

Prevention of over-indebtedness Recommendations

Based on the results of several studies conducted by MFC on the indebtedness of microfinance clients¹, recommendations for key groups of industry stakeholders were developed. Three main areas were identified in which actions can improve the current situation and prevent the deepening of indebtedness: (i) responsible lending practices (ii), transparency and information sharing about credit activities and (ii) financial education of clients.

Financial institutions

- Strengthen the assessment of income projections

The financial crisis uncovered the vulnerability to income shocks. Microfinance clients who suffered from income decline more often defaulted on loan repayment. MFIs should, therefore, place more attention to the assessment of future cash flows especially in case of long-term loans.

- Lend cautiously to clients with multiple loans

In the assessment of loan applicants financial institutions should place more emphasis on the number of active loans the applicant already repays, especially if they are taken from several different institutions. Although cross-borrowing from different institutions does not always lead to over-indebtedness it can be a symptom of cyclical debt.

- Refrain from excessive growth

Ambitious growth plans on crowded credit markets can result in over-exposing clients to debt. Financial institutions are encouraged to revise their expansion strategies to prevent lending to clients with low repayment capacity or with already high debt exposure.

- Participate in the information exchange

In countries where credit bureaus exist all financial institutions are advised to provide full information on credit disbursements and repayment performance of all its clients in a timely manner. The loan underwriting process should also be strengthened with credit bureau data. In countries where no credit bureaus or registries exist credit providers are encouraged to set up the mechanism for sharing information about their disbursements with other financial institutions.

- Conduct over-indebtedness prevention campaign among clients

As the issue of (potential) over-indebtedness is new in many countries, borrowers may not be aware of the risk involved in borrowing. It is important that financial institutions engage in activities promoting wise and safe borrowing and good money management. Messages can be developed using materials from financial education programs and can be disseminated through leaflets, posters and other printed materials.

¹ Studies on the risk of over-indebtedness among microfinance clients were conducted by MFC for European Fund for Southeast Europe (EFSE) in Bosnia-Herzegovina and Kosovo and for ICCO in Kyrgyzstan

- Support financial literacy programs for clients

Financial institutions can either directly engage in delivering financial education to their clients or liaise with other organizations (NGOs, educational institutes, etc.) which are already engaged in educational activities.

Financial education can be provided by an MFI in the form of training or counselling and can take place during group meetings, or individually at the time of placing a loan application or making monthly repayments.

Credit bureaus

- Continue improving the quality of data and availability of credit information

Credit bureaus, where exist, are advised to continue building comprehensive databases with convenient access to both positive and negative credit information.

- Periodically publish main statistics about credit use and repayment

In order to maximize the use of Credit bureaus should periodically analyze and disseminate information about the main developments which will allow for better identification of early warning signals.

Regulators

- Obligate financial institutions to report to credit bureau

The participation in the exchange of credit information facilitated by the credit bureau should be made a necessary requirement for all financial institutions. In countries where credit bureaux already operate regulations should make it mandatory for all credit providers to report all their disbursements. In countries where credit bureaux do not exist, efforts should be made to create them.

- Actively engage in client protection

The involvement of the regulator in customer protection can either take a form of general promotion of the Client Protection Principles among financial institutions, or more specific guidance (for instance, development of acceptable dispute resolution procedures, fair conduct and collections codes) or the introduction of certain requirements (for instance, minimum information disclosure requirement).

- Engage in awareness raising on the dangers of over-indebtedness

The regulator can initiate the information campaign for the population explaining the risks involved in borrowing and the consequences of excessive indebtedness. Such information campaigns in public media can be in a form of social advertisements on radio or TV – short spots highlighting the risk of over-borrowing. It can also take a form of leaflets, posters and other printed materials which will be distributed among the population.

- Engage in programs promoting financial education

The authorities should support initiatives strengthening knowledge and financial management skills of the population. This can be done through the coordination of the activities of non-government institutions already implementing educational programs for

adults or by influencing the educational decision-makers (Ministry of Education or other) to integrate financial education into school teaching programs.

Donors, investors

- Support the development of credit bureaus

In order to improve the availability of information about borrowers the development of the capacity of credit bureaus should be supported, especially to ensure the data completeness, reliability and timeliness of information updates.

- Recognize socially-responsible credit providers

Funders are encouraged to include social criteria in the selection of investees and to base their funding decisions not only on financial indicators of MFIs but also on their performance towards clients. The assessment of financially responsible practices should be a part of the due diligence of potential investees.

- Support MFIs in implementation of Customer Protection principles

Funders can play a role in supporting MFIs in developing systems ensuring the adherence to Customer Protection principles.

