



AMFIU

CLIENT PROTECTION MARKET DIAGNOSIS

An Overview of the Implementation of the Client Protection
Principles in the Ugandan Market

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Client Protection Market Diagnostic Tool

Summary Table

Consumer Protection Areas	Systems & Legal Framework	Industry Practices
Country's Client Protection Legal Framework	◐	N/A
Transparency		
Credit Products	●	●
Deposits & Other Products	◐	◐
Fair Treatment	◐	◐
Protection of Clients		
Borrowers	◐	◐
Depositors	●	◐
Recourse Mechanisms	●	◐
Data Protection	●	●

Legend	
●	Meets basic conditions
◐	Work in progress, but needs improvement
○	Inadequate

Markets with Credit Products Only

Consumer Protection Areas	Systems & Legal Framework	Industry Practices	Clients' Experience
Country's Client Protection Legal Framework	◐	N/A	○
Transparency			
Credit Products	●	●	◐
Fair Treatment	◐	◐	◐
Protection of Clients			
Borrowers	◐	◐	◐
Recourse Mechanisms	●	◐	●
Data Protection	●	●	◐

1. BACKGROUND

Client protection has emerged as a key aspect of the microfinance industry in Uganda and globally. This has come in the wake of the microfinance sector to renew their focus on the client and ensure that client needs are at the core of the microfinance business. Even the commercialized MFIs strive to implement the principles of client protection to ensure that they do not harm their clients and therefore increase client retention rates and promote a good sector image. Globally, microfinance has gone through a series of criticisms, ruining the image of the business as one that is only profit oriented and not concerned about the needs of the clients they serve. Uganda has not been spared in this negative publicity and that's why AMFIU, as the national association of microfinance institutions joined the campaign to put the client first in all the decisions made by the financial institutions in order to ensure that they are not harmed.

Against this background, AMFIU joined the global microfinance sector to promote the seven principles of client protection and build the capacity of the microfinance practitioners to implement these principles. The results of the awareness, promotion and capacity building have been encouraging as the following milestones have been achieved;

- Increased appreciation of the client protection principles by the various stakeholders in the industry. Client protection is considered as one of key priorities of the microfinance industry as agreed by the stakeholders during the national microfinance conference
- The draft microfinance bill intended to regulate tier 4 microfinance institutions has provisions on the implementation of the client protection principles
- The Central Bank of Uganda issued consumer protection guidelines and monitors the implementation of the principles among the regulated financial institutions
- AMFIU established a national complaints handling system that provides third party arbitration to the clients of MFIs in order to prevent these complaints from escalating into the media and also ensure that the clients get redress and promote an amicable relationship between the MFIs and the clients.

1.1 Introduction

This report is based on three principles of financial client protection that should guide the conduct of financial institutions, namely:

- i. Reflect transparency of costs and other conditions, clearly communicate key information at appropriate times - before, during and after the conclusion of a financial transaction - and promote healthy competition between financial institutions;
- ii. Ensure fair and ethical treatment. Under this concept is included not only the way in which institutions treat their customers, but also issues related to credit (debt recovery,

- prevention and treatment of over-indebtedness), safeguarding of deposits and protection of personal data;
- iii. Offer internal and external recourse mechanisms, which are effective in correcting errors, processing claims, and resolving disputes.

2. METHODOLOGY

The report is based on both primary and secondary data that was collected during the AMFIU code of conduct review exercise, which is mainly comprised of the principles of client protection. The primary data was collected from 45 AMFIU members and other stakeholders like the Bank of Uganda, Ministry of Finance, Private Sector Foundation and other development partners. The secondary data was gathered by reviewing laws and regulations that govern the financial sector that include; the Financial Institutions Act, the MDI Act, the proposed Tier 4 bill, the Bank of Uganda consumer protection guidelines, the chattels Act and the Mortgage Act. Other secondary data was obtained from the SMART client protection assessments carried out and other literature on the status of client protection for individual institutions.

3. FINDINGS

a. Laws and Regulations on Client Protection

There is currently a microfinance law to regulate Tier 4 institutions under development and sections of this law relate to client protection: The Tier 4 Bill, Section 3d (vii). Section 3 of the Act states that;

The purpose of this Act is to regulate Tier 4 microfinance institutions by–

- (a) facilitating the microfinance industry to promote social and economic development;
 - (b) promoting legitimacy and confidence building of members, customers and investors in the microfinance industry;
 - (c) applying prudential standards to microfinance institutions in order to safeguard the deposits of persons and prevent financial system instability of the depositors' funds and ensuring stability of the financial system;
 - (d) applying non prudential standards to Tier 4 microfinance institutions.
- (vii) prompting customer protection by –
- (a) designing appropriate products;
 - (b) avoidance of over indebtedness;
 - (c) transparency in pricing;

- (d) responsible pricing;
- (e) avoidance of unethical behavior in debt collection;
- (f) confidentiality in client data; and
- (g) complaint handling systems.

The regulation serving as the basis for client protection is: The Bank of Uganda Financial Consumer Protection guidelines, 2011. Enforcement of client protection rules is as crucial as clear regulation. According to the findings, there is no self-regulation by the microfinance sector related to client protection. The Association has a code of conduct that comprises client protection principles but only applies to the Association members. There is no specific institution in charge of enforcing client protection rules for the non-regulated institutions but it has been suggested that the proposed Uganda Microfinance Regulatory (UMRA) will be in-charge of this function for the Tier 4 institutions but can delegate this authority to a national apex.

4. **TRANSPARENCY & PRICING**

The central issue in this section is to determine whether MFIs clearly communicate key information on their products to clients and whether the rules and regulations intervene in that regard. This is important for loans since lending institutions in many contexts, lending institutions charge not only interest rates but also some fees and other components that add up to the total cost for the loan -- bit unclear. It is also a crucial aspect of client protection on other products such as deposit, savings accounts, transfers or insurance products if MFI provide these types of services.

Key questions revolve around (1) whether laws and regulation limit pricing in any way, (2) standardized way to calculate product pricing, especially for credit, (3) disclosure of price, (4) understanding by clients and, (5) competition between financial institutions.

a. **Laws and Regulations**

In Uganda, laws governing transparency are currently in development. The Tier 4 Bill. Part 1 Section 3d (vii, c). The purpose of this Act is to regulate Tier 4 MFIs by.....

- (a) designing appropriate products;
- (b) avoidance of over indebtedness;
- (c) transparency in pricing;
- (d) responsible pricing;
- (e) avoidance of unethical behavior in debt collection;
- (f) confidentiality in client data; and
- (g) complaint handling systems.

Transparency is also governed by regulations: The Bank of Uganda issued Financial Consumer

Protection guidelines that all regulated financial institutions are required to abide by. PART II of the guidelines under section - OBLIGATIONS OF THE FINANCIAL SERVICES PROVIDER, the following key principles are stated;

1. Fairness
2. Reliability
3. Transparency

In addition to laws and regulations, transparency may also be subject to industry self-regulation or rule. However, in this case there are none currently in place, except for the Association members that have to abide with the code of conduct that spells out rules for transparency and pricing.

b. Credit Products

Providing clear communication to clients on the overall cost of credit products is crucial. Too often, clients are unable to understand the different components of credit pricing which include not only the level and type of interest charge over the period of the loan but in many cases also some sorts of fees, compulsory insurance or other charges that add on to the overall cost to the client. Ideally, the client should also be able to compare pricing on credit products from different institutions. This is why regulators in different parts of the world have been implementing standard pricing formats, so that clients are able to compare offers from various financial services providers.

In Uganda, much as there are several formulas used to inform clients on credit products pricing, there is no specific formula stipulated by law or regulation. The country runs a liberalized economy and prices are determined by forces of demand and supply. Different institutions use different formulas to calculate their interest rates.

Limitation on interest rate is a controversial topic. While this is a way to protect financial clients against unreasonable interest rates, capping interest rates often have the undesirable effect of limiting the provision of credit provided to remote areas and clients considered as riskier (often the poorest). In this environment, there is no legal limitation on credit products pricing in the microfinance sector.

FALSE Enforcement on price limitation also plays a significant role and the supervisory authority needs to be pro-active to verify that rules are actually followed by all lenders.

Transparency works best when clients are aware of rules and can apply their knowledge to inform themselves and compare products before choosing one. Clients are not always able to easily compare loans from various institutions. Much as the institutions display their costs and fees, they do this using the nominal rates and do not display the effective interest rate as one figure. The different costs and fees can be confusing for the clients to compare.

Another important aspect of transparency is when and how costs and other important conditions related to credit products are disclosed to clients. In Uganda, there are rules that address this. The Bank of Uganda Consumer Protection guidelines state that; The terms and conditions provided by a financial services provider shall highlight to a consumer the fees, charges, penalties, relevant interest rates and any other consumer liabilities or

obligations in the use of the financial product or service. Requirements regarding the manner in which costs and conditions are displayed also exist. The disclosure requirements were developed by the regulator. The format has been tested to assess the level of understanding from clients.

Loan officers also have to explain the costs and conditions of loans to clients. Costs and conditions of loans must be disclosed at a specific time. Most MFIs publically display costs and conditions of credit products.

Channels used by MFIs to display information are as follow: Posters in branches (most MFIs), Pamphlets (most MFIs), Information on the Internet (few MFIs). Few MFIs feel that displaying cost and conditions of credit is challenging. The standard format of disclosure is well accepted by the microfinance sector. No major complaints have arisen from the standard disclosure requirements and the financial institutions are complying with them

Disclosure rules should not only focus on credit products but should also be in place for deposits, savings and other microfinance products. In Uganda, there are rules regarding disclosure of remuneration, fees, and conditions for all savings and deposit products. The Bank of Uganda Consumer Protection guidelines state that “For both interest-bearing deposits and loans, a financial services provider shall prior to the consumer signing the contract:

- (a) inform the consumer of the term of the fixed deposit or loan;
 - (b) inform the consumer of the charges, if any, for, and consequences of, prematurely terminating a fixed deposit or loan;
 - (c) inform the consumer of whether the interest is fixed or variable;
 - (d) give a consumer information on the applicable interest rates for the contracted period and the basis and frequency on which interest payments or deductions are to be made;
 - (e) explain the method used to calculate interest rates;
 - (f) disclose prominently the total amount of income the consumer shall receive on the fixed rate deposits of the consumer; and
 - (g) disclose the total cost of credit.
- (5) Officers must explain remuneration, fees and other conditions on savings products to clients.

In addition, there are disclosure requirements for all other products offered by MFIs. Disclosure applies to all products. In practice, some MFIs publicly display remuneration and fees on deposit and savings products but this is mainly done by the regulated financial institutions. Channels used by MFIs to display information are as follow: Posters in branches (most MFIs), Information on the Internet (some MFIs), MFIs typically do not feel that displaying cost and conditions on savings and deposit products is challenging.

Some clients are able to compare savings, deposit and other products offered by different institutions. In conclusion, it seems that rules on disclosure somewhat foster healthy competition in the microfinance sector.

5. FAIR TREATMENT

MFIs should ensure that all clients receive fair and ethical treatment and that there is no discrimination. All clients should be treated with respect. Non-discrimination includes avoiding any discrimination based on gender, ethnicity, age, religion, etc.

To date, there are no laws on fair treatment but the Bank of Uganda issued regulations on fair treatment under the Financial Consumer Protection guidelines which state that; A financial services provider shall act fairly and reasonably in all its dealings with a consumer.

(b) A financial services provider shall not:

(i) engage in unfair, deceptive or aggressive practices such as threatening, intimidating, being violent towards, abusing, or humiliating a consumer;

(ii) offer, accept or ask for bribes or other 'gifts' or unfair inducements. discriminate against any consumer on the grounds of sex, race, colour, ethnic origin, tribe, birth, creed or religion, social standing, political opinion or disability;

(iv) take advantage of a consumer whether or not he or she is able to fully. To date, no industry self-regulation exists.

In practice, most MFIs seem to treat all clients in a fair way although there have been isolated cases of unfair or discriminatory treatment. Most cases are related to inappropriate collection practices.

Having clear rules on how staff are expected to treat clients is important to avoid unfair treatment and discrimination. On the one hand, Most MFIs clearly spell out staff behaviors which are expected or prohibited. On the other hand, only some clients are aware of rules on fair treatment and non-discrimination. They are briefed about staff conduct during pre-disbursement training. But this mainly applies to group clients.

Protecting clients and other consumers against fraud and corruption is also part of fair treatment. In this context, there are some rules linked to protecting clients against fraud or acts of corruption committed by MFIs' employees.

Protecting clients as borrowers as well as depositors requires different measures. For borrowers, MFIs need to ensure that clients do not become over-indebted and that while collecting late payments, they respect the dignity of the clients.

When clients are depositing money in a microfinance institution, they should be protected against any risk that their own savings could be lost because of a lack of prudential management. This is of course why adequate prudential supervision is key. Beyond that, a deposit protection mechanism can increase depositors' safety.

Credit bureaus and other information sharing mechanisms that allow MFIs to check on credit records are important tools to prevent over-indebtedness. In Uganda, MFIs use: a system run by the Central Bank, The information sharing mechanism is partially efficient in preventing over-indebtedness. It is just a few institutions (the regulated ones) that can use the system while the bulk of the unregulated financial institutions have no access to it.

The law establishes rules on debt collection that apply to the microfinance industry. It is also crucial that all clients are made aware of the collection process, preferably when they take up the loan. It is standard practice among most MFIs to inform clients on measures that can be taken in case of default.

Collection practices are occasionally considered unfair or disrespectful by MFIs' clients. Selling off collateral using unclear processes and before expiry of loan term were cited as the major complaints by microfinance clients according a report compiled from AMFIU's complaints handling system.

Few MFIs use third parties for collecting late payments or bad debts. It has been reported that these third parties occasionally use methods which are deemed unfair. The extra cost to pay the third party debt collector is viewed as unfair by the clients and the harsh and coercive means used by the debt collectors.

There is a deposit protection mechanism in place for the microfinance sector but currently only applies to the regulated microfinance institutions since the Tier 4 bill is not yet law. The legal basis for the deposit protection mechanism is in the law: The MDI Act, the Financial institutions Act and the draft Tier 4 bill. This mechanism includes all deposit taking institutions and is managed by the Central Bank. However, the Central Bank manages only for the regulated financial institutions. A proposed microfinance regulatory authority will manage the deposit insurance for the tier institutions. The extent of the coverage is: Up to UGX 3,000,000 of a client's deposit.

In practice, there have been isolated cases where clients have lost money deposited with MFIs mainly arising from closure and liquidation of the institutions. The deposit protection mechanism has been used for the regulated financial institutions. This was used when one of the commercial banks was closed and clients were refunded up to UGX3,000,000. Most consumers believe that their money is safe if deposited in a regulated MFI.

6. RECOURSE MECHANISM

Ideally, clients should have access to readily available recourse mechanisms to find solutions to their grievances. This would first involve the formalization of recourse mechanisms within each MFI and second, some external, non-judicial recourse mechanisms to be used if a solution was not found internally. Rules should specify the minimum measures that MFIs should take to ensure clients have access to efficient recourse mechanisms and to encourage the systematic use of recourse-related statistics.

There are some regulatory requirements that apply to internal recourse mechanisms in MFIs. The Bank of Uganda Consumer Protection guidelines emphasize the establishment of a consumer complaints handling system in every regulated financial institution. The proposed tier 4 microfinance bill also has provisions on complaints handling. Although there is no current law or regulation that ensures that the non-regulated institutions establish complaints handling systems, some MFIs provide recourse channels to their clients. The major channels used include, complaints registers, client days, hotlines, walk-ins and suggestion boxes. The national apex (AMFIU) also provides a third party recourse channel.

Some MFIs, especially the regulated ones register and monitor complaints in a systematic way. It is a requirement by the Central Bank for all the regulated ones. However, a few who are not regulated have also made an effort to introduce complaints handling systems. Collecting and sharing statistics on complaints collected through internal recourse can be an effective way to monitor financial consumer issues. Regulated MFIs are required to report on internal recourses to the regulator. The Bank of Uganda Consumer Protection guidelines state that, “a financial services provider shall provide Bank of Uganda with a report, in the format set out at Appendix A, concerning its receipt and handling of complaints. This report shall not include complaints which it has resolved by the end of the business day after it received the complaint. Reports shall cover the first six months of the year and the second six months of the year and shall be sent to reach Bank of Uganda by the end of one month after the end of the period.”

Obviously, recourses are only effective if all clients are informed about them and if the mechanism is accessible to all, including uneducated individuals and people living in remote areas. For the most part MFIs' clients are informed that recourse mechanisms are available. But they rely mainly on the Credit Officers to communicate this. Only in a few MFIs, are all clients, including the less educated, able to use recourse mechanisms easily.

MFIs' clients are not able to actively use the recourse mechanisms.

There is an external recourse mechanism available to MFIs' clients, provided by the microfinance association. The institutional framework for the external recourse mechanism is linked to the microfinance association. There is no legal or regulatory framework for this mechanism.

The channels available to use this recourse mechanism are described below: A dedicated person in-charge of complaints handling, an internal complaints handling committee and a toll free phone line. The Internal and external recourse mechanisms are linked to some extent because the Association contacts the MFI first to brief them on the complaint their client has made before proceeding forward. The clients do not need to use the internal mechanism first but if they do, they need to mention it. Complaints received and their resolutions are statistically treated and reported to MFIs.

Much as some institutions have made an effort in informing the clients of MFIs about the external recourse mechanism, a lot more effort is needed in this area. The main awareness channel that the Association uses to communicate the system to the clients is through the media. This recourse mechanism is accessible to all clients, including the less educated. MFIs' clients have been actively using this recourse mechanism however, the mechanism is mainly used when adverts about the system are running in the media.

7. DATA PROTECTION

Clients should be protected against any misuse or misappropriation of information related to their person, family, finance or business that MFIs have collected. There should be some legislation or regulation covering the gathering, processing, use, storage and distribution of clients' information. Data protection and privacy issues are covered by general rules as described below.

In practice, it is important to know if MFIs are sharing information with other entities and if clients are aware of it. MFIs share information on clients in the following ways: All regulated MFIs share information with regulatory authorities and with the credit bureau. Few MFIs share information for marketing purposes. In the microfinance sector, there have been no reported incidents where clients' information was stolen or used illegally.

Majority of the MFIs ensure that clients have access to the information related to their account and have a process that allows clients to request rectification if any information related to the client is not correct. Clients are able to opt out if information is shared with external parties.

8. CONCLUSION

Client protection is recognized as a crucial aspect in the financial sector in Uganda. Government, regulators, practitioners and other stakeholders all agree on the importance of the sector complying to the principles of client protection. Many practitioners are making an effort in complying to the principles but the inclusion of the CPPs in the legal and regulatory frameworks is mainly still work in progress. This is because the Tier 4 bill, under which the majority of the MFIs lie, is not yet enacted into law. The consumer protection guidelines issued by the Bank of Uganda only apply to the regulated institutions, leaving out the bulk of the non-regulated institutions. The network and other players have made an effort in creating awareness, lobbying and building capacity of the institutions to comply with the principles and this has paid off as most institutions are aware about the principles and are making individual efforts to institutionalize them in their organizations.