

African Microfinance Pricing Transparency Leadership Forum Discussion Insights: Challenges and Solutions

The African Microfinance Pricing Transparency Leadership Forum, which took place in Nairobi in October 2011, gathered representatives of 24 different African countries as well as industry experts from other regions around the world. More than 120 participants, primarily policymakers, regulators and microfinance institution (MFI) network representatives, tackled some of the most complex issues that the microfinance industry faces in facilitating transparent pricing.

Rather than a straightforward summary of the discussion, this article presents some of the main challenges or questions and solutions arising from the presentations, panels, roundtable discussions and delegate meetings centered around three core themes: pricing calculation, standards for reporting and client financial education. It is our hope that these insights help to prepare policymakers and regulators to take important steps toward implementing policy for responsible pricing.

Pricing Calculation

The discussions around pricing calculation were fueled by training sessions given by *MFTransparency*, as well as a plenary discussion moderated by Moses Ochieng of CGAP/DFID and led by Ghépié Anin of BCEAO and Gladys Chongo Mposha of Bank of Zambia. These helped launch an ongoing debate among participants about what an official pricing disclosure formula should include and how to effectively implement it. The following are the main challenges that participants perceived in this process, as well as some solutions that were proposed for each.

Challenge: How can policymakers and regulators implement official pricing formulas that prevent microfinance institutions from using pricing terms to mislead borrowers?

Solution: Although this is a complex question, there are a few straightforward policy measures that participants discussed as concrete ways to facilitate transparent pricing practices.

1. **Ban flat interest rates.** Widespread adoption of the declining balance interest rate calculation method would lead to drastic improvements in the level of pricing transparency in many markets. Declining balance rates much more accurately depict the price of a loan; a price communicated as a declining balance rate is much closer to the true price than one communicated as a flat rate. If all institutions were required to use the declining balance method, it would be much easier for borrowers to compare products based on price, and this widespread knowledge of the prices of products would enable MFIs to set prices based on those of their competitors. Cambodia is a great example of a market where the regulator has implemented this requirement and the market has benefited tremendously as a result.

2. **Include all mandatory fees in the official pricing formula.** In addition to specifying how to calculate interest, official pricing formulas required by regulators should also include any fees charged to the client. The true price of a loan includes not only interest but all charges a borrower must make in order to access credit. Fees, insurance charges and security deposit requirements are examples of extra charges frequently charged by lenders that are not always captured in the price communicated to the borrower. Requiring their disclosure would bring the market as a whole much closer to communicating true prices and greatly enhance borrowers' knowledge of what they must pay in order to access a loan.
3. **Require the use of a standardized repayment schedule template.** Some participants argued that an official pricing disclosure formula is only as good as the quality of the disclosure mechanism. When it comes to disclosure to borrowers, repayment schedules are one of the best ways to communicate pricing information. Policymakers and regulators can require the use of a template repayment schedule by all lenders that includes information about interest rates, fees and charges, cash flow and terms and conditions. In addition to ensuring that essential information is disclosed, this type of policy also facilitates comparison between products. For example, when using a template lenders cannot bury important information deep into a loan contract or obscure it by including it in a confusing way. In addition, while a borrower might not understand the concept of Annual Percentage Rate (APR), if every repayment schedule he/she sees has this figure in the same exact location they can at least determine which is lowest.
4. **Ensure agreement between the official formula and required disclosure to clients.** In addition, disclosure to clients of the official rate (if one exists) should be required. Institutions should not disclose Total Cost of Credit (TCC) to clients and Effective Interest Rates (EIRs) to regulators, for example; both should be disclosed. It is important to require disclosure of an official rate to all parties and through multiple channels, to facilitate its widespread adoption and understanding as a standard for disclosure.

Challenge: How can policymakers and regulators select an official pricing disclosure formula that accommodates the diversity of the market, in terms of institution types, product types, etc.?

Solution:

Establishing an official pricing formula is not about masking diversity in the market, it is about standardizing disclosure so that in spite of existing variety meaningful comparisons can be made. It is helpful to look at this from the perspective of the client. While certain institution types and products bear different costs for the lender and different profit opportunities, from the perspective of the client price always consists of the cash outlay required in order to access credit. A borrower is not necessarily concerned with an institution's cost of funds or whether the money they pay for insurance goes to the institution or to a separate company; from their perspective any charge is a cost of borrowing, and all such charges should be considered in an official pricing formula.

That said some worry that by using one formula for calculating all prices the non-financial distinctions between different institution types may be lost. For example, if an official formula shows microloans from NGOs to be much more expensive than those from commercial banks some may perceive NGOs as being relatively profit-seeking when in reality they may carry higher operating costs or may offer additional services such as training or financial education. This is the concern that MFTransparency seeks to address through education and the

inclusion of contextual and descriptive information alongside pricing data. There are numerous factors that determine pricing, and numerous factors in addition to pricing that determine a client's decision about borrowing. Responsible transparency means accompanying pricing data with education and contextual information, so that these factors are understood.

Challenge: Many microfinance institutions lack the technical skills to implement complicated pricing formulas.

Solution:

While technical capacity is a challenge in terms of pricing disclosure for multiple stakeholder groups, there are many resources available for overcoming this obstacle. Any new policy should be accompanied by a training and sensitization process, but this may be especially true in the case of pricing as it is technical by nature.

One way of addressing this need is for policymakers and regulators to offer tools and software that simplify the process of adhering to disclosure requirements. Streamlining the process of converting prices to a new formula, this type of support can be vital in ensuring adherence to new regulations. In addition, participants raised the idea of policymakers and regulators hosting workshops and seminars to educate industry stakeholders about pricing in general and new formulas in particular.

In addition, numerous technical assistance providers exist in the industry that can offer the training needed to ensure MFIs' understanding of pricing calculations. Some, such as *MFTransparency*, offer free services and tools, for example technical assistance sessions tailored to the needs of specific institutions and resources such as an APR calculator and educational articles. Others provide services for a fee. Some participants discussed the possibility of donors or investors funding such programs. In addition, the local networks may potentially have a role to play in partnering with funders and technical assistance providers to ensure that the right institutions are included and the right issues are addressed.

Challenge: How can implementing an official pricing formula be effective in a market where not all institution types are regulated?

Solution:

One of the reasons for the pervasion of non-transparent pricing practices in the microfinance industry is that if some institutions are not transparent it becomes very difficult for others to remain transparent and still be competitive. Participants in the forum discussed the question of potential market distortions that might arise if policymakers and regulators required regulated institutions to disclose their prices and unregulated institutions were not required to do so. In some markets, where a significant portion of microfinance services are offered by unregulated institutions, this is an important concern.

A few solutions to this issue were proposed. One is to create incentives for unregulated institutions to voluntarily follow the same disclosure requirements as their regulated competitors. This might, for example, include a public relations campaign expounding on the virtues of transparent pricing and the value of working with officially recognized institutions. Or it could be a voluntary program offered by the regulator that couples



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compliance with new policy requirements and a benefit for MFIs, such as perhaps free training or technical assistance. In this sense the policy could in effect be applied to all institutions, regulated or not.

Another potentially valuable resource in addressing this challenge is the local MFI networks or associations. In cases where their membership consists of unregulated institutions, networks can lead the process of adopting Codes of Conduct, in this sense serving as the implementing agent to require their unregulated members to adopt the official pricing formula.

While difficult to develop, an educated client base could be an important tool in addressing this issue. If borrowers are informed about the advantages to them of choosing a transparent institution, it could start to erode the competitive edge of non-transparent institutions.

Challenge: How do you prepare a market to switch from the flat balance method of calculating interest to the declining balance method?

Solution:

Many participants felt strongly that an important and relatively straightforward pricing disclosure policy approach was the banning of the flat balance interest rate calculation method, by which borrowers are charged interest on the initial loan amount throughout the loan term rather than only on the principle amount remaining as they repay the loan. However, concerns arose about how to facilitate this. Would institutions have the technical capacity to make this change? What if prices were found to be higher than previously thought?

One of the best solutions to this challenge, also true for many pricing disclosure policy challenges, is education. Institutions with a good understanding of pricing calculations are more likely to be successful in making the transition to declining balance rates. Sensitization of the media, politicians and the general public is also essential to the success of such a policy measure. Declining balance rates appear lower than their equivalent using the flat balance calculation method. Therefore, education and open discussion is necessary to ensure that this new level of transparency has a positive impact. Materials such as MFTransparency's recent article "Flat versus Declining Balance Interest Rates: What is the Difference?"¹ can be useful in this process.

Perhaps the most effective way of addressing this issue is to learn from the example of other markets. MFTransparency recently published a case study on the experience of the Cambodian market in switching from the flat to the declining balance interest calculation as the result of regulation banning the use of the former². This policy was established more than ten years ago in Cambodia, but is currently being applied for the first time in the Philippines. Following the experience of the Philippine market can yield valuable lessons for regulators in other countries considering a similar approach.

Numerous other challenges and questions relating to the theme of pricing calculations were raised at the African Microfinance Pricing Transparency Leadership Forum, including what terms should be included in an

¹ http://www.mftransparency.org/pages/wp-content/uploads/2011/10/Article_Flat-vs-Declining-Balance-Interest-Rates.pdf

² http://www.mftransparency.org/pages/wp-content/uploads/2011/10/Case-Study_Cambodia_Regulation-Outlawing-Flat-Interest.pdf

official disclosure formula, what disclosure format is most effective, how to approach enforcement and many others. These are addressed in-depth in the related resource “The Debate about Official Pricing Disclosure Formulas”.

Standards for Reporting

Another core theme of the African Microfinance Pricing Transparency Leadership Forum was standards for reporting, or what pricing information policymakers and regulators should require institutions to report and how it should be disclosed. A panel discussion between Harry Ndambala of Bank of Tanzania and Salem P. Aoutcheme of BCEAO, moderated by Philippe Serres of Agence Française de Développement (AFD, lead funder of the event) provided material for insightful and productive roundtable discussions among participants. The following are some of the challenges and solutions for defining and adhering to standards for reporting identified by Forum participants.

Challenge: Of the information that institutions report to regulators and policymakers, what should also be disclosed to the public?

Solution:

Participants at the Forum had a range of opinions on this question, but all agreed that it is somewhat difficult to decide what information it is important for the general public to know versus what regulators need to know to adequately supervise the market. Specifically in terms of information related to pricing, should interest rates be disclosed? Fees? Repayment schedules? Institutions’ cost structures? Profits? Penalty fees? Prices for all products or only some? A weighted average of all prices?

While participants seemed to agree that the specifics of this approach are highly dependent upon the unique circumstances of a given market, one pervasive idea emerged: like any other product, borrowers should have information on the prices of microloans, as this is “outward facing” information. Information about an institution’s cost structure, profit margins or funding sources, for example, are not necessarily essential for clients to know. When consumers buy most products they do not necessarily have, or consider, this information, but knowledge of all costs is essential.

This raised other questions about exactly what pricing information to report and in what format. Should regulators publish a range in prices? A weighted average depending on number of clients with a given product? Some regulators shared their approach of publishing matrices providing rates charged by microfinance institutions by loan amount and term, to enable comparison and allow borrowers to evaluate the prices they pay on their own loans relative to similar loans in the market. While participants did not necessarily arrive at a uniform solution to this challenge, MFTransparency’s recommendation is that prices be disclosed by product, covering a range in loan amounts and in a comparable format such as Annual Percentage Rate (APR) and Effective Interest Rate (EIR).

Challenge: What is the best way to share pricing information reported to the regulator with the general public?

Solution:

The discussion around how to share pricing information reported to the regulator with the general public centered around three main questions:

1. What information should be published and in what format?
2. What is the best venue for sharing this information?
3. Is it the regulators' responsibility to determine how to make this information public or merely to collect it?

Participants of the Forum exchanged many ideas for how to address this first question. There was no general consensus on the extent of detail that should be published or exactly what the best way to convey this information is, but there were some general principles that participants believed should guide the process. Regulators at the forum agreed that it is important to publish pricing information in a way that is both standardized and comparable but that also takes into account variation among the products reported on. Regulators agreed that a standard formula should be used and that information about the type of institutions reporting should be included, so that readers can differentiate between banks and cooperatives, for example. Participants were less in consensus on the question of whether or not to publish information about fees specifically and if yes which fees. Some participants put forth ideas about how to tackle the question of loan amount and loan term, suggesting that public pricing information should be differentiated on this basis, for example published in separate tables.

Many venues for publishing this information were also discussed. These included newspapers, the radio, in the premises of microfinance institutions, in brochures and through special workshops. Issues were raised about literacy levels and language differences as limitations to the effectiveness of newspapers and brochures, for example. Participants also cited the challenge of the limited circulation of newspapers, particularly in rural areas. Others felt that publishing information through the regulators' website is sufficient.

In addition to raising the challenge of identifying an appropriate mechanism for sharing this information, participants also questioned whether this responsibility should fall to regulators at all. For example, some participants argued that if regulators make pricing information available through their own official websites then other industry organizations should take up the task of determining how best to communicate it to clients, MFIs, investors, etc. Some participants suggested that regulatory agencies develop training programs, seminars, trade fairs, or other mechanisms for communicating this information to the public. Others believed that this role is best played by MFI networks, NGOs and consumer protection agencies in the microfinance industry.

Challenge: In the event that some institutions do not adhere to reporting requirements, what types of sanctions are appropriate?

Solution:

Even in a market where all institutions are capable of adhering to reporting requirements, there will inevitably be those that choose not to and violate the requirement. Participants shared their experiences with non-compliant institutions, who either reported late, submitted incomplete information or declined to report their pricing information at all, realizing that there were little or no repercussions to this action.

Regulators at the Forum debated what the appropriate course of action might be in these cases. Are sanctions advisable? Feasible? Is it the regulator's responsibility to impose punishments on institutions that do not disclose prices according to the official formula or is it merely to set these standards in the first place? Some participants recommended the "name and shame" approach whereby institutions opting not to disclose prices as required are identified publicly to their competitors and clients. Others disagreed with the principle of using negative incentives at all. Is there a place for this type of approach? If so when is it appropriate or possibly even preferable?

The question of being able to enforce the requirement of a new policy was of the utmost concern to policymakers and regulators whose entire base of authority is at risk if they are shown to be incapable of holding institutions to their legal obligations. Some regulators shared their approaches, which included heavy fines for late reporting, closure of the institution as a punishment for breaking pricing standards and even jail time in some cases. While each regulatory authority must agree on their own approach to applying sanctions, the general consensus was that there must be some consequence for failing to comply with reporting requirements.

Participants also addressed the underlying dynamic behind poor institution reporting practices: in times of industry turmoil, many institutions believe that reporting is a distraction and unnecessary use of resources and therefore lower it in priority. In these cases it is important that reporting requirements are viewed among industry players not as a peripheral part of operations but a closely integrated, essential component to a healthy functioning market. This suggests that regulators might consider, as an alternative or complement to sanctions, ensuring that the reporting framework in place is in fact well integrated and tailored to institutions' interests and also that it is perceived as such among reporting institutions.

Challenge: What pricing information should be included in required standardized loan documentation?

Solution:

The question of what pricing information might be included on standard loan documentation templates was not one that participants found agreement on, but many possible solutions were suggested.

Participants agreed that a range of information about interest rates should be included on mandatory pricing disclosure documentation templates. This includes the interest rate amount, interest rate period (i.e. monthly, annual) and calculation method (nominal or effective, flat or declining, for example). Ideally the interest rate



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required for disclosure would be the one calculated with the official formula whose definition would also be included on the loan documentation.

In addition to interest rate participants agreed on other terms of the loan that are essential for disclosure. Among these were loan amount, loan term, repayment frequency and dates, installment amounts and total cost of credit. Many believed that it is important to include the name of the credit provider and contact information that clients can use in the event of any questions or complaints. In general participants believed that it is important to include a full repayment schedule rather than just a list of terms, so that borrowers can see the payments due on each date and their cash flow over the loan term.

Many additional ideas were discussed but not necessarily universally agreed upon. Forum participants mostly agreed with the idea that information about fees should be included in mandatory documentation templates, but not all participants agreed on exactly which fees this should include. For example, most participants felt that mandatory fees paid to the lender should be mandatorily disclosed, but the disclosure of optional fees, fees paid to third parties and penalty fees generated some heated debates. Security deposit requirements generated similarly differing opinions.

In general participants agreed that the most essential pricing information should be disclosed in loan documentation clearly and on the first page, rather than buried several pages into a contract, an example shared by a South African delegate.

Challenge: How can regulators facilitate transparent pricing while also ensuring that the industry is not unfairly portrayed in a negative light by the media?

Solution:

Forum participants agreed that the media is a serious challenge in transforming markets to pricing transparency, and none seemed to feel completely confident in any solution put forth for managing their potential negative influence. Group discussions all seemed to reflect the idea that the media is an inherently unpredictable though important factor.

One essential component to addressing this variable that participants identified was education. In order to improve the quality of media coverage of the microfinance industry, journalists and other players in the media should be educated on the industry, and specifically on pricing within the microfinance industry. Whether regulators or other industry players take up the task of training journalists directly, they should at least be included in educational and training programs provided to other industry groups to improve the basic understanding of pricing in the industry. While the incentive for the media to publish exciting stories over accurate stories will always exist, putting forth information supported by education may be an effective way for providing substantive though positive stories as an alternative, thus enhancing the industry's credibility.

Financial Education

The third main theme of the African Microfinance Pricing Transparency Leadership Forum was client financial education. A panel discussion between Daniel Tallam of the Central Bank of Kenya, Lanjes Sinoya of the Reserve Bank of Malawi and Kobina Amoah of the Ministry of Finance and Economic Planning of Ghana, moderated by



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Bilha Maina of Financial Sector Deepening Kenya, sparked the discussion among participants of this essential component of responsible microfinance. The following are some of the main challenges and solutions to the difficult but important task of educating clients that participants of the Forum identified in roundtable discussions.

Challenge: What is the right approach to educating clients about pricing, in terms of channels and formats for information?

Solution:

While Forum participants agreed that client financial education is an essential component to healthy microfinance markets, they also agreed that it is a challenge on several levels: clients are difficult to reach, financial education is expensive and general education levels (let alone financial education levels) tend to be very low among microfinance clients. Still, participants put forth several potential ways of addressing this issue.

Similar to the discussion of publishing reported pricing information, many of the same vehicles for reaching clients with financial education material were suggested, such as newspapers, the radio, trade fairs, seminars and workshops and brochures and posters at MFI offices. Participants acknowledged the benefits and limitations of each, for example that newspaper pieces would not reach illiterate or many remote rural clients and trade fairs might not provide the ongoing source of training and education really necessary to develop new knowledge. Another idea discussed was instituting a staff help desk at MFI offices manned by employees whose sole job it is to explain to clients their rights and responsibilities. This was considered as a potentially less expensive alternative to the time-consuming, resource-intensive and not necessarily effective long-term educational programs run by some MFIs. One idea discussed by many participants was the implementation of youth financial education programs in schools. Though a more structural and long-term solution, many participants agreed that this missing component is needed to develop a new generation of educated clients.

In addition to teaching clients about pricing in general, participants discussed the need to educate microfinance clients about the regulations themselves. An educated client base can serve as a mechanism for ensuring adherence to regulatory requirements, where clients can hold institutions accountable if they know the rights they are promised by the regulatory framework.

Challenge: Which microfinance industry stakeholder group should be responsible for client financial education?

Solution:

Many ideas and examples of approaches in place across Africa were discussed as part of the question of whose role it is to educate clients.

Some participants believed that the government should be responsible for measuring client financial education levels as well as designing, implementing and funding financial education programs. Delegates from Malawi put forth the idea that while this responsibility could comfortably fall to the government it might be best handled by a separate regulatory agency within the central bank, for example.

Other participants expressed the opinion that regulators should monitor financial institutions' performance and should not be expected to divert time and resources to financial education where they do not have the expertise anyway. These participants suggested that specialized NGOs might be better placed to undertake this role, funded by donors. Others suggested that networks might be a good dissemination hub for financial education programs, possibly in coordination with consumer protection agencies.

The question of MFI financial education programs was also discussed. Some participants believed that in order to practice responsible microfinance, institutions should prioritize client financial education. The majority of participants believed, to the contrary, that client financial education programs run by MFIs are not only a drain on MFI resources but also represent a conflict of interest. It is difficult to differentiate between marketing and genuine education, and while MFIs should be held responsible for explaining their products and the rights of the borrowers, they cannot be expected to educate clients to the extent necessary to ensure their ability to make educated decisions between products available to them.

Challenge: How can we assess client financial education levels in order to tailor appropriate programs?

Solution:

There was general agreement among participants at the forum that a better understanding of exactly what levels of financial education exist among clients, what challenges there are to improved financial education and how this understanding varies among different client groups is an essential first step toward building comprehensive client financial education programs.

Many Forum participants suggested that baseline research should be done to generate a foundation of knowledge about the state of client financial education in the market. The concept of client segmentation was strongly emphasized as well, as levels of education, literacy and inclusion in the formal financial system can vary greatly among different client groups. Delegates also shared examples of such research underway in the countries they represent, including baseline studies done by central banks in Ethiopia and Tanzania and national strategies for financial education being developed in Malawi and Zambia.

Rather than regulators undertaking this work some participants suggested that this is an area where donors should step in and both fund as well as execute such studies. In addition, participants explored the idea of regional cooperation on this question, where research methods and basic findings about client financial education in some markets may be valuable to industry stakeholders in other markets undertaking similar work.

Numerous other challenges and questions relating to the theme of financial education were raised at the African Microfinance Pricing Transparency Leadership Forum, including an in-depth look at how to implement client financial education programs and what the roles of different stakeholder groups should be. These are further addressed in the related resource "African Microfinance Pricing Transparency Leadership Forum Discussion Insights: Financial Education".

Conclusions



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While many challenges raised did not meet with definitive solutions or agreements among participants as to the best solutions put forth, the opportunity to discuss these challenges in general yielded valuable insights. Two important themes shaped these discussions in general.

Though the sessions of the Forum were divided along three main themes, pricing calculation, standards for reporting and client financial education, throughout the course of the discussions participants identified the relationships between them. New official pricing calculation formulas as well as standards for reporting increase the volume of information available and change the format of pricing information that industry players are used to seeing. This in turn is likely to raise questions among clients thereby increasing the need for financial education. Being able to address these questions in a meaningful way is vital, as MFIs may fear losing clients if clients lose **confidence** in them over a lack of clarity around pricing. This dynamic may naturally incentivize MFIs to make more efforts to educate clients, increasing the positive outcomes of pricing transparency.

Finally, the most repeated theme of the event was the need for capacity building at all levels of the market; this includes MFIs, clients, the media and even policymakers and regulators themselves. Questions of how to build capacity, whose responsibility it is, what skills are essential and who should fund the needed training processes remain, but with a general consensus on the importance of this step the practical solutions are likely to evolve over time.



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