Ministry of Foreign Affairs of the Netherlands

27 January 2011 -The Hague

Responsible Finance Forum

The second Responsible Finance Forum was organized by the Dutch Ministry of Foreign Affairs, jointly with Her Royal Highness Princess Máxima of the Netherlands in het capacity as UNSG's Special Advocate for Inclusive Finance for Development, BMZ, CGAP, and IFC.
This forum focused on how pro-active efforts by investors for responsible finance can motivate and reinforce initiatives by retail microfinance providers and related networks and associations.
During the forum a group of 41 microfinance asset managers and institutional investors investing in microfinance signed the Principles for Investors in Inclusive Finance, a set of Principles developed by a working group of microfinance investors and Princess Máxima. The Principles aim to raise awareness among investors and motivate them to integrate responsibility towards end-users of microfinance and other stakeholders in their decision-making and business models. They were drafted in the course of 2010 during which a broad consultation process took place.

For the opening statement of Minister Knapen and keynote speech of the United Nations Secretary General's Special Advocate for Inclusive Finance for Development HRH Princess Máxima click on their respective names.

This report summarizes the key points of the plenary sessions and the workshops. A more detailed discussion of the workshops can be found in the appendices.

Background
Recent microfinance crises show the need for appropriate products, practices and policies to protect and positively impact the end-users of microfinance. Collective action of MFIs, industry associations, national regulators, donors and investors is required. Shareholders/investors need to support MFIs to have a long-term vision of sustainable delivery of services to clients. By signing the Principles, investors signal their commitment to actively support and encourage the responsible development of the microfinance sector. In addition, from the point of view of investors showing the active prevention of a negative impact is a way to manage downside risk. Irresponsible financing practices jeopardize (long-term) financial returns; this encourages both investors and MFIs to develop responsible finance practices.

Current issues
Improving access to financial services is still a huge need in most countries. Participants of the conference debated the central challenge of ensuring that financial access is provided in a healthy and responsible manner. The Forum focused on the specific roles of investors in achieving this vision, while also exploring the roles of the other key stakeholders including industry, regulators and consumers. Panelists and participants addressed a range of issues relevant to responsible finance. In a small number of sectors including Bosnia and most recently parts of India, issues such as multiple lending and even client over-indebtedness are arising as microfinance sectors get more competitive. Very high MFI growth targets (arguably facilitated by investor demand and the availability of abundant foreign capital), aggressive competition, and an erosion of credit quality standards combined with rigid and limited products, a lack of transparency, a weak credit information sharing framework, and inadequate regulation contributed to the crises in these markets. Beyond the small number of crisis markets, overarching issues of transparent and responsible pricing and product diversity and appropriateness represent broader challenges for the industry.

The role of national regulators: lessons from Peru

- Government regulation and policies focusing on the long term are needed to promote transparency, fair treatment and effective recourse, as well as promoting financial education. Consumer protection 'rules of the game' and financial capability are essential conditions to safeguard client welfare.
- Market forces determine price-setting and competition is a key factor for driving interest rates down, but enforcing transparency of pricing information is a necessary condition for the price to come to its equilibrium. In Peru the media plays an important role in facilitating transparency and newspapers have a section devoted on pricing. The Banking and Insurance Superintendent began with disclosure rules for credit, which have brought about an appreciable decline in credit prices. The regulator is now turning to improved disclosure of prices, terms and conditions for deposit products, and expects comparable improvements in pricing and quality.
- Transparency on loan terms and conditions is very important to protect clients. Transparency regulation can only achieve its intended benefits if clients have sufficient financial literacy: i.e., the loan conditions may be disclosed properly but the client must also be able to have a thorough understanding of this information, to make good decisions regarding financial services. Together with the Ministry of Education in Peru, the Superintendent in Peru developed a program to integrate financial education into the core curriculum of public education, as well as exploring innovative ways to improve the financial capability of different segments of adult financial consumers.

- The Superintendent is focusing now on how to avoid widespread over-indebtedness in the markets. Work with credit-bureausis an essential element of this strategy.
- Effective regulation in the area of consumer protection would help create a more conducive environment for healthy development of financial markets. Investors should be supportive of well-enforced consumer protection rules, since they help manage key risks and ensure client protection, transparency and fair treatment. The Peruvian case demonstrates the benefits of promoting financial inclusion and responsible finance hand in hand. Regulators in countries such asPeru and Malaysia are keen to share their experiences and emerging good practices with other countries.

Role of Investors / Suggestions for investors
Direct investors (fund managers)

- Take shared responsibility to develop and harmonize methods which assess the social performance of MFIs.
- Build in-house expertise on client protection and how it can be assessed and improved. With regard to prices, develop a thorough understanding of the prices of each individual product that are part of the microfinance partner's portfolio; portfolio yield alone is not a good reflection of the prices end-users pay.
- Start by being transparent about one's own activities, for example on the interest rates charged to the MFIs; MFIs should also be protected from being charged excessive interest rates.
- In addition to specific scorecards on client protection and social performance, sector-wide analysis (such as whether there is a risk of market saturation) should be taken into account when assessing the MFI. Investors are advised to use updated data from sources as the Smart Campaign and MF Transparency in their due diligence process.
- Use transparent and comprehensive contracts based on local laws.
- Be a partner for MFIs and start a dialogue with MFIs on client protection and social performance, enabling mutual learning and improvement over time.

Direct and indirect (asset owners) investors

- Develop a long-term investment horizon rather than focusing on maximizing short-term profits.

Suggestions and comments on the implementation of the PIIF

- Design a clear framework and unambiguous methods to track social performance and the compliance with the PIIF, taking into account the whole value-chain of financiers.
- Develop hands-on tools to implement the Principles (similar to the tools used to implement the CPPs). Readily available and practical tools will promote broad implementation of the Principles.
- To make the principles concrete, investors should collaborate as much as possible and focus on strengthening existing initiatives, structures and networks to move the debate forward and implement the principles.
- Assign different roles to direct and indirect investors. All stakeholders have responsibilities with regard to the implementation of the PIIF, but have different levels of influence. Indirect investors should hold fund managers (the direct investors) accountable. In general, signatories should hold each other accountable for complying with the principles (the power of peer pressure).
- The focus should not only be on increasing the number of signatories but also on the implementation and operationalization of the Principles.

Other comments/suggestions

- There is a need for country level collaboration. An example can be taken from Oikocredit, which worked together with regulators, MFIs and the Smart Campaign in the Philippines to further integrate policies and good practices in the area of client protection.
- Social Ratings of MIVs (such as supported by Anthos) are considered to be important as they make it easier for private individual investors to select MIVs.
- Investors could play an important role in stimulating the development of a favorable environment by discussing emerging good practices of effective consumer protection regulation with national governments.
- It is proposed to design an action plan to proceed with the harmonization of monitoring- and impact evaluation tools as well as data disclosure (e.g. annual effective interest rate). Financial education of investors is also important: they need to know that the 'honeymoon' is over and need to have a realistic perception of the microfinance sector.
- Encourage signatories to pool funds for social audits and subsequent publication of the results.

Key-points for follow up

- Setting-up a steering committee responsible for implementation and operationalization of the Principles.
- Developing a tracking and monitoring framework to check whether investors comply with the Principles.
- Investors need to keep each other and other parties involved in microfinance accountable for complying with the Principles.
- Initiatives in which different stakeholders such as governments, investors, DFIs and MFIs cooperate to improve nation-wide practices, regulation and policies promoting responsible inclusive financial sectors.
- Sharing practices and harmonizing tools.

Next events

- Social Investors Meeting, Social Performance Task Force, Den Bosch, June 20th
- 3rd Responsible Finance Forum, hosted by IFC, early 2012

Appendices

- Programme
- Workshops: Points for follow up and Reports
  1 The role of investors in transparency and client protection: collective action in practice
  2 Fair treatment and balanced results
  3 Tracking commitment and impact: reporting and monitoring of investors' principles