EUROPEAN MICROFINANCE network

EMN Note

December 2011

European Code of Good Conduct for Microcredit Provision

Many people in the microfinance world in Europe will be familiar with the acronym JASMINE, a programme whose full name is Joint Action to Support Microfinance Institutions in Europe. It is a joint initiative of the European Commission (EC), the European Investment Bank (EIB) and the European Investment Fund (EIF). It was launched to: enhance the capacity of micro-finance institutions that are not banks; and to help them become sustainable and viable operators. As part of this initiative, the European Commission has published a good practice guide entitled: European Code of Good Conduct for Microcredit Provision (the Code).

The Code is voluntary, and not expected to cut across any legislative requirements in any of the European Union's member countries. It applies chiefly to non-bank Microfinance Institutions (MFIs) which provide loans of up to €25 000, and encompasses a set of unifying standards for the sector. The goal is to benefit the microfinance sector itself, including its: funders, investors, customers, owners, regulators and partner organisations.

The Code has been developed with the aims of incorporating specific and measurable content, so that MFIs can take concrete action to improve their operations and governance, and has been adjusted to cater for the diversity of MFIs in the EU, all of which operate in different markets, institutional forms and legal frameworks. It claims to emphasise common standards by balancing best practice within realistic operational constraints.

The Code is set out in five sections, each dealing with one broad aspect of the business. A novel feature of the Code is that it identifies a number of differences between each of its recommendations: for example, there are indicators for 'priority clauses', ie, those that are regarded as the most important; a second system of indicators identifies what the writers believe to be the level of difficulty in implementing the provisions of a recommendation; third, those recommendations that are intended to apply primarily to large institutions are identified as such. There is also a glossary to explain some of the more technical terms and precise definitions of others.

The remainder of this Note is dedicated to a synopsis of each of the five sections. It is not an exhaustive list of the Code's provisions – for this, it is clearly best to go to the Code itself - but this synopsis is aimed at giving an idea of the issues covered in the document. While reading this synopsis, most people will think to themselves that the Code is scarcely anything novel; it is not 'rocket-science', as they say. The Commission recognises this, of course, and emphasises that the Code reflects best practice in the sector; many MFIs themselves will also recognise that they meet many of the Code's provisions, but there may well be areas where each one has more work to do to meet all the recommendations. In this way, best practice will be spread among MFIs and the challenges of accessing long-term financing and raising the quality of services will be more easily achieved.

Important message from the President of EMN

The EC Code builds and expands upon our own 'Ethical Code of Conduct'; as such, the Board has adopted the EMN Code as binding for all members, along with the CGAP 'Client Protection Principles'. The EC Code is intended to assist MFIs and other stakeholders to assess the performance and functioning of MFIs - and can be compared to the plans to launch worldwide a 'Seal of Excellence'. It is planned that we will also publish recommendations on Social Performance Measurement in 2012.

1. Customer and Investor Relations

This first section of 29 clauses deals with six aspects of an MFI's work: customer relations; customer rights; avoiding over-indebtedness; customer care; ethical behaviour; and investor relations.

Within this section there are three 'priority' clauses – recommendations that the Code regards as the most important to implement. First, 'microcredit providers will disclose the cost [to the customer] as an annual percentage rate of charge' (APR). It defines where the APR should be featured (advertising and credit agreements) and also what charges should be included in the calculation of the APR. Second, customers should have a 'cooling-off' period of 14 calendar days after signing the credit agreement, should they change their minds and wish to withdraw. Third, there should be a mechanism within each institution, with staff specifically dedicated to the task, to deal with customer complaints.

2. Governance

This section on institutional governance of 44 clauses deals with four aspects of work: business planning; the board of directors, including its composition, independence, responsibilities and work organisation; management of the institution, including issues of employees' expertise, work organisation and human resources; and audit. The section is probably one of the most important of all, in the longer term, as it provides an effective and transparent operational framework for MFIs.

Major areas of recommendation include the development of a business plan, which is reviewed at least annually, and defines certain issues that should be included within the business plan. The Code also recommends that MFIs have a board of directors, with a majority of its members being independent (ie, not its managers, staff, customers or their immediate family).

3. Risk Management

This section of 23 clauses deals with five aspects: the framework of institutions' risk management activities; the management of risk; the planning and quality control of the portfolio; management of fraud and security risk; and internal audit. As with any financial institution, risk management is an essential process for microcredit providers' viability and longer-term development, and requires robust systems and procedures for its implementation.

Among the major recommendations is the necessity to have formal processes and procedures to identify, assess and prioritise risks. In addition, a senior member of the management team should be specifically tasked with the responsibility for risk management. A seemingly small, but critical, recommendation is that at least two people should approve any loan agreement. Finally, in this section, there is a major recommendation that all institutions should have an internal audit activity.

4. Reporting Standards

This section deals with three aspects: financial reporting; social reporting and disclosure. The Code deals, in some significant detail, with the multitude of individual indicators that it regards as basic requirements in externally reporting the profile of an institution's business. The indicators are largely based on the definitions used by the 'Microfinance Information Exchange' and internationally accepted accounting standards.

Publishing information about both MFIs' 'portfolio at risk' and 'operational sustainability ratio' are identified in the financial reporting recommendations as priority items. Among non-financial items that are regarded as particularly important issues for disclosure are institutions' social mission and data detailing the number of customer complaints.

5. Management Information Systems

This final section of recommendations includes 15 clauses, of which three are regarded as 'priority'. The Code defines a Management Information System (MIS) as processes for '... capturing raw data, processing the data into useable information and disseminating the information to users in the format needed'.

The Code regards as particular requirements of an MIS that it has the following outputs: income statement, balance sheet, daily loan and delinquency reports. An MIS should also be able to monitor and manage loan quality functions, and maintain data about clients.

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EMN is supported by the European Community Programme for Employment and Social Solidarity (2007-2013). The information contained in this publication does not necessarily reflect the position or opinion of the European Commission