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Emerging market economies have been experiencing high credit growth and high delinquency rates amongst retail banking customers in recent years. However, collections practices have not always kept pace with this rapid growth; many collectors still rely on relatively unstructured processes and weak oversight frameworks. It is therefore important to consider how fair and ethical treatment of borrowers can be better promoted in these markets.

To this end, International Finance Corporation (IFC) commissioned a study in 2009 to examine the question of what guiding principles should financial institutions follow to raise their responsible and ethical standards in collections. IFC has subsequently commissioned Oliver Wyman to study existing global retail debt collections practices and recommend tangible actions that lenders and collectors can take to promote responsible and ethical standards in the field. The conclusions of this study are based on field research conducted by IFC and Oliver Wyman, industry experts’ analysis and opinion, and a survey of institutions in 20 emerging markets.

Overview of practices observed

This study confirms that collections practices lag best practice along three key dimensions that impact how strong controls are on customer treatment.

First, the study finds there is a strong correlation between the legal infrastructure available for enforcement of claims and the sophistication of the controls employed by collectors. For instance, in many emerging market economies, field collections tends to be the dominant mode of customer contact, while in more developed markets, collectors can tend to rely more heavily on voice contact, where oversight options are stronger.

Second, an independent governance and oversight framework is also relatively rare amongst emerging markets economies collectors. The responsibility for setting and ensuring adherence to ethical standards sits within the collections function itself, and external oversight is generally uncommon. It is no surprise, therefore, that participants of the study reported that their collections policies place greater emphasis on achieving the highest possible recoveries than on ethical treatment of customers. Similarly, customer complaints tend to be handled and monitored using rudimentary procedures.

Lastly, the training offered to employees is often limited and incentives weakly tied to process discipline.

This study recognizes that while no collections control system can be totally effective, there is a lot that collectors in emerging markets can do to enhance borrower protection. Using the Responsible Finance Forum’s “three pillar” structure, the following recommendations are proposed:

1. Regulation and policy

Regulation should go beyond the oversight of collections activities to provide a legal recourse framework, a consumer protection framework, protection from creditors through personal bankruptcy options and recourse mechanisms for ill-treated borrowers (e.g. ombudsman offices). Policies should also promote strong credit information infrastructures, customer education and training and licensing of collections agents.

2. Responsible practices by financial providers

Disciplined practices processes can not only achieve better control over the customer experience, but also deliver superior collections performance. Institutions that focus on applying best practice in analysis and strategy will naturally see the incidence of customer conflict reduced. Strong measuring and reporting of collections activities can also greatly improve institutions’ ability to identify and respond to weaknesses in controls.

3. Financial literacy

Well-informed consumers can make good financial decisions and defend themselves against coercive and improper treatment by collectors. In addition to regulators and providers, financial education institutions and industry associations can play a role in creating greater “financial literacy” both in better aligning financial products to customer needs as well as better resolution of hardship cases.
IFC is committed to promoting responsible finance. This stems from its broader goal of alleviating poverty by helping to enhance access to finance to the world’s underserved segments. While recognizing access to financial services does not alone achieve this goal; financial products must also be matched to client needs and help lift them out of poverty without trapping them in debt.

Because lending cannot exist without repayment, and repayment requires collections, debt collection practices are integral to the responsible finance agenda. Collectors must not only effect repayment but they must also conduct their work in an open, honest and legal manner.

Debt collection assumes special significance in emerging market economies1 because of the high credit growth rates, high delinquency rates and, as yet, developing legal recourse mechanisms that prevail in these regions. These challenges have led to some high profile accusations of collections abuses. The publicity around these cases has contributed to regulatory backlash, reputational loss to banks, discontinuation of whole lines of business and legal difficulties for some bank staff. In this way, insufficient investment in responsible practices can roll back access to finance.

IFC commissioned a study in 2009 to examine the question what guiding principles can financial institutions follow to raise their responsible and ethical collections standards. The study proposed the following set of principles based on lessons learned from developed credit market systems—and the principles fall into the following three categories2:

1For the purpose of the report, emerging market economies refers to the jurisdictions under scope of the study, as listed in Appendix B of the report.

2Derived from IFC's Global Practices in Responsible and Ethical Collections, working paper 2009.

<table>
<thead>
<tr>
<th>Table 1: Principles of collections conduct</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Principle</strong></td>
</tr>
</tbody>
</table>
| **1. Investing in a transparent relationship with the borrower** | • Borrower awareness of the consequences of default  
• Terms and conditions clearly communicated  
• Education about avoiding delinquency  
• Avoidance of predatory lending practices |
| **2. Interacting with the customer in a fair and respectful manner** | • Non-discrimination  
• Contact at reasonable hours and frequency  
• Polite, respectful, non-threatening language  
• Respect of privacy  
• Good faith participation in negotiations, mediation and other processes for consensual resolution of debts |
| **3. Develop relationships and systems to support ethical practices** | • No outsourcing of unethical practices to other collectors  
• No manipulation of legal or political institutions to condone irresponsible/unethical practices  
• Internal systems to regularly audit practices and operational performance to ensure compliance with ethical guidelines  
• Loan restructuring and other solutions for hardship cases  
• Training and incentives for ethical practices |
This study builds on the above-mentioned work, focusing on the control mechanisms that lenders and collectors can use to ensure that actual practices align to stated conduct standards. It does not attempt to define standards on how customers should be treated; under what circumstances; and cultural context. Rather, the study focuses on the control mechanisms currently used by emerging market collectors to promote ethical practices. From these observations of actual practices in a variety of markets, the study formulates recommendations for collectors.

As in developed markets, customer mistreatment will never be eliminated in all its forms. Limitations on legal recourse for lenders in many emerging markets can make it challenging to ensure agents do not overstep boundaries in their efforts to recover dues. Nevertheless, this study reveals that collections practices in emerging markets are rapidly professionalizing. Successful initiatives by market leaders demonstrate that obstacles are not insurmountable.

While targeted investment in governance, professionalized processes and measurement can give lenders more comfort that the risks in collections are being managed, it is also important to note that issues in collections can also stem from poor practices at other points in the lending cycle – and can be resolved by eliminating them.

In this report, we first present the context and methodology of the study. We then summarize the key insights. Finally, we make recommendations for improving responsible collections control mechanisms.
3. OVERVIEW OF THE STUDY

Rationale, objectives, and approach

3.1. WHAT IS RESPONSIBLE FINANCE?

Limited access to finance is a challenge to economic growth in emerging markets economies, and expanding it does help to lift people out of poverty. But access to finance alone is not sufficient. Rather, finance must be delivered in a responsible way, which allows informed individuals to invest in productive assets and businesses without subjecting themselves to excess leverage, costs or indignity.

While the Consultative Group to Assist the Poor (CGAP) defines responsible collections simply as “not abusive or coercive,” the Responsible Finance Forum* defines responsible finance as “coordinated public and private sector interventions that encourage and assist financial services providers and their clients in improving their understanding and approaches, practices, and behaviors that can eventually contribute to creating more transparent, inclusive, and equitable financial markets.” Further, the Responsible Finance Forum has articulated a three-pillar concept consisting of:

I. Regulation for consumer protection
II. Responsible practices by financial providers
III. Financial capability

Figure 1: Responsible finance: A multi-stakeholder (three-pillar) approach

<table>
<thead>
<tr>
<th>AREAS OF ACTION</th>
<th>Providers of financial services – banks, MFIs, NBFIs, other – and their associations</th>
</tr>
</thead>
<tbody>
<tr>
<td>KEY STAKEHOLDERS</td>
<td>Regulators (central banks, financial regulators, consumer protection agencies)</td>
</tr>
<tr>
<td>CROSS-CUTTING ISSUES</td>
<td>Consumers – individuals and businesses – and advocacy organisations</td>
</tr>
</tbody>
</table>

1. **Consumer protection (regulations):** a regulatory framework for financial consumer protection, at both national and international levels
2. **Responsible providers:** voluntary commitments, practices, standards, and initiatives in the financial sector (individually and at industry level, nationally and internationally)
3. **Financial capability:** interventions aimed to build and enhance financial capability of financial institutions’ clients – the consumers of financial products and services

Source: Responsible Finance Forum.

* The Responsible Finance Forum, established in 2010, is an annual event aimed at gathering a diverse group of actors in responsible finance, comprised of bilateral and multilateral donors, development finance institutions, investors and practitioners in the financial sector. The Responsible Finance Forum has thus established a community of practice with the common goal to improve cooperation and share knowledge on the emerging concept of responsible finance.
This study focuses on the practices of financial institutions in the area of retail debt collections. Specifically, it is interested in the control frameworks that institutions can put in place to ensure that collections activities are consistent with the principles of responsible lending and treating customers with dignity.

3.2. COLLECTIONS IN EMERGING MARKETS

For the most part, lenders in emerging markets have underinvested in collections capabilities as their retail businesses have grown. As a result, they have struggled to develop collections processes that are effective, cost-efficient and protect the customer from harassment or abuse.

Collections practices across emerging markets vary with legal frameworks, regulatory processes, risk appetite and credit culture. Nevertheless, they face a reasonably common set of challenges, which are summarized below:

**Weak information infrastructure**

- Important credit information is unavailable for the original lending decision, especially the applicant's income and other debt obligations. Hence, many customers are offered products whose repayment does not properly match their income in amount, tenor or currency. This leads to high rates of default and fraud.
- Limited credit information is available at the time of collections. It is difficult to access the customer's repayment records with other lenders and service providers, and to verify the customer's income. This makes it difficult to determine which customers are genuinely unable to pay and which are merely unwilling.
- Vetting employees and agencies is also more challenging in emerging markets where employment history and unique ID numbers are not always easily verified

**Insufficiently developed legal support for collections**

- Criminal and civil legal procedures are usually costly, lengthy and uncertain
- Many emerging markets are characterized by weak or non-existent personal and corporate bankruptcy frameworks that would permit judicial determination of ability to repay and allocate losses among creditors.
- They also lack a mediation/negotiation culture and institutions to facilitate non-judicial resolution

**Customer awareness**

- Customers can have low awareness of the importance of a good credit history
- Many emerging markets often lack convenient non-cash repayment mechanisms accepted by borrowers. The predominance of cash increases the need for field collections and the opportunity for agent fraud.
- Informal lenders with reputations for aggressive tactics are a further challenge wielding more leverage over borrowers than other more regulated lenders. The prevalence of such lenders and their tactics may shape popular perception of the industry and “legitimize” certain tactics in the minds of collection agents.
Figure 2: Credit information is generally weaker in emerging markets – proportion of population covered by public registry or credit bureau

Proportion of population covered by public registry or credit bureau

The conclusions of this study are based on a series of interviews with collections practitioners across various emerging market countries, as well as input from Oliver Wyman and IFC subject matter experts with experience working in collections in these countries.

### Table 3: Sources of insights

<table>
<thead>
<tr>
<th>Field research</th>
<th>Industry Experts</th>
<th>Survey</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Understand collections practices at select firms</td>
<td>• Observations and opinions from industry experts at IFC and Oliver Wyman</td>
<td>• Written survey distributed in ~20 emerging markets</td>
</tr>
<tr>
<td>− Hold discussions with senior management of firms</td>
<td></td>
<td></td>
</tr>
<tr>
<td>− Visit and conduct detailed research with a small number of firms</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

This study focuses primarily on countries whose retail and consumer debt industries are evolving from underpenetrated to mature. This is when countries collections challenges tend to be greatest and the need to build the institutional elements of responsible collections is most acute. To this end, the selection of target regions was based on two criteria:

1. Sufficient scale and history of retail lending to have built up collections infrastructure that has been “tested” through an economic downturn (or consumer debt crisis)
2. Legal and public information infrastructure illustrating at least one of the challenges of emerging retail and consumer finance markets, such as immature credit bureaus, absence of national legislation governing debt collections practices, lengthy or unpredictable legal processes, lack of nationwide professional debt collections agencies

Given these criteria, we focused on the Indian subcontinent, China, Central and Eastern Europe, the Middle East and Southeast Asia. Other emerging markets were covered primarily through secondary sources. These include Latin America, whose largest economies have more mature credit infrastructure and West and East Africa, whose retail lending institutions are as yet too new to provide extensive insights.

Site visits of one to two days each were conducted in 19 institutions across a broad subset of the target jurisdictions. The participants include a broad spectrum of institutions, including originators of consumer and small and medium enterprises (SME) loans (including Microfinance Institutions (MFIs)), debt servicing firms, consumer debt purchasers and a technology provider specializing in financial inclusion infrastructure. To supplement the findings from these interviews, a written survey was distributed to lenders in jurisdictions where site visits were not conducted.
The focus of the survey was retail loan portfolios including:
- Home loans
- Auto/2W/Hire-purchase
- Unsecured personal loans/CC
- Small business loans (secured/unsecured)
- Microfinance

We used the surveys and site visits to cover:
- Retail lenders
- Microfinance Institutions
- Collections servicing agencies

A full list of jurisdictions covered in the project is provided in Appendix B.
5. KEY OBSERVATIONS

The study’s investigations conclude that there are no “silver bullets” and “checklists” of best practices that can ensure that customers are always well treated. Nevertheless, we have observed several laudable attempts to strengthen controls, most notably among professionalized collections servicers, and have highlighted many of these throughout this report.

The key observations from the study include:

• There is a strong correlation between the legal infrastructure available for enforcement of claims and the sophistication of controls employed by collectors. Jurisdictions with strong legal recovery mechanisms tend to have more evolved collections practices.
  - Less evolved markets, tend to make more use of field (door-to-door) collections than call centers
  - More advanced markets use negligible field contact and usually focus on phone collections and letters
• Responsibility for setting and enforcing conduct standards generally sits within the collections function itself, with only a few institutions having independent oversight.
• Policies are designed to maximize collections value. Fair treatment of customers generally remains only a secondary concern.
• Little training is provided to employees, and incentives are usually directly aligned to amount collected. Conduct issues tend to be addressed only in extreme situations.
• Complaint handling and tracking mechanisms can be rudimentary.

In this section, findings are summarized across the following key dimensions:

• 5.1 Industry and geographical trends
• 5.2 Policy setting
• 5.3 Borrower contact
• 5.4 Human resource management
• 5.5 Monitoring and complaint handling systems

5.1. INDUSTRY AND GEOGRAPHICAL TRENDS

5.1.1. Geographical trends

The sophistication of collections tends to follow the maturity of the retail finance market and effectiveness of legal recourse in each geography. This is likely driven by two factors. First, lenders have tended to invest initially in product development, underwriting and sales, only belatedly recognizing the centrality of collections to the retail finance business. Second, in jurisdictions where the legal framework better supports lenders’ claims against borrowers, lending businesses were able to take root earlier.

Leaving aside some significant intra-regional variations, collections capabilities are most developed in Latin America and parts of Southeast Asia. Here, the debt collection business is more consolidated and professionalized, analytics support customer segmentation and most customer contact is via call centers. The most challenging environments for collectors are in South Asia and the Central and Eastern European countries. In these regions, collections are performed by a fragmented third-party industry, working “in the field” with little use of technology or customer segmentation analytics. These observations are consistent with the assessments of the rating agency Fitch regarding the effectiveness of legal recourse mechanisms for debt collection.\(^1\)

\(^1\)“Country-Specific Treatment of Recovery Ratings,” Fitch Ratings, 23 February 2011. The Fitch ratings focus on corporate recoveries. We expect a broad correlation between development of legal framework for recoveries for both corporate and retail customers.
5.1.2. Industry trends

Participants in this study include conventional lenders, collections servicers and microfinance institutions. These players face different challenges and incentives, giving rise to different approaches to collections.

- **Lenders**: Retail lenders for the most part do not view collections as a core competence. Many lenders rapidly moved to build their retail portfolios without investing in the collections capabilities required, doing so only when delinquencies became a problem. Because of the direct impact on P&L, day-to-day flow rates tend to be the over-arching performance metric receiving management attention. For the most part, lenders’ collections functions are not strongly influenced by independent units that have an interest in fair treatment of customers, such as customer relationship management, operational risk management or corporate social responsibility units.

- **Servicers**: By definition, collections is a core capability for professional loan servicers. They have therefore invested more in both capabilities and controls. Their focus on controls is due to the fact that maintaining an untarnished reputation is important to a professional servicers’ ability to secure future contracts. Unfortunately, in many markets the servicing sector remains fragmented and dominated by small unprofessional players for whom reputation can be less important.

- **Microfinance Institutions**: The participating MFIs all operate on the joint liability self-help group structure (whereby the MFI lends not directly to individuals but to small groups of customers who have come together to share liability for repayment). In this structure, the risk of mistreatment of borrowers by MFI agents is actually deemed to be low for two reasons. First, agents’ roles include business development, loan servicing and collections. Because they operate within the community, their activities are highly visible, and they seek to maintain good relationships with the communities in which they hope to generate future business. Second, when a member of a self-help group becomes unable or unwilling to repay, it is the other members of the group who put pressure on that borrower to maintain payments.

For all its merits, this model fundamentally “outsources” front-line collections function to the group itself, and because of this MFIs themselves have little to no control over the tactics employed. The participating MFIs are aware of the challenges, particularly in the wake of the crisis in Andhra Pradesh India, which was precipitated by allegations of collections abuses. Examples of factionalism and abusive behavior by group leaders show that formation of a self help group does not alone guarantee sound collection and portfolio management decision-making.

5.2. POLICY SETTING

Responsible collections start with senior management articulating how they expect the institution’s customers to be treated. All the institutions participating in this study reported having a collections policy document. However, when probed about the primary purpose of the document, a majority of participants cited maximizing collections and avoiding litigation as the primary purpose of the guidelines, while preserving customer relationship and Corporate Social Responsibility are ranked as lesser priorities.

Further, responsibility for drafting the policy usually rests within the collections function or retail business unit, and many policies are not signed off by senior management. As a result the interests of potential stakeholders, such as the compliance, reputational risk or service quality functions, do not have a significant voice in policy setting. Through discussions with collectors, it was further apparent that collections policies are not always understood by field collectors and, hence, had limited effect on behavior.

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**Figure 5: Participants in collections policy setting**

<table>
<thead>
<tr>
<th>Position</th>
<th>Participants</th>
</tr>
</thead>
<tbody>
<tr>
<td>Board committee</td>
<td>0%</td>
</tr>
<tr>
<td>Executive committee</td>
<td>21%</td>
</tr>
<tr>
<td>Retail loan head</td>
<td>50%</td>
</tr>
<tr>
<td>Collections head</td>
<td>71%</td>
</tr>
<tr>
<td>Others</td>
<td>29%</td>
</tr>
</tbody>
</table>

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Formal written procedures to cover irresponsible use of borrower contact channels, collections strategies and debt recovery procedures are common. However, the following limitations were observed:

- “Special case” treatment is rarely defined. Where hardship case procedures do exist, they tend to be limited in scope, such as the death of a borrower. As a result, collectors are left to their own devices in such cases.
- While policies prohibit threats and intimidation, they tend to be silent on other potential goals, such as protecting customer privacy, limiting threats of incarceration, protecting customers’ credit record or when and how to contact guarantors.

CASE STUDY: Centrality of code of ethics – Mexican MFIs

Mexico is host to a number of microfinance institutions and enjoys a relatively favorable legal environment for enforcing claims (Fitch places the country in “Group C,” ahead of the bulk of countries studied in this report). Two firms, FinComún and Compartamos Banco, have drawn distinction for their efforts in promoting ethical and responsible treatment of customers.

FinComún is a deposit-taking microfinance institution in Mexico. In response to rising delinquency rates in 2008, management set forth a new “philosophy” based on collection agents treating customers with respect and dignity. The new framework introduced a code of ethics based on the “golden rule”, eliminating outsourced collections, ethics in recruiting and soliciting customer feedback.

The framework has enabled the institution to improve on-time payments and weather not just the global financial crisis but also the impact of the H1N1 outbreak which damaged the economies of the communities in which it operates.

The for-profit Compartamos Banco MFI is also recognized for its strong institutional commitment to its clients and employees. Its Institutional Code of Ethics and Conduct covers all employees and management levels. Among other things, the code protects customer information and requires that customers be treated with dignity in the collections process. Embedding these values throughout the organization has been accomplished through strong leadership as well as tangible initiatives such as:

- Independent department charged with the oversight and promotion of the institutional values and mission
- Annual certification of all staff
- Toll-free whistle-blowing hotline
- Toll-free customer complaints hotline
- Third party review of client impact
- KPIs related to ethics and conduct incorporated into balance scorecards for staff appraisals

5.3. BORROWER CONTACT

In more mature financial markets, voice channels (call centers) are the dominant mode of customer contact, while field agent visits are reserved for special cases such as skip tracing and candidates for repossessions or foreclosure. In the jurisdictions studied, the mix of voice and field contact varied widely, with some markets dominated by voice (e.g., Central and Eastern Europe, South East Asia) while others mostly used field contact, even for borrowers in the early stages of delinquency (e.g., South Asia).

5.3.1. Field collections

In jurisdictions such as those in South Asia, field visits are essential to the collection process. For many borrowers, physical instruments (cash or cheque) are the only practical or trusted forms of repayment. In some cases, borrowers have even come to expect and appreciate this “doorstep service” from their lenders. One South Asian institution which aspired to eliminate all cash handling by agents acknowledged that this was next to impossible without a fundamental shift in borrower culture.

Study participants consistently viewed field collections as the most risky channel, from both a customer treatment and reputational risk perspective because none of the automated monitoring and control features of a call center are available. Furthermore, there are real and perceived threats to collectors which can quickly escalate the situation. Much attention is placed on the problem of cash defalcation (collectors pocketing customers’ payments), which is both a cost to the lender and a problem for customers, since it inevitably leads to a dispute situation.

Lenders commonly make monthly case allocations to field agents on the basis of product types and period of delinquency. Seldom are borrowers segmented within a given delinquency bucket. In some cases, agents are provided with tools to support their efforts, such as workflow automation, feedback from prior customer contact or guidance on handling hardship cases or arranging exit options. In other cases, agents are left to their own devices. In the worst cases, lenders’ management information systems (MIS) are incapable of aggregating exposures to a borrower, and multiple agents are despatched to a customer’s residence to collect on different facilities.

Where field collectors are employed at early stages of delinquency, the reasons cited were generally the difficulty in contacting borrowers by phone and a lack of non-cash modes of repayment. Skip tracing activities also rely heavily on field investigation in most countries.

There appears to be a strong negative correlation between the use of field contacts and the frequency of legal action (such as court cases, repossessions, etc). We postulate that in those countries where a strong, credible threat of legal repercussions is present, the perceived “need” for intensive customer contact is greatly reduced and, with it, the risk of customer abuse.

The following sections provide a description of how each contact channel is used, and the types of controls applied to each:
The study’s participants use four different control mechanisms:

1. **Close supervision**: Field agents are generally managed in small teams, with management spans as low as 10:1. Agents will typically report daily to team leaders who closely manage their caseflow, accompany agents on selected visits and bring in more senior collectors for more difficult cases or those requesting modifications or settlements.

2. **Mobile technology**: Mobile technology is now being employed by collectors for conventional lenders and MFIs to help manage workflow, record customer trail information, track collectors’ whereabouts and issue receipts to borrowers. Such systems show promise, especially with regards to reducing fraud and cash defalcation, but do not yet provide a window into the agent-customer interaction.

3. **Team visits**: Several collections servicers send staff in pairs or teams, or send staff to accompany third parties engaged for repossessions. This ensures that a second pair of eyes keeps a check on the customer interaction and discourages fraud. It is costly, however, and used mostly for higher value cases or non-routine visits.

4. **Visit follow-ups**: A few lenders have established a system of random follow-up calls to customers visited by field agents. These confirm that a visit was made, verify the outcome of the visit (i.e., whether a payment or promise to pay was given) and seek feedback on the collector’s conduct. At least one lender calls customers where no contact has been reported by the agent.
### Table 2: Practices snapshot: Field contact channel observed practices

<table>
<thead>
<tr>
<th>Leading</th>
<th>Typical</th>
<th>Minimal</th>
</tr>
</thead>
<tbody>
<tr>
<td>Field collections</td>
<td>Mix of field and phone</td>
<td>Heavy reliance on field</td>
</tr>
<tr>
<td></td>
<td>Cash is handled to certain extent</td>
<td>Mostly cash handled</td>
</tr>
<tr>
<td>Low reliance on field</td>
<td></td>
<td></td>
</tr>
<tr>
<td>No cash handling</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Field used mostly for skip tracing</td>
<td></td>
<td></td>
</tr>
<tr>
<td>and asset recovery</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

5.3.2. Phone collections

Phone contact is used for soliciting repayment for early stage delinquencies. Use of phone contact declines for later stages of delinquency, and is more prevalent in markets with more robust legal recovery frameworks and where non-cash repayment mechanisms are readily available.

With few exceptions (see case study), collections institutions do not completely centralize phone contacts at a call center. Instead calls are made from branches or by collectors using their own mobile phones. This distributed calling is usually unscripted, unrecorded and only loosely monitored. As a result, there is a greater risk of misconduct than in a formalized call center.

### Table 3: Practices snapshot: Voice contact channel observed

<table>
<thead>
<tr>
<th>Leading</th>
<th>Typical</th>
<th>Minimal</th>
</tr>
</thead>
<tbody>
<tr>
<td>Phone collections</td>
<td>Mix of phone and field</td>
<td>Low/no use of phone</td>
</tr>
<tr>
<td></td>
<td>Most calls scripted</td>
<td>No call scripts/protocol</td>
</tr>
<tr>
<td></td>
<td>No auto dialling</td>
<td>No system/logic behind dialling</td>
</tr>
<tr>
<td></td>
<td>Limited training using call records</td>
<td>No training/call records not used in training</td>
</tr>
<tr>
<td>High reliance on phone</td>
<td></td>
<td></td>
</tr>
<tr>
<td>All calls scripted, with call</td>
<td></td>
<td></td>
</tr>
<tr>
<td>termination protocol</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Predictive dialling</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Training using call records</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
CASE STUDY: Thailand – a voice-dominated market

Among the countries studied, Thailand has one of the most professionalized collections industries and receives a favorable "C" assessment from Fitch for enforceability of claims1. More attention was spent on the oversight of collectors than in most other countries covered. Some practices observed included:

• Customer contact dominated by phone calls, with field collectors being employed primarily for skip tracing and asset recovery; payments can be conveniently deposited with local merchants such as 7-11
• Customers assigned to field agents are also contacted by phone to verify contact (or non-contact) and solicit feedback on interaction
• Call centers have an open floor plan, tight management spans and call recording for effective peer and supervisor line-of-sight dedicated complaint hotline and behavioral scoring used to triage customers for contact strategy


5.4. HUMAN RESOURCE MANAGEMENT

Study participants were asked about four key dimensions of human resource management: recruitment, training, incentives and vendor management. Across the board, results reveal that sincere attempts are made to attract and retain good staff, yet participants cited several obstacles. In general, turnover rates are high and qualified applicants are scarce.

5.4.1. Recruitment

In most markets, experienced collectors are scarce and most agents are new to the job, with entry level staff or internal transfers. For entry level hires, lenders typically seek candidates with a high school diploma and seldom expect more than 3 years of experience. The profile of a firm’s staff depends on the proportion of work done in the field, the demographics of the clientele, and the nature of the portfolio (e.g., secured vs. unsecured).

Most firms use some form of background check but some noted that the effectiveness of these investigations is limited given applicants’ inexperience and the paucity of data available for background investigations.

CASE STUDY: Central and Eastern Europe – recruiting experienced staff from other industries

Among the countries studied, the general trend has been to recruit collections staff at the entry level or to make internal transfers. This allows staff to be trained in ethical collections practices but is costly and time consuming.

In Central and Eastern European countries, lenders found themselves lacking capacity to cope with rapidly rising defaults. Lacking sufficient experienced staff to rapidly train others, some banks turned to collection experts from outside their industry. Specifically, they recruited staff from the leading mobile phone operators – renowned for their effective collections departments – to build capable collection teams rapidly. Because these recruits were already experienced in customer interactions and collections in a non-lending and relationship-oriented environment, they were well suited to transition to ethical collections in lending.

Table 4: Practices snapshot: Recruiting observed practices

<table>
<thead>
<tr>
<th>Qualifications</th>
<th>Leading</th>
<th>Typical</th>
<th>Minimal</th>
</tr>
</thead>
<tbody>
<tr>
<td>Graduate/post graduate</td>
<td>High school/diploma/college</td>
<td>Middle school/no criteria</td>
<td></td>
</tr>
<tr>
<td>5+ years</td>
<td>1-3 years</td>
<td>&lt;1 year, inexperienced hires</td>
<td></td>
</tr>
<tr>
<td>References required, fraud checks</td>
<td>Checks required</td>
<td>No checks</td>
<td></td>
</tr>
</tbody>
</table>
5.4.2. Training

The quantity of training varies considerably across participants and is often driven more by regulatory than business requirements. Typical study participants report providing 15 hours of training to new employees, with annual refresher courses of around 10-30 hours. In some cases initial training is as much as 100 hours.

This study was unable to assess the effectiveness of training in imparting ethical collections values to agents. Most respondents indicated that ethical practices are covered within the training curriculum.

<table>
<thead>
<tr>
<th>Table 5: Practices snapshot: Training observed practices</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Hours of training</strong></td>
</tr>
<tr>
<td>Training on ethical collections</td>
</tr>
<tr>
<td>Training on ethical collections</td>
</tr>
</tbody>
</table>

5.4.3. Performance evaluation and incentives

As with sales functions, collections performance is driven by strong incentive mechanisms. Most firms covered in this study evaluate employees primarily on the basis of the amount collected from borrowers, with targets being differentiated by difficulty of collecting (e.g., by product and delinquency bucket). Adherence to processes is only a secondary consideration of incentive policies.

**Figure 9: Most firms evaluate employees by amount collected from borrowers, with only 40-50% evaluating adherence to process**
5. Key Observations from the Study

5.1. Incentives in the Relationship Manager Model

One alternative incentive structure is the relationship manager model. In this model, which is most commonly practiced in microfinance or very small business loans, collections activities are carried out by the same loan officers who originate and service the loan. This approach fundamentally alters the collections incentives, because the relationship officer has strong incentives to retain the customer relationship and to maintain good relations in the community in order to foster future business. These “long view” incentives allow the officer to play the role of problem solver rather than enforcer. In many institutions, the case may be referred to a recovery agent if the customer remains unresponsive. While reportedly effective in “good times”, this model has been less successful under stress (high NPLs), when the prospect of future business no longer outweighs the need to get payments on existing delinquencies.

Table 6: Practices Snapshot: Performance Evaluation Observed Practices

<table>
<thead>
<tr>
<th>Performance Evaluation</th>
<th>Leading</th>
<th>Typical</th>
<th>Minimal</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Balanced scorecards with financial and process elements</td>
<td>• Field collectors evaluated on financial performance</td>
<td>• Evaluation and incentives tied to financial performance alone</td>
<td></td>
</tr>
<tr>
<td>• Severe penalties for transgressions</td>
<td>• Voice collectors evaluated on multiple criteria</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Although performance-linked incentives are an important driver of performance in a collections function, they can also have the effect of encouraging collectors to use any means, fair or foul, to realize a payment. As in the case of sales abuses (e.g. mis-selling), strong negative incentives (e.g. termination, prosecution) are essential for discouraging inappropriate behavior. In almost all cases, respondents reported that allegations of misconduct are dealt with seriously and termination is the most frequent remedy.

CASE STUDY: Incentives in the Relationship Manager Model

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5.4.4. Vendor Management

Engaging third-party agencies at some stage in collections occurs virtually wherever permitted by law. In some cases, third parties participate in all stages of collections and are contracted not for special skills, but simply to augment capacity. In other cases, they are contracted for specific skills which the lender is not able to provide, such as skip tracing.

For the most part, the participants in this study use vendors to provide door-to-door field collections services. Somewhat surprisingly, among the study respondents there were few examples of either outsourcing of call center operations or “managed service” arrangements.

The professionalization of agencies varies by geography. Predictably, those jurisdictions with more favorable legal frameworks tended to also have more professionalized collections industries, while others tend to be dominated by small, local “sole proprietorship” agencies. In these fragmented markets, ensuring responsible practices by these agencies is a serious challenge.

Few institutions have invested in vendor management capabilities that would help give comfort that customers are being treated with dignity. When vetting vendors, reputation and performance are paramount, while the number of customer complaints received is seldom a prominent consideration. A common reason for outsourcing is to benefit from the greater “flexibility” available to third parties, including, but not limited to, better relations with offici-aldom (including police and politicians).

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* In managed service contract, the service provider manages all aspects of collections under a set of pre-agreed SLAs, in exchange for payment based on collections outcome.
Further, when selling debt to third parties, participants did not cite the quality of controls as a significant factor in selecting a purchaser. Nor are customer protection mechanisms commonly built into the sale contracts.

**CASE STUDY: Vehicle repossession process in India**

As in many countries, vehicle repossessions in India are often outsourced to third-party providers. These agents benefit from an informal cooperative network to locate vehicles of delinquent borrowers and bring them to the attention of the lien holder. In most cases, the owner or driver must be physically present and voluntarily relinquish the keys to the repossessing agent. One asset reconstruction company reports that to monitor the conduct of the repossession agent and minimize chance of conflict, a staff member accompanies the third party agent throughout the process. Often a police officer is also present. While reportedly effective in “good times,” this model has been less successful under stress (high NPLs), when the prospect of future business no longer outweighs the need to get payments on existing delinquencies.

### 5.5. MONITORING AND COMPLAINT HANDLING SYSTEMS

Active monitoring and complaint handling mechanisms were found to be generally at a rudimentary or ad hoc level. As will be discussed in the following section, this is an area where investment is essential for responsible emerging markets economies lenders and collectors.

#### 5.5.1. Monitoring systems

Monitoring of activities in professional call centers tends to be strong, with tight management spans (typically 1 supervisor to 10-12 callers) and call recording in place. Among study participants, however, advanced tools such as detection of foul language or aggressive tones are not prevalent.

In cases where voice contact remains decentralized in branches, scant infrastructure is available for monitoring.

Monitoring of field collections is inherently the most difficult. In most cases, field collectors visit debtors alone except in difficult cases, leaving only scope for remote oversight such as:

**Mobile technology:** Some lenders have implemented mobile device applications which track collector activities. This technology is nascent, with only a few institutions having initiated or piloted it (see case study box below).
Follow-up contact: A more effective mechanism is the practice of making random calls or visits to customers to solicit feedback and verify collector reports.

Most lenders have a system of checks and controls for supervising third parties, often with in-house staff regularly monitoring and supervising agency operations.

CASE STUDY: Technology for field agent monitoring (India and Thailand)

Several collectors spoken to are experimenting with mobile technology for assisting and monitoring field agent collection activity. In these pilots, field collection agents are equipped with handheld devices with Global Positioning System (GPS) and General Packet Radio Service (GPRS) capabilities which can be used to track their whereabouts as they do their rounds. These systems can provide daily workflow support, such as customer address, delinquency and trail information, and can also be used to upload trail updates after customer contact.

The systems can be linked to portable receipt printers via Bluetooth® technology so that customer receipting is automatically synchronised with lender account records.

In the case of one MFI, each customer has a biometric card with their thumb impression captured on it. The card is swiped in the mobile device, thereby reassuring the client that payment will be credited to the correct account.

While these devices show promise in limiting fraudulent activities by agents, they do not provide the kind of direct line-of-sight to the customer interaction that can be achieved in call centers.

5.5.2. Complaint handling systems

Few lenders have invested in formalized complaint handling and resolution systems. For the most part, complaints were handled in an ad hoc fashion, without mechanisms for recording and tracking the level or nature of complaints received over time. Whistle-blowing policies and processes were found only in a minority of cases.

Quick resolution of customer complaints is an important part of customer service and a mechanism for avoiding future conflict or litigation. Monitoring complaints also serves as an early warning mechanism to identify weaknesses in controls. Some lenders have taken steps to formalise their complaint and redress procedures, including:

- Establishing dedicated complaints hotlines
- Providing alternative complaint channels – SMS, email, mail
- Advertising hotlines to customers through documents, receipts and in one case employee business cards
CASE STUDY: Debt collector regulation in South Africa

South Africa has a relatively professionalized and well-regulated collections industry; it also enjoys the highest rating of “A” by Fitch for the effectiveness of judicial recourse. Phone contact strategies dominate the market, in part because of the effectiveness of legal measures and in part because door-to-door collection is deemed to be a dangerous activity for collectors.

The South African government has established entities charged with promoting responsible practices in microfinance lending and debt collections for conventional lending. In addition to these, the Association of Debt Recovery Agents maintains its own code of conduct and investigates its members*. The Micro Finance Regulatory Council (MFRC) is a non-governmental body created in 1999 with a mandate for:

- Promotion of micro-lending industry
- Encouragement of sustainable growth in the industry
- Lending credibility to the industry
- Serve credit needs of South Africans who may not have access to credit by formal banks
- Protection of consumers against unfair business practices by lenders
- To educate consumers and lenders about their rights and obligations

All microfinance lenders must be accredited by the MFRC as a condition for the waiver of usury restrictions. The Council has established guidelines for fair business conduct, including limitations on collections practices. Consumer complaints can be directed to the MFRC through phone, fax, email or website. MFRC then has the power to investigate and discipline lenders.

For most other consumer debt, collectors are regulated by the Council for Debt Collectors. The council has been operational since 2003. All debt collectors must be registered by the council and agree to adhere to its code of conduct. Though the documentary requirements for consumer complaints are more onerous that those of the MFRC, the council does have the mandate to investigate complaints and discipline violators (including levying fines).

* Meagher, Peter, Ed., "Microfinance Regulation in Seven Countries: A Comparative Study Submitted to Sa-Dhan, New Delhi by the IRIS Center, University of Maryland, 31 May 2006
  www.debthol-council.co.za
  www.mfrc.co.za
  Anderson, Raymond, "Micro-lenders: Sub-Prime Lending and Its Implications for Credit Bureaux and Credit Scoring in South Africa", Presented at Credit Scoring & Credit Control VII, University of Edinburgh 3-5 September 2003

CASE STUDY: China – Call Center Quality Control

One major Chinese lender has recently implemented an advanced collections system, which enables the collections department to take a customer-level view, track collections trails in detail and segment borrowers according to their aggregate exposure and account behavior.

Unlike most Chinese lenders, who manage collections activities out of city branches, collections is a centrally-coordinated activity with monitoring, analytics, letter dispatching, SMS and call center all run out of headquarters. The management of door-to-door activities remains with the branches. Only the mailing of dunning letters is outsourced. Customer contact is kept in-house to better control reputational risk concerns.

The call center is a critical element of the customer contact strategy, and the bank has established several monitoring mechanisms for their call center, including:

- Centralized complaint handling unit charged with identifying, following up, resolving and tracking customer complaints
- Call recording system through which all calls are recorded and checked on a sampling basis by an internal monitoring/quality assurance team
- Reconciliation of call logs by call center managers on a sample basis.
- Real-time oversight of calls by the team leader
- Periodic assessment of the call center by headquarters
6. RECOMMENDATIONS

Despite the good intentions and significant effort of collectors, much can still be done to strengthen the controls on collections activities. The following recommendations focus on the guiding principles that can be followed more rigorously in institutions. Successfully implementing this guidance cannot provide fail-safe protection of consumers, but can do a great deal to mitigate the risks associated with collections and promote fair treatment of borrowers.

In the structure of the Responsible Finance Forum’s three pillars of responsible finance, the following recommendations focus primarily on practices which can be adopted by financial providers. However, regulators and policymakers can also facilitate greater fairness in collections by strengthening supporting institutions.

6.1. PILLAR 1: REGULATION AND POLICY

The role of regulation must go beyond the oversight of collections activities. It must create an environment conducive to fair interactions without inadvertently playing into the hands of those willing to operate on the fringes of system. Important features of such an environment include:

- **Legal recourse**: Lenders should have access to timely, equitable and enforced *civil*\(^5\) proceedings against defaulting borrowers, whether the debt is secured or unsecured. Lenders should also be protected from the kind of frivolous claims often put forward by borrowers’ intent on taking advantage of the inefficiency of the courts.

- **Consumer protection**: Just as lenders’ legitimate interests should be protected by reliable legal recourse against borrowers in breach of their contractual obligations, so should borrowers be protected by legislation banning them with recourse against fraudulent, intimidatory and other unethical collection practices.

- **Personal bankruptcy legislation**: Customers who are in financial distress need recourse to a legal process by which their financial situation can be independently assessed and a degree of repayment apportioned to creditors in exchange for protection from further obligations.

- **Credit information**: Access to good credit information improves the quality of underwriting and hence reduces the risk of mis-selling or excesses by collectors. Key tools include credit bureaus and national ID systems.

- **Customer education**: Financial literacy in emerging markets is a challenge. Some customers can easily be mislead about their legal rights, dispute resolution channels or the financial consequences of their repayment behavior.\(^6\)

- **Agent training and licensing**: Training and licensing collections agents raises their awareness of the principles of responsible collections, and encourages them to engage with customers in more humane and effective ways.

- **Ombudsman office**: Regulators can promote centralized mechanisms for raising and resolving or publicizing customer complaints. In some jurisdictions regulators themselves may be able to operate these recourse mechanisms, while in others independent ombudsmen or other entities might be more appropriate.

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\(^5\) In some jurisdictions, the only effective legal recourse is criminal proceedings under laws governing negotiable instruments (i.e. writing bad checks). In these jurisdictions, post-dated cheques are taken at time of loan disbursement and encashed only in the event of delinquency. The inevitably returned cheque then provides basis for criminal proceedings and often incarceration. In our view, judicial avenues which do not involve threat of incarceration are preferable.

\(^6\) For example, some collectors see incentive to keep customer in delinquency instead of making regular payments. Customers may not understand that failure to regularize subjects them to unnecessary late fees and/or penal interest. One lender reported that their customers were unaware of the importance of taking a receipt when making a doorstep payment.
6.2. PILLAR 2: RESPONSIBLE PRACTICES BY FINANCIAL PROVIDERS

The internal controls of many emerging market lenders give insufficient comfort that consumers will not be abused even in benign market conditions, let alone in a period of mass delinquency. Although professional collections agencies and debt collectors have generally invested more in their control frameworks, they still have shortcomings and the following recommendations is broadly applicable to them too.

Lenders can take comfort that the investments required will pay dividends in the form of improved collections efficiency. This is because many of the practices recommended minimize the chance of excessive pressure from collectors by giving them more effective ways to understand borrowers’ ability and willingness to repay and hence, to quickly achieve the best possible outcome. In other words, more responsible collections processes requires being smart about collections, not being soft. It is recommended that institutions focus on the following three areas:

1. **Governance**: Clear ownership and management of collections initiatives
2. **Process**: Best practice use of information, analytics and tactics
3. **Monitoring**: Measurement and reporting mechanisms to ensure line-of-sight to the customers interface

### 6.2.1. Governance

A consistent finding of this study is that few institutions have designated clear accountability for collections’ being carried out ethically. Oversight of collections rarely extends beyond the collections unit or retail lending business.

Institutions that take responsible finance seriously must improve their governance structures. Specifically, they should assign independent responsibility for defining and monitoring ethical standards of conduct within collections.

Ideally, such responsibility should rest with an independent function reporting to senior management. In most institutions it is impractical to have a function dedicated to ethical collections practices. Responsibility could instead be assigned to a function with a related mandate, such as Compliance, Risk Management or other departments responsible for customer service quality. Where this is impractical, institutions may consider assigning responsibility to a suitably constituted committee.

---

**Figure 7: Practices snapshot: Performance evaluation observed practices**

- Clearly defined responsibility for setting and monitoring conduct standards for collections staff, independent from collections or lending business
- Line-of-sight to customer interface
  - Tight management spans
  - Call center recording/monitoring
  - Follow-up calls to customers
  - Innovative field tracking technologies
  - Customer complaint mechanisms
  - MIS reporting of key indicators
- Whistle-blowing mechanisms
- Internal audit
- Best practice processes both improve performance and minimize risk
  - Customer intelligence
  - Process triage
  - Remediation tools
  - Process discipline
  - Vendor management
The unit responsible for collections standards must work with other stakeholders, such as the lending business, the collections function and relevant independent stakeholders to set and maintain appropriate ethical standards. It must also ensure that adequate measurement and reporting frameworks for monitoring performance are established. Mandates for all stakeholder functions must be clearly defined.

Besides strengthening governance, institutions should review their existing policies to ensure sufficient emphasis on the fair treatment of customers, including:
- Transparent relationship with borrowers
- Guidelines for interacting with fairness and respect
- Conditions for the application of financial penalties
- Customer information security
- Dealing with hardship cases
- Processes for training and certifying staff

6.2.2. Process excellence

Effective collections practices apply the right contact approach to each borrower and wield a combination of carrots (e.g., in the form of modification solutions) and sticks (e.g., in the form of legal recourse). The key elements of good collections are:

<table>
<thead>
<tr>
<th>Element</th>
<th>Common shortcomings in emerging markets</th>
</tr>
</thead>
</table>
| 1       | Early identification of the borrower’s situation, ideally pre-delinquency or after the first missed payment, assessing likely capacity and willingness to repay. | • Limited behavioral scoring applied  
• Qualitative feedback from customer contact not captured or incorporated into strategy |
| 2       | Triage of borrowers to align contact strategy to customer situation, balancing costs with expected recoveries. Reassessment of tactics as new information is received. | • One-size-fits-all – single process applied to all customers based on delinquency level and value only  
• Poor information flows between individuals in contact with customer |
| 3       | Access to a variety of “exit options” including restructuring, modifications and concessions. | • Few alternative exit options available  
• Where available, ad hoc or burdensome processes for execution |
| 4       | Judicious threat of severe but proportionate consequences for failure to voluntarily repay, including enforceable claims on property, civil recourse for unsecured exposures, criminal liability in fraud cases and credit bureau reporting. | • Limited enforceability of property liens  
• Few credible mechanisms for leverage against unsecured borrowers |

While the fourth element in the table above is beyond the direct control of lenders, there is significant opportunity for improvement in the first three. More systematic and analytical approaches to the first two will lead to lower risk of abuse simply by reducing the number of customers being approached by field agents. It will also facilitate a more personalized dialog with customers and place less responsibility for tactical decisions in the hands of relatively inexperienced collections agents. Providing a wider range of resolution options for customers changes the dialog from one of confrontation to one of problem solving.

In short, the tools that help collectors assess borrowers’ circumstances and choose approaches aligned to the customers’ likely ability and willingness to repay both maximize recoveries and minimize the chance of mistreatment.
3. **Tools:** Lenders need a more complete suite of remediation options, with flexible processes that enable collectors to work in problem-solving mode with customers. Care must be taken not to introduce undue moral hazard or to make excessive concessions unnecessarily.

4. **Process discipline:** All collections processes should be clearly defined and delineated. Channel usage according to products and buckets, third party monitoring mechanisms, complaint handling and tracking mechanisms should be communicated clearly to employees and adherence to these processes should be tracked and monitored.

5. **Vendor management:** Where third-party agencies are used, strict empanelment and performance monitoring are required to optimize performance and mitigating risk.

For microfinance institutions, the tools and processes differ from conventional lenders in several respects, and best practices are evolving rapidly. One learning from this study is that for joint liability lending; protection of individual borrowers from inappropriate intra-group pressure requires lenders to quickly identify borrower distress and intervene before tensions within the group become unmanageable. For more information about emerging best practices in microfinance, we refer the reader to other excellent research which has been done in this space.

### 6.2.3. Measurement and reporting

Measurement and reporting tools complete the loop, allowing management to understand the effectiveness of processes and creating awareness among staff that their actions are under scrutiny. The objective should be to identify inappropriate behavior for disciplinary action (against individuals or vendors) and to track “key performance indicators” that would indicate the overall health of processes and areas that need improvement:

1. **Line-of-sight to customer interface:** Management must have confidence that the agent-customer interface is well understood. An effective line-of-sight program would include most of the following elements:

   - **C.** Tight spans of control at ground level (field or phone) to provide adequate oversight on collector activities
   - **D.** Technology that monitors call voice contacts – software to monitor language and tone of agents in interaction with customers
   - **E.** Random follow-up calls to customers contacted by field or phone to verify that contact was made, outcome of contact and get feedback from customer.
   - **F.** Innovative technologies for monitoring field collection agent activities. Mobile-phone based applications are being introduced to better manage field agent workflow, monitor activities and issue receipts. The effectiveness in regulating agent behavior is unproven but there is potential in this area.
   - **G.** Effective and well advertised customer complaints mechanisms:
     - **a.** Accessible channels for raising grievances (e.g. hotlines, SMS, email),
     - **b.** Raise customer awareness of the grievance channels
     - **c.** Organizational structure for timely redress of grievances and internal follow-up (individual penalties and process improvements).
     - **d.** Complaints “dashboard,” showing level and trends of key customer satisfaction indicators, regularly reported to top management.

   - **H.** MIS and reporting of key risk indicators, such as survey feedback, customer complaints, lawsuits and regulatory penalties.

2. **Trusted and effective whistle blowing channel:** A whistle blowing channel provides a vehicle for top management to learn of potentially risky practices before they cause significant customer impact or reputational damage.

3. **Internal audit:** Independent internal audit is critical for understanding ground realities of process implementation. The audit function should be given a clear mandate to evaluate processes for their impact on customers. Its reports should be presented to all internal stakeholders.

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6.9. PILLAR 3: FINANCIAL CAPABILITY

Collections abuse is also found in developed markets. However, it is kept under control by borrowers’ financial literacy and knowledge of their rights. In addition to emerging markets regulators and financial providers, other institutions, such as those devoted to financial education or industry associations, can help to advance the financial capability of consumers:

- **Standards for ethical practices**: Industry associations can take the initiative to create standards for responsible collections, which can be used by consumers as benchmarks to compare lenders’ policies.
- **Borrower awareness**: Financial education institutes and industry associations can take a leading role in promoting financial awareness amongst borrowers. They could also write booklets, given to new borrowers, informing them of their rights and redress mechanisms.
- **Ombudsman office**: Industry associations can promote centralized mechanisms for raising and resolving or publicizing customer complaints, especially in jurisdictions where regulators themselves do not provide adequate recourse mechanisms.

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**CASE STUDY: SMART Campaign\(^*\)**

The Smart Campaign is a global effort to unite microfinance practitioners and supporters around a core set of client protection principles. The Smart Campaign educates and incentivizes MFIs to treat their clients fairly and to avoid harming them.

These client protection principles are the minimum standards that clients should expect when doing business with a microfinance institution:

- Avoidance of over-indebtedness
- Transparent and responsible pricing
- Appropriate collections practices
- Ethical staff behavior
- Mechanisms for redress of grievances
- Privacy of client data

\(^*\) [www.smartcampaign.org](http://www.smartcampaign.org)
There are no sure-fire mechanisms to ensure full compliance to customer treatment norms. The study finds, however, that despite the inherent challenges in emerging markets, lenders and collectors can take meaningful steps to reduce the risk of collections abuses without impinging on collectors’ ability to deliver financial results. Fortunately, many of those steps will actually improve collections performance by bringing a more scientific approach to decisions about how to approach each customer and by improving line-of-sight to collections activities.

To recap, the study encourages the industry to focus on three key innovations:

1. Governance mechanisms that ensure focus on fair treatment of customers
2. Process excellence which brings a scientific and disciplined approach to collections strategies
3. Measurement and reporting that enables clear line-of-sight to collections activities and proactive monitoring of key indicators

These initiatives for financial providers will be most effective when they are supported by balanced legal and policy frameworks and when borrowers are empowered with access to fair recourse mechanisms and awareness of their options.
APPENDIX A: STANDARDS FOR ETHICAL COLLECTIONS PRACTICES

The following guiding principles are derived from an earlier study commissioned by IFC. They have been adapted from collections practices in developed markets as a foundation for developing responsible and ethical collections standards. The key principles articulated are:

1. **Investing in a transparent relationship with the borrower**: borrowers should be made aware of the consequences of defaulting on a payment. All terms and conditions should be clearly communicated to the borrowers, and they should be educated about ways to avoid delinquency. In the event that a borrower defaults on his loan due to some hardship, loan restructuring options or other solutions should be offered to him in such a way as to avoid over-indebtedness and help him out of his situation.

2. **Interacting with the customer in a fair and respectful manner**: while sheer business economics dictates that lenders should try and recover as much of their outstanding debt as possible and minimize loss, it is imperative to ensure collections are done in a humane, respectful manner. The following policies should be adopted and followed strictly:
   A. No discrimination on the basis of race, religion, gender etc.
   B. Borrowers should not be contacted at unreasonable hours or frequency
   C. Language and behavior used should be polite, respectful, and non-threatening. On no account should collectors resort to physical violence or verbal abuse.
   D. The customer's privacy should be respected. His state of indebtedness should not be unduly revealed to third parties.

3. **Develop relationships and systems to support ethical practices**: in order to sustain respectful interactions with borrowers, collectors must internally commit to responsible and ethical practices. Interactions with the broader set of stakeholders – not just borrowers – should reflect this ethos. Example practices include:
   E. Do not outsource unethical practices to other collectors
   F. Do not manipulate legal or political institutions to condone unethical practices
   G. Develop internal systems to regularly audit practices and operational performance to ensure compliance with ethical guidelines
   H. Train collectors in ethical practices and incentivize responsible behavior

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APPENDIX B: JURISDICTIONS COVERED AND FITCH RATINGS

Figure 12: Jurisdictions covered in the study

<table>
<thead>
<tr>
<th>Jurisdiction</th>
<th>Region</th>
<th>Fitch grouping</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bangladesh</td>
<td>South Asia</td>
<td>D</td>
</tr>
<tr>
<td>Brazil</td>
<td>Latin America</td>
<td>D</td>
</tr>
<tr>
<td>China</td>
<td>North Asia</td>
<td>D</td>
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<tr>
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<td>South Asia</td>
<td>D</td>
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<tr>
<td>Indonesia</td>
<td>Southeast Asia</td>
<td>D</td>
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<tr>
<td>Kazakhstan</td>
<td>Central and Eastern Europe</td>
<td>D</td>
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<tr>
<td>Malaysia</td>
<td>Southeast Asia</td>
<td>C</td>
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<tr>
<td>Mexico</td>
<td>Latin America</td>
<td>C</td>
</tr>
<tr>
<td>Philippines</td>
<td>Southeast Asia</td>
<td>D</td>
</tr>
<tr>
<td>Russian Federation</td>
<td>Central and Eastern Europe</td>
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</tr>
<tr>
<td>South Africa</td>
<td>South Africa</td>
<td>A</td>
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<tr>
<td>Taiwan, China</td>
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<td>A</td>
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<td>Thailand</td>
<td>Southeast Asia</td>
<td>C</td>
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<tr>
<td>Turkey</td>
<td>Middle East and Turkey</td>
<td>D</td>
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<td>United Arab Emirates</td>
<td>Middle East and Turkey</td>
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<tr>
<td>Ukraine</td>
<td>Central and Eastern Europe</td>
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</tbody>
</table>
RESPONSIBLE DEBT COLLECTION

Figure 13: Fitch country groupings for recovery ratings

<table>
<thead>
<tr>
<th>Grouping</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>A</td>
<td>Jurisdictions that generally support the priority of claims on bankruptcy and display other features that are deemed to be creditor-friendly, including generally reliable enforceability</td>
</tr>
<tr>
<td>B</td>
<td>Jurisdictions where insolvency and bankruptcy procedures place less emphasis on the priority of claims, and display other features that are deemed to be generally more debtor-friendly</td>
</tr>
<tr>
<td>C</td>
<td>Jurisdictions where the letter of the law is balanced against governance indicators, suggesting that enforceability of claims may be variable, for example, where enforceability has yet to develop a demonstrable track record</td>
</tr>
<tr>
<td>D</td>
<td>Jurisdictions where the law is not supportive of creditor rights, and/or where significant volatility in the application of law and legal enforceability of any claim materially limits the practical chances of recovery, or greatly increases the volatility of recovery prospects</td>
</tr>
</tbody>
</table>

Figure 14: Fitch categories for commercial recoveries

Source: Fitch, Country-Specific Treatment of Recovery Ratings, 2/2011

*Country-Specific Treatment of Recovery Ratings, Fitch Ratings, 23 February 2011*
APPENDIX C: COLLECTIONS CONTROLS BENCHMARKING

We have classified emerging markets into leading, typical, and minimal on certain key dimensions below.

C.1. COLLECTIONS POLICY

<table>
<thead>
<tr>
<th></th>
<th>Leading</th>
<th>Typical</th>
<th>Minimal</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Policy coverage</strong></td>
<td>Corporate social responsibility, reputational risks and customer relationship are viewed on par with collections efficiency</td>
<td>Collections efficiency is primary while recognizing importance of reputational risk and customer relationship</td>
<td>Impact of collections not covered in policy</td>
</tr>
<tr>
<td><strong>Top management involvement</strong></td>
<td>Board committee approves collections policy</td>
<td>Executive committee approves policy</td>
<td>Collections dept. drafts collections policy and head of collections approves it</td>
</tr>
</tbody>
</table>

C.2. PROCESS MANAGEMENT

<table>
<thead>
<tr>
<th></th>
<th>Leading</th>
<th>Typical</th>
<th>Minimal</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Field collections</strong></td>
<td>• Low reliance on field</td>
<td>• Mix of field and phone</td>
<td>• Heavy reliance on field</td>
</tr>
<tr>
<td></td>
<td>• No cash handling</td>
<td>• Cash is handled to certain extent</td>
<td>• Mostly cash handled</td>
</tr>
<tr>
<td></td>
<td>• Field used mostly for skip tracing and asset recovery</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Phone collections</strong></td>
<td>• High reliance on phone</td>
<td>• Mix of phone and field</td>
<td>• Low/no use of phone</td>
</tr>
<tr>
<td></td>
<td>• All calls scripted, call termination protocol</td>
<td>• Most calls scripted</td>
<td>• No call scripts/protocol</td>
</tr>
<tr>
<td></td>
<td>• Predictive dialling</td>
<td>• No predictive dialling</td>
<td>• No system/logic behind dialling</td>
</tr>
<tr>
<td></td>
<td>• Training using call records</td>
<td>• Limited training using call records</td>
<td>• No training/call records not used in training</td>
</tr>
</tbody>
</table>


### C.3. FIELD COLLECTIONS AND COLLATERAL RECOVERY

<table>
<thead>
<tr>
<th></th>
<th>Leading</th>
<th>Typical</th>
<th>Minimal</th>
</tr>
</thead>
</table>
| **Collateral recovery** (moveable property) | • Mechanisms to ensure alternative resolution options considered  
• Additional controls support such as checklists and pre-assembled documentation packets | • Manager sign off and legal "due process" | • Immutable processes or decision at agent level, minimal oversight to ensure compliance |
| **Home repossession** | • Same as above but with consideration of availability of alternative accommodation for customer in repossession decision  
• Same as above, with support for customers wishing to sell properties | • Same as above, with support for customers wishing to sell properties | • Same as above |
| **Hardship cases handling** | • Special process for hardship cases, with authorized personnel required to approve resolution strategy  
• Hardship cases are forgiven loans as a policy in some firms (a few MFIs) | • Life insurance is typically bundled with loan, with lender as beneficiary  
• Some firms are considering disability insurance as well | • No special treatment of hardship cases |

### C.4. EMPLOYEE SKILL MANAGEMENT

<table>
<thead>
<tr>
<th></th>
<th>Leading</th>
<th>Typical</th>
<th>Minimal</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Qualifications</strong></td>
<td>• Graduate/post graduate</td>
<td>• High school/diploma/college</td>
<td>• Middle school/ no criteria</td>
</tr>
<tr>
<td><strong>Average experience</strong></td>
<td>• 5+ years</td>
<td>• 1-3 years</td>
<td>• &lt;1 year, inexperienced hires</td>
</tr>
<tr>
<td><strong>Hours of training</strong></td>
<td>• 80-100 hours</td>
<td>• 15 hours</td>
<td>• No training, &lt; 10 hours</td>
</tr>
<tr>
<td><strong>Training on ethical collections</strong></td>
<td>• 30-100 hours, quarterly refresher courses</td>
<td>• 10-30 hours, annual refresher courses</td>
<td>• No training</td>
</tr>
<tr>
<td><strong>Field collector background check</strong></td>
<td>• References required, fraud checks</td>
<td>• Checks required</td>
<td>• No checks</td>
</tr>
</tbody>
</table>
| **Performance evaluation** | • Balanced scorecards with financial and process elements  
• Severe penalties for transgressions | • Field collectors evaluated on financial performance  
• Voice collectors on multiple criteria | • Evaluation and incentives tied to financial performance alone |
## C.5. MONITORING SYSTEMS

<table>
<thead>
<tr>
<th></th>
<th>Leading</th>
<th>Typical</th>
<th>Minimal</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Field collections</strong></td>
<td>• GPS used to track collectors</td>
<td>• GPS not used</td>
<td>• No GPS used</td>
</tr>
<tr>
<td></td>
<td>• Collectors visit customer in pairs for better peer oversight</td>
<td>• Collectors usually visit customers alone except in difficult cases</td>
<td>• Collectors always visit alone</td>
</tr>
<tr>
<td></td>
<td>• Audit team conducts random customer visits for feedback</td>
<td>• Random calling/visits for verification and feedback</td>
<td>• No random calling/visits</td>
</tr>
<tr>
<td><strong>Phone collections</strong></td>
<td>• All calls recorded and monitored</td>
<td>• Some calls recorded, reviewed in case of complaints only</td>
<td>• No call records maintained</td>
</tr>
<tr>
<td></td>
<td>• Software to detect tones of voice, use of abusive language</td>
<td>• No software to monitor quality of interaction</td>
<td>• No software to monitor quality of interaction</td>
</tr>
<tr>
<td></td>
<td>• Centralized open floor call centers with tight supervision</td>
<td>• Branch calling as well as call centers, adequate supervision of call centers</td>
<td>• Non centralized calling only with low supervision</td>
</tr>
<tr>
<td><strong>Third-party collections</strong></td>
<td>• In-house staff embedded in agency operations</td>
<td>• In-house staff embedded in agency operations</td>
<td>• No staff embedded in agency operations</td>
</tr>
<tr>
<td></td>
<td>• Strong checks and balances (random in-house calling/visits, clearly defined complaint handling process, no cash handling)</td>
<td>• Checks and balances in place</td>
<td>• No checks and balances</td>
</tr>
</tbody>
</table>
## APPENDIX D: SPECTRUM OF CUSTOMER HARM

<table>
<thead>
<tr>
<th>Class of harm</th>
<th>Description</th>
<th>Example controls</th>
<th>Control effectiveness</th>
</tr>
</thead>
<tbody>
<tr>
<td>Usurious financial penalties</td>
<td>Systematic application of charges beyond those legally permissible</td>
<td>Compliance function oversight in product design and audit of implementation</td>
<td>High</td>
</tr>
<tr>
<td>Collector fraud or collusion</td>
<td>Most common abuse is cash defalcation, where collector &quot;pockets&quot; cash payments from borrowers; also may include collusion with borrower to obtain concessions from lender</td>
<td>Collector background checks, receipt book monitoring, customer education, provision of non-cash payment and third party collection points (banks, convenience stores, etc.)</td>
<td>Moderate</td>
</tr>
<tr>
<td>Harassment</td>
<td>Contacting borrowers at inappropriate hours, repetitive and excessive outreach</td>
<td>Clear definition of limits, training, oversight and complaints handling, call center monitoring</td>
<td>Moderate</td>
</tr>
<tr>
<td>Disrespectful treatment</td>
<td>Telephonic, electronic or physical communication using abusive or profane language</td>
<td>Training, oversight and complaints handling, call center monitoring</td>
<td>Low</td>
</tr>
<tr>
<td>Misrepresentation or deception</td>
<td>Any number of dishonest practices intended to deceive borrower into making payment or divulging information</td>
<td>Clear definition of acceptable boundaries, training, oversight, complaints handling and strong disincentives</td>
<td>Low</td>
</tr>
<tr>
<td>Violation of privacy</td>
<td>Inappropriate revelation of customers indebtedness to third parties (e.g., neighbours, co-workers, etc)</td>
<td>Clear definition of acceptable boundaries, training, oversight, complaints handling and strong disincentives</td>
<td>Low</td>
</tr>
<tr>
<td>Unfair forfeiture of property</td>
<td>Taking recourse to property without due process or in contravention of acceptable norms</td>
<td>Diligent processes and oversight. In most emerging markets economies, legal processes sufficiently burdensome to discourage imprudent foreclosures</td>
<td>High</td>
</tr>
<tr>
<td>Threats and intimidation</td>
<td>Using local gangs to threaten and physically harm borrowers, seizure of unjustified assets</td>
<td>Training, oversight, complaints handling and strong disincentives</td>
<td>Moderate</td>
</tr>
</tbody>
</table>
APPENDIX E: REFERENCES


“Consumer Protection Regulation in Low-Access Environments: Opportunities to Promote Responsible Finance,” CGAP Focus Note, No. 60, November 2010.

“Country-Specific Treatment of Recovery Ratings,” Fitch Ratings, 23 February 2011

