conduct test and/or take a Code of Conduct refresher training, which includes concrete illustrations of practices that are laid out in the Code of Conduct.<sup>5</sup> Ongoing training for collections staff should include specific strategies for handling difficult collections and real life case studies.<sup>6</sup>

In addition to training staff on the Code of Conduct and appropriate collections, FIs should provide information on their non-discrimination policies, and ensure that employees know how to practice non-discrimination toward clients.<sup>7</sup> FIs can place a staff member in charge of educating other staff members on non-discrimination, and in charge of reaching out to specifically discriminated groups of the client population.<sup>8</sup>

In addition to receiving training, staff must be informed of penalties for non-compliance with the Code and collections policies. FIs should describe the sanctions that will be taken in case of violation of the Code of Conduct or collections policies (harassment, discrimination, theft, corruption, kickbacks, etc.) that can result in termination of employment. Finally, managers and supervisors should monitor and assess ethical behavior, professional conduct and the quality of interaction with customers as part of staff performance evaluations. Violations should be sanctioned, and additional training offered, as necessary.

**2) Complaints handling—policies and training**

FIs should have a policy for staff that describes how to handle complaints from clients, and how to inform clients about the institution's complaint mechanism. To reinforce this policy, FIs' dedicated staff induction training should include a session on how the complaints

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<sup>5</sup> This practice refers to a standard that is beyond the certification standards

<sup>6</sup> This practice refers to a standard that is beyond the certification standards

<sup>7</sup> A common form of discrimination is treating clients differently and less favorably because of characteristics that are not related to their ability to meet the requirements of the financial institution. Client selection and treatment should not involve discrimination on the basis of personal characteristics or personal affiliations. For more information on non-discrimination, see the Smart Campaign's *Responsible Treatment of Clients: Practicing Non-discrimination*, <http://www.smartcampaign.org/tools-a-resources/548>

<sup>8</sup> This practice refers to a standard that is beyond the certification standards

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mechanism works, the loan officer's role in the process, how to explain the client's right to complain, and how to appropriately manage complaints until they are completely resolved (how to handle complaints and refer them to the appropriate person for investigation and resolution).

**3) Data handling—policies and training**

FIs should have a policy to describe how staff must talk to clients about client data. The policy should require that staff present clearly to clients how they will use and share client data. In addition, the Code of Conduct should penalize misuse or misappropriation of client data.

To educate staff on this policy and ensure client data protection, FIs should provide technical training on how to protect the confidentiality, security, accuracy and integrity of customers' personal and financial information. Loan officers, in particular, should receive training in data management and how to explain data protection to clients.

**Section II: Client Protection in Each Phase of the Group Lending Process**

**PHASE 1: CLIENT RECRUITMENT & GROUP PREPARATION**

<b>Service Point</b>	Promotions <i>Promote products to potential clients.</i>	Product Description <i>Provide specific product information to potential clients.</i>	Group Formation and Training <i>Give clients guidance on group formation and solidarity.</i>
<b>Client Protection Principles</b>	Transparency; Ethical Treatment of Clients; Mechanisms for Complaint Resolution	Transparency; Ethical Treatment of Clients; Privacy of Client Data	Prevention of Over-indebtedness; Ethical Treatment of Clients; Mechanisms for Complaint Resolution
<b>Client Protection Policies</b>	<ul style="list-style-type: none"> <li>• Use at least two different communication channels for disclosing clear and accurate information about the product: written and verbal (to address literacy limitations).</li> <li>• Avoid using pricing mechanisms that create confusion on the total costs, and disclose pricing information in a public domain.</li> </ul>		

<p><b>Client Protection Practices</b></p>	<ul style="list-style-type: none"> <li>Do not use high pressure or aggressive sales techniques.</li> </ul> <p><b>Clear communication with clients always includes:</b></p> <ul style="list-style-type: none"> <li>Use of local language(s)</li> <li>Plain terminology</li> <li>Verbal explanation for illiterate clients</li> </ul> <p><b>For marketing materials specifically:</b></p> <ul style="list-style-type: none"> <li>Do not oversell benefits of credit.</li> <li>Marketing materials should include:             <ul style="list-style-type: none"> <li>basic eligibility requirements for taking a loan;</li> <li>contact information for the institution; and</li> <li>instructions for registering a complaint or question.</li> </ul> </li> </ul>	<ul style="list-style-type: none"> <li>Describe all costs associated with the product(s): price—including the total cost of the loan<sup>9</sup>—the interest rate, other charges, and third-party fees, and whether the above can change over time.</li> <li>Describe: all loan terms and conditions, installments, penalties, linked products, necessary documentation, eligibility criteria, any compulsory programs (e.g. insurance, savings).</li> <li>Describe process for loan recovery in case of late payments (including collateral seizing), and the process for rescheduling credit.</li> </ul>	<ul style="list-style-type: none"> <li>Explain the group guarantee mechanism (solidarity), to encourage the prudent self-selection of members. Explain the rights and responsibilities of each group member; responsibilities in the case of a client death; and mandatory group/center requirements (attendance, group behavior, etc.).</li> <li>Train group members on the dangers of over-indebtedness and multiple borrowing.<sup>10</sup></li> <li>Train group members to identify other group members' likely cash flow to support loan repayment.<sup>11</sup></li> <li>Train group leaders to safeguard group member information, particularly saving account balances, dates of loan disbursement, and information on repayment problems.</li> <li>Inform clients of the main aspects of the Code of Conduct. Information includes clients' right to complain and how to submit a complaint.</li> </ul>
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<sup>9</sup> The institution should provide the client with the total cost that they pay for the loan, regardless of local regulation on pricing transparency. A high standard of client protection requires institutions to follow Annual Percentage Rate (APR) or Effective Interest Rate (EIR) calculation formulae.

<sup>10</sup> This practice refers to a standard that is beyond the certification standards.

<sup>11</sup> This practice refers to a standard that is beyond the certification standards.

**PHASE 2: LOAN APPLICATION**

<b>Service Point</b>	<b>Group Loan Application</b> <i>Guide groups through the process of applying for a loan.</i>	<b>Management of Client Information</b> <i>Explain and ensure the security of client data.</i>
<b>Client Protection Principles</b>	Transparency; Mechanisms for Complaint Resolution; Privacy of Client Data	Ethical Treatment of Clients, Privacy of Client Data
<b>Client Protection Policies</b>	<ul style="list-style-type: none"> <li>• During the group loan application process, emphasize the concept of solidarity payment, to encourage appropriate loan size requests.</li> <li>• In an institutional policy, describe acceptable pledges of collateral, and include clear guidelines for how collateral is registered and valued.</li> <li>• Provide group members with the credit bureau credit checks done on other members.</li> <li>• In an institutional policy, describe how the institution maintains the security and privacy of client data.</li> <li>• Govern the gathering, processing, use, distribution and storage of client information through a written privacy policy that covers current staff and those who leave the organization.               <ul style="list-style-type: none"> <li>○ Have systems in place (including secure IT systems) to protect the confidentiality, security, accuracy and integrity of customers’ personal and financial information.</li> <li>○ Use different password protection systems that are changed periodically with different access levels according to staff security clearance.</li> <li>○ If files are stored in physical format, store the client files in a secure location, within the branch or headquarters that 1) has restricted access only to selected persons; 2) is kept in a facility secure from fire or theft.</li> </ul> </li> <li>• Provide clients with a privacy clause in the contract, in plain language, and not hidden in confusing language or buried in the contract.</li> </ul>	
<b>Client Protection Practices</b>	<ul style="list-style-type: none"> <li>• Register and value client collateral according to institutional policy.</li> <li>• Explain why assets are being recorded (e.g., for loan size evaluation and collateral) and what can happen to these assets in case of default. Include on the application any assets recorded as collateral.</li> <li>• Explain the client consent form and what a signature implies for the client and group.</li> <li>• Include institution’s contact information on the application.</li> <li>• Explain how application data will be used and stored.</li> </ul>	<ul style="list-style-type: none"> <li>• Inform customers how their information will be used internally and, when applicable, when it will be shared externally.</li> <li>• Obtain written client consent before sharing personal information with any external audience, including credit bureaus, insurance agents, collections companies, and others.</li> <li>• Ask clients to sign a separate document from the contract called a Privacy Agreement where credit bureaus, disclosures, and consents are explained.<sup>12</sup></li> <li>• Read the Privacy Agreement aloud to the client.</li> </ul>

<sup>12</sup> This practice refers to a standard that is beyond the certification standards.

**PHASE 3: GROUP LOAN APPROVAL**

Service Point	Financial Analysis <sup>13</sup>
	<i>Analyze personal and financial information to determine group eligibility and loan size.</i>
<b>Client Protection Principle</b>	Prevention of Over-indebtedness
<b>Client Protection Policies</b>	<ul style="list-style-type: none"> <li>• Monitor the risk of client over-indebtedness at the management and Board levels.</li> <li>• When incentivizing staff, balance portfolio growth with portfolio quality to discourage lending to over-indebted clients.</li> <li>• Establish and ensure that loan officers understand explicit guidelines for client debt thresholds and acceptable levels of debt from other sources.</li> <li>• Adequately disseminate the FI's repayment capacity policy among staff, considering staff growth and turnover.</li> <li>• Use internal audit to routinely check loan officers' financial analysis, and to follow up with a sample of delinquent clients to check for over-indebtedness.</li> </ul>
<b>Client Protection Practices</b>	<ul style="list-style-type: none"> <li>• Review client data from the credit bureau to assess group/client repayment capacity prior to disbursement at each loan cycle. If no credit bureau is available, consult with competitors, as feasible in the local context.</li> <li>• Perform a repayment capacity analysis at each loan cycle, even if simplified for secondary aspects at loan renewal. Base the analysis on a client visit, performed by the loan officer or trained group members.</li> <li>• Do not rely solely on guarantees (whether peer guarantees, co-signers or collateral) as a substitute for good capacity analysis.</li> <li>• Avoid parallel loans within the FI (i.e., combining loan products to meet the same need, or restricting the loan use).</li> </ul>

<sup>13</sup> For in-depth guidance on financial and non-financial loan analysis, please see the Smart Campaign's *Avoidance of Over-indebtedness: Guidelines for Financial and Non-Financial Evaluation*, at <http://smartcampaign.org/tools-a-resources/514>

**PHASE 4: DISBURSEMENT**

<b>Service Point</b>	Disbursement <i>Verbally review important account information before opening account.</i>	Documentation <i>Provide clients with a summary document to take home.</i>
<b>Client Protection Principles</b>	Prevention of Over-indebtedness, Transparency; Responsible Pricing; Ethical Treatment of Clients	Transparency; Responsible Pricing; Ethical Treatment of Clients; Mechanisms for Complaint Resolution
<b>Client Protection Policies</b>	<ul style="list-style-type: none"> <li>• Allow sufficient time in the disbursement process for clients to ask questions and address concerns.</li> <li>• Ensure contracts contain simple language and no fine print nor hidden conditions.</li> <li>• Offer a cooling off period (i.e., client can change his/her mind and cancel the loan within certain period, even after signing the contract).</li> </ul>	
<b>Client Protection Practices</b>	<ul style="list-style-type: none"> <li>• Do not force clients to sign contracts (no forced signing of any individual borrower or group member, or any guarantor).</li> <li>• Verbally review each loan document with the group, including the repayment schedule.</li> <li>• Read the summary sheet to the group (see right).</li> <li>• Explain all costs (e.g. stamp duty, margin money, insurance, any other linked products, etc.). Advise clients not to pay additional fees or commissions to staff, beyond what is explained in disbursement speech.<sup>14</sup></li> <li>• Advise clients to always ask for a receipt for all transactions.</li> <li>• Provide clients with the time and opportunity to ask questions and to choose not to continue with the loan disbursement, based on their careful consideration of the above information.</li> </ul>	<ul style="list-style-type: none"> <li>• Provide clients a hard copy of all documents signed by clients (including, but not limited to the contract) with all terms and conditions.</li> <li>• Ensure that there are no blank terms in any documents signed by clients (including, but not limited to the contract).</li> <li>• Provide <i>each</i> client with a contract, and/or an individual passbook or payment book with contact terms and signature (even if the contract is between the group and the FI).</li> <li>• Provide a clear facts summary page if the legally necessary contract is difficult for clients to understand.</li> <li>• Explain the above summary sheet in non-legal terms and ask the group if they have questions or concerns.</li> </ul>

<sup>14</sup> This practice refers to a standard that is beyond the certification standards.

**PHASE 5: CUSTOMER SERVICE AND COLLECTIONS**

<b>Service Point</b>	<b>Ongoing Customer Service</b> <i>Continuously support client satisfaction and product understanding.</i>	<b>Collections</b> <i>Collect on-time payments.</i>	<b>Loan Recovery</b> <i>Collect late payments and recover loans.</i>
<b>Client Protection Principles</b>	Transparency; Mechanisms for Complaint Resolution; Privacy of Client Data	Ethical Treatment of Clients	Ethical Treatment of Clients
<b>Client Protection Policies</b>	<ul style="list-style-type: none"> <li>• Provide staff with specific procedures to actively work out solutions (i.e., through workout plan) for rescheduling loans/ refinancing/ writing off on an exceptional basis for late clients who have the “willingness” to repay but not capacity to repay, prior to seizing assets.</li> <li>• Provide staff with prudent limits to allow for the renewal of a loan in case of early repayment by the group.</li> <li>• Enforce an institutional Code of Ethics that spells out values and standards of conduct required by all staff, and clearly defines sanctions for unethical behavior.</li> <li>• Enforce debt collections policies that detail acceptable and unacceptable collections practices to prevent subjective decision making by collections staff.</li> <li>• Monitoring staff behavior (using operations department, internal audits), to provide education or sanctions as necessary.</li> <li>• Evaluate and/or incentivize staff on the quality of their interactions with clients.</li> <li>• Put in place an effective, appropriate system to resolve client complains in a timely way; it should be actively used by clients. Assign a staff member to handle complaints and refer them to the appropriate person for resolution.</li> <li>• Use a reporting system to ensure complaints from branches reach the complaints handling staff, and check that complaints are resolved satisfactorily.</li> <li>• Enforce a non-discrimination policy that prohibits discrimination against clients based on non-financial characteristics.</li> </ul>		

<p><b>Client Protection Practices</b></p>	<ul style="list-style-type: none"> <li>• Inform clients about their right to complain and how to submit a complaint to the appropriate person (or where they could find that information if they don't know it first-hand).</li> <li>• Provide clients with a timely response to any issues—within a month of complaint submission.</li> <li>• Provide clients with clear and accurate information regarding their accounts (e.g., account statements, receipts, balance inquiries, proof of payment for loans).</li> <li>• Honor account information requests in a timely way.</li> <li>• Ensure staff is available to answer client questions.</li> <li>• Provide verbal account information to illiterate clients.</li> <li>• Include institution contact information on all materials, and post in service points such as branch offices.</li> </ul>	<ul style="list-style-type: none"> <li>• Always provide a receipt when receiving repayments from clients.</li> <li>• Treat clients with respect during the collections process. Do not use aggressive collection practices.</li> </ul>	<ul style="list-style-type: none"> <li>• Clearly explain to clients their options for credit rescheduling, based on the FI's policies.</li> <li>• Follow institutional procedures for late payment recovery, and do not use inappropriate methods for recovering loans.</li> <li>• Ensure clients understand late payment penalties, additional charges, and adjustments.</li> <li>• If clients have questions or complaints about their group members, loan repayment, or other issues, refer them to the appropriate person.</li> </ul>
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**Annex. Client protection tools to improve practice at each service point**

Institutions can use client protection tools available from the Smart Campaign to assess and improve their client protection practices. In the chart below, each service point is listed alongside the Smart Campaign’s client protection tools that can improve an institution’s ability to protect clients at that particular service point.

<b>Operations that Apply to All Service Points</b>	<b>Client protection tools available from the Smart Campaign</b>
<b>Product Design</b>	<a href="#">Calculating Transparent Prices Tool from MFTransparency</a> ; <a href="#">Smart Note on Appropriate Product Design and Delivery</a>
<b>Staff Training</b>	<a href="#">How to Develop an Institutional Code of Ethics</a> ; <a href="#">Client Protection and Ethics Codes: Examples for Getting Started</a> ; <a href="#">Code of Conduct E-Learning Module</a> ; <a href="#">Client Protection and Financial Education Simulation</a> ; <a href="#">Loan Officer Training Manual</a> ; <a href="#">Illustrations and Activities for Training Loan Officers on Customers’ Rights and Responsibilities</a>

<b>Service Points</b>	<b>Client protection tools available from the Smart Campaign</b>
<b>Promotions</b>	<a href="#">Transparency in Promotions and Sales: A Checklist for Financial Service Providers</a>
<b>Product Description</b>	<a href="#">Putting Transparency into Practice: Communicating About Pricing</a> ; <a href="#">Essential Documents for New Clients (section “Sample Delinquency Information”)</a>
<b>Group Formation and Training</b>	<a href="#">Debt Management Guide for Clients</a> ; <a href="#">How to Talk to a Bank: A Brochure for Consumers</a> ; <a href="#">Educating Clients About Client Protection: A Guide for Financial Service Providers</a> ; <a href="#">Essential Documents for New Clients (section “Sample Client Education Materials”)</a>
<b>Group Loan Application</b>	<a href="#">Essential Documents for New Clients (section “Loan Contract Guidelines”)</a>
<b>Management of Client Information</b>	<a href="#">Pocket Guide to Financial Security for Clients</a> ; <a href="#">Essential Documents for New Clients (section “Sample Data Privacy Agreement” and “Sample Privacy Summary Statement”)</a>
<b>Financial Analysis</b>	<a href="#">Avoidance of Over-indebtedness: Guidelines for Financial and Non-financial</a> ; <a href="#">Client Business Evaluation Toolkit</a>
<b>Disbursement</b>	<a href="#">Essential Documents for New Clients (section “Client Welcome Letter” and “Institutional Pledge to Clients”)</a>
<b>Documentation</b>	<a href="#">Loan Contract Summary Handout for Clients</a> ; <a href="#">Essential Documents for New Clients (section “Sample Loan Summary and Repayment Schedule”)</a>
<b>Ongoing Customer Service</b>	<a href="#">Complaints Analysis Spreadsheet</a> ; <a href="#">Complaints Handling Manual</a> ; <a href="#">Complaints-Handling Brochure for Clients</a> ; <a href="#">Responsible Treatment of Clients: Practicing Non-discrimination</a> ; <a href="#">Essential Documents for New Clients (section “Sample Complaints Information Flyer”)</a>
<b>Collections</b>	<a href="#">Best Practices in Collections Strategies</a>
<b>Loan Recovery</b>	<a href="#">Collections Practices and Code of Conduct for Collections</a>

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