Voices of Microfinance

Pakistan: A protected microfinance borrower?

November, 2009

Arsala Kidwai
Introduction

The genesis of the Pakistan microfinance sector can be traced back to the early 1970’s when the government directed/subsidized credit schemes, especially in the rural areas. The history of establishment, growth and evolution of the microfinance sector in Pakistan is a long discussed and fairly well documented process. There have also been numerous debates surrounding the intertwined concepts of poverty alleviation and categorizing microfinance as a means to achieve that end or asserting that it is a concept tangent to poverty alleviation and functions on the social standpoint of Pakistan’s development as opposed to contributing to its economic indicators. Statistics laying out the number of institutions, their individual and combined outreach and the math involving the monetary disbursements and recoveries are all well archived.

However, when an industry grows, focus does eventually shift (or rather should) to the impact it has in terms of qualitative and social indicators on the consumers of its service. One of the main aspects that ought to be logically discussed is the industry’s attention to consumer rights and their protection. Off late with the seeming fortification of Pakistan’s microfinance industry, information is being made available by formal and informal channels pertaining to the industry outlook and practice, within regimes of regulation and best practices, towards the consumers. Some good and some not so good news is doing the circuits. At the same time, the evolution of the industry has brought into the picture various laws, regulations and organizations which are either supportive of a trend towards consumer protection or are a hindrance to the consumer being able to protect itself from the practices followed by the industry.

The aim of this paper is to highlight the various laws and regulations in place in Pakistan, which either protect the microfinance consumer, or are a burden on their rights. Also, it will point out the lack of regulation in certain pertinent areas. Discussion will also proceed on the roles of various regulatory agencies, self regulatory organizations and industry associations in helping the spread of awareness amongst the Pakistani microfinance consumer and protecting its rights (statutory or envisaged).

Central Issues:

In the course of this paper we will look at various indicators which might point to the state of consumer affairs in Pakistan. The particular aspects looked at are as follows:

- Transparency and disclosure in lending practices of microfinance institutions and emphasis on educating the consumers.
- The type of collateral collected and the way of enforcement.
Pakistan: A protected microfinance borrower?
Arsala Kidwai

- Credit information sharing amongst the sector, along with determining the problem of over indebtedness and placing onus on borrower/lender for over indebtedness.
- The mechanisms available to the microfinance sector, and those used, for the purpose of recovering loans. Due emphasis has been given to the process followed, the laws available (or not) for recourse to the consumer as well as those mandating procedure to be followed by the microfinance sector.
- Availability of redress mechanisms to the consumer and accessibility to the same in terms of cost, ease and practicality.

Before we begin our analysis, we must first establish the categories of institutions (in terms of microfinance service providers) that are at the center. Pakistan is one of those countries which has a specific piece of regulation that deals with microfinance institutions which choose to become (either at inception or with the process of transformation), regulated banks. These are the Microfinance Banks (MFBs) which are governed by the Microfinance Institutions Ordinance (MIO) 2001. They are not however, mainstream commercial banks, or those which could be considered to be covered by the country’s general banking laws. The other institutions exist either as trusts, charitable organizations, self help groups or NGO supported institutions. These are out of the realm of regulation of the MIO.

Pakistan also has a matrix of regulators and coordinators with respect to its microfinance industry. Each entity functions in the microfinance sphere, divided in its role depending upon the composition and model of the microfinance institution in question. The State Bank of Pakistan (SBP) is the uncontested regulator and supervisor of the entire microfinance industry, and the MFBs in particular. The Pakistan Microfinance Network (PMN) is an association of microfinance institutions, MFBs, NGO supported institutions, Rural Support Programs (RSPs) etc. The Association focuses primarily on themes of providing an enabling environment, capacity building and information sharing for and amongst stakeholders of member institutions. These are the two main organizations functioning as over lookers of the microfinance industry in Pakistan. They are assisted by a few administrative and judicial bodies, and a group of interlinked laws and regulations, in their supervision of the industry. These assisting tools will be discussed in detail under the heads that follow.

Transparency and Disclosures:

“Pakistan borrowers accuse MFIs of fleecing borrowers”³. This headline was enough to spark interest in the state of affairs of the microfinance consumer in Pakistan. The long and short of the article points out that farmers from various villages in the Bahawulpur district complained to the Planning

---

2 Official Website : http://www.microfinanceconnect.info/
Commission in Islamabad that various microfinance institutions had run them dry as a result of repaying loans indiscriminately thrust upon them and the immense interest rates attached to these loans. They insisted that the microfinance institutions took advantage of their “innocence, illiteracy and unawareness”. What is more surprising is that the microfinance institutions who were the culprits in this scene are well known and long standing forts of the industry.

This brings to light a rather dismal picture. Being a developing country, with a sizable sector of the population suffering from adversities of poverty, one would be safe in assuming that the poor in Pakistan would be victims of illiteracy or at the very least, would not be in a position to fully understand the financial and legal terms and conditions attached to loan agreements. Thus, one must look to the supportive legal structure to understand if any onus is placed on the lending segment to provide full and complete disclosure to the borrower along with mechanisms to provide a detailed understanding of the contract. Of course legal heads around the world would argue for void ability of contract on the grounds of mistake or misrepresentation as determined by the Contract Act of 1972, but again, the borrower probably does not even know what a contract is and its validity determinants, let alone the prevailing contract law of the country.

The SBP has come out with a set of Prudential Regulations\textsuperscript{4} for the MFBs. Point 30 on the list is what the SBP likes to refer to as the doctrine of Truth in Lending. The rule makes it “incumbent” upon the MFB to “facilitate the borrower in making an informed decision”. Thus, they are required to not only point out, but also explain the terms and conditions of the contract to the borrower, and in a local language if required. Education of customers is also a responsibility placed on their shoulders.

The PMN has also come out with a Code of Conduct (Code)\textsuperscript{5}. Signatories to this code are member institutions. The Code also lays down best consumer protection guidelines that ought to be followed by the members. Transparency is listed as one of their main goals. It follows in the same tone of SBP’s Prudential Rules, and requires that the consumer be made effectively aware of the repayment schedule and amount of debt it is effectively taking on, computing interest into the repayment burden.

From an understanding of the article, one would also viably argue that not only is an informed lending and borrowing process a mandate, but also that the lenders should pay attention to the borrower’s need for a loan and its repayment capacity. Where the Prudential Regulations stay silent on this account, the Code does place onus on its members to lend to borrowers commensurate to their needs as well as their repayment capacities. This would necessitate that indiscriminate standard loans are not handed out to each borrower, and that the MFI must develop products to meet the need of their clients.

\textsuperscript{5} Text for Pakistan Microfinance Network’s Code of Conduct: http://www.microfinanceconnect.info/pdf/COC.pdf
**Type of Collateral collected and mode of Enforcement:**

There are times where borrowers of microcredit may be required to provide collateral or guarantees on their loans. It is not an unheard of practice amongst Pakistani MFIs to require their borrowers to provide some form of collateral.

Our focus primarily centers on movable property collateral. There appears to be an inherent weakness in the process of collateralizing movable property in Pakistan. An efficient system, both from the consumer’s as well as lender’s perspective would require a healthy mechanism for identification of property capable of being collateralized, registration of the same (to prevent multiple loans being handed out on the basis of the same collateral) and a due process for recovery. The main issue stems from the fact that there is no unified codified law for the security of movable property in Pakistan. Multiple statutes speak of the ability to hypothecate, pledge, pawn and mortgage movable property. Also, the registration of a security interest in movable property is available only to an organized and incorporated company, not to individuals or sole proprietorships.

In Pakistan, many MFIs are in the practice of collecting letters of hypothecation from the borrowers. Up on default, the ideal practice (mandated by law) would be to approach the Court for the realization of such collateral to recover the loan. However, information is available through industry participants who wish to remain anonymous, that the MFI uses pressure tactics in the form of threats or harassment or perhaps something milder like regular visits to the borrower to collect on this collateral. This saves the lengthy Court procedures involved in recovering on such collateral. However, which of the two vices is a better option for the borrower is debatable either ways without a satisfactory position obtained on one or the other. Another issue pertains to whether the law provides that certain movable property like personal effects and those required for basic livelihood and sustenance are out of the purview of collateralization. At present, it seems, household goods can be hypothecated for the purpose of securing a loan. However, on this accord, the PMN Code of Conduct does provide that in any circumstance the borrower “must not be deprived of their basic survival capacity as a result of loan repayment”.

Another extremely important facet of the law on movable property collateralization is that a debtor cannot provide as collateral an asset which is not in its possession. This brings to light the legal viability of blank cheques or post dated cheques collected by MFIs for the purpose of securing a borrower’s repayment. It could be viewed that the blank/post dated cheque covers an amount which could or could not be in the borrower’s possession at the time of creating the collateral, whether the amount is available on a future date is not open to interpretation, since the law mandates existence at the point of creation of interest. Here clearly lies an adverse implication on the lender. What is not

---

Pakistan: A protected microfinance borrower?
Arsala Kidwai

clear is, if such an interest is created, is it simply void, or is there a civil or legal penalty on the creator of the interest or on the person in whose favor the interest has been created.

A necessary repercussion is the legal implication of cashing an uncovered cheque on the drawer of such an instrument. In Pakistan, under Section 489F of the Pakistan Penal Code, it is a criminal offense punishable with arrest, to issue an uncovered cheque. The penalty may go up to three years of imprisonment or fine or both. The element of mens rea is absent, and it seems to be, on the face of it, an offense punishable by mere act. The only caveat for protection comes in terms of burden resting on the drawer of the cheque, to prove that arrangements with the bank were made to cover the cheque. I am sure we can appreciate how this caveat is nullified in the instance of our microfinance borrower and his blank cheque collateral.

Again, one would think if such implications are recited to the borrower at the time of collecting such collateral, because a safe guess lies in assuming that the borrower has no knowledge of the penalty attached to dishonor of a blank cheque or a post dated cheque not covered.

Credit Information Sharing and the Issue of Over Indebtedness:

An important theme of consumer protection in the microfinance space gaining ground presently is the concept of credit information sharing amongst lending institutions, in order to be able to determine not only the credit worthiness of a borrower but also the level of indebtedness associated with a particular borrower. This in turn helps the institution determine the repayment capacity of the borrower and from the borrower’s perspective protects them from being over indebted in situations where they are themselves unable to judge the cost and repayment onus of the debt they accumulate.

The SBP has established a central Credit Information Bureau (CIB) since 1992. All Commercial Banks, Development Finance Institutions, Non Bank Financial Companies and MFBs are required to be members of this system. It essentially is responsible for the collection and collation of credit information pertaining to borrowers of these institutions. As would be envisaged, credit reports from the system are available only to member banks and financial institutions and the SBP does not hand out information to non participating entities as a matter of regulation and policy. Prior to extending or renewing a facility of over 500,000 Rupees, the member entities must obtain a credit information report from the CIB. In the case of MFBs, the Prudential Regulations state that such report should be obtained in case of all disbursements above 50,000 Rupees.

---

Section 489F of the Pakistan Penal Code (Act XLV of 1860) read as follows: “Dishonestly issuing a cheque: Whoever dishonestly issues a cheque towards repayment of a loan or fulfillment of an obligation which is dishonored on presentation, shall be punished with imprisonment which may extend to three years or with fine, or with both, unless he can establish, for which the burden of proof shall rest on him, that he had made arrangements with his bank to ensure that the cheque would be honored and that the bank was at fault in not honoring the cheque.”
Pakistan: A protected microfinance borrower?
Arsala Kidwai

The PMN has also established a similar Credit Information Bureau, with its pilot project being launched in province of Lahore last year. All operators in the microfinance sphere, who are members of the organization, have access to this bureau for information, irrespective of organizational structure.

This facilitation effort by the two dominant coordinators seems to be a lead in the direction of integrating information sharing activities amongst members of the sector.

However, an issue which has been raised in Pakistan is with respect to the right of a borrower to access information regarding their own credit report as part of one of these systems. The prevalent practice of the PMN CIB is yet to be diagnosed in this front; however, a declaration by the Director of the CIB and the Banking Surveillance Department does put to rest the uncertainty with respect to the SBP CIB. The case was advocated by the Consumer Protection Committee of Pakistan (CRCP), on behalf of a letter submitted by a Standard Chartered Bank account holder to the Director of the CIB. The account holder requested access to information pertaining to his records available on the CIB’s systems. The Director of CIB instantly declared that the CIRs were only for the member institutions, and that borrower’s did not have the right to access to such information. The CRCP advocated the case on the grounds that this amounted to the violation of an individual’s right to have access to his own personal information. The publishing and release of such information is under the control and discretion of the SBP, and after interaction with a member working on this accord, it is clear that the SBP does not view access to personal information as an undeniable right, and does not look to disclose the information to borrowers in the future, until policy changes and consumer advocating prove to change its ideology. Access to such information could be an essential tool to enable borrower’s to assess their indebtedness situation, and make them wise in their financial planning process, in the instance that the microfinance lenders fail to make a proper assessment of their indebtedness situation and repayment capacities. Self reliance amongst borrowers in financial planning should be supported.

An interesting and praise worthy aspect of the Prudential Regulations for Microfinance Banks (Rule 11), issued by the SBP is that it requires that the lending institution develop an internal policy for managing its own risk to borrower indebtedness exposure, as well provide for responsible lending and minimize risk of the borrower for over indebtedness. The MFB is required to take a written declaration from the borrower, whereby information may be obtained regarding their total debt exposure to facilities provided by any financial institution (whether bank/MFI/NBFC/other MFBs etc). The MFB is then required to lend in a prudent manner, keeping in mind the repayment capacity of the borrower.

This is an interesting move towards consumer protection, since the MFB is now responsible in preventing over indebtedness of the borrower, instead of all reliance being placed upon financial judgment of the possibly illiterate and unaware borrower.

---

Pakistan: A protected microfinance borrower?
Arsala Kidwai

Process for Recovery of Loans:

Concern is warranted over the procedures followed by the sector for the recovery of loans, delinquent or otherwise, and the actions taken against defaulting borrowers.

It has come to light that this aspect of a MFIs functioning (even an MFB), is immensely unregulated. The practice and procedures relating to the penalties on default, the action that will be taken by the lender, the procedure for recovering the loan etc, are largely left to individual institution policy in this regard. Some disturbing attributes of the procedures adopted by leading MFIs are interest rates being charged on a per day basis for past due loans, legal action against the borrower if the loan is not repaid (no willing information was given or is available through accessible sources as to what kind of legal action could be taken), non extension of loan to guarantor for failure of primary debtor to repay the loan. Upon inquest, it was found that each MFI had the discretion to determine their own course of action, and that there was no uniform law governing these practices⁹.

The PMN with its Code of Conduct provides that the “Fair Practices” be adopted in the recovery of loans from borrowers. This vouches for the fact that member institutions must follow practices of recovery that keep in mind the dignity of the borrower. It also lists that certain occasions should be avoided to make recovery visits, and at the very basic, not inflict inhuman treatment, or indulge in mental or physical harassment¹⁰.

The SBP is responsible for a seemingly effective piece of legislation in the field of loan recovery. This is the Financial Institutions (Recovery of Finances) Ordinance, 2001¹¹. The Ordinance provides for the establishment of special Banking Courts and a detailed legal and judicial procedure for recovery from defaulting debtors and realization of collateral (immovable only). The procedure involves notices being sent to the borrower, followed by a Court proceeding and determination thereafter. Admittedly the procedure might be lengthy, but at the same time it does provide for due process of law. The establishment of a separate system of courts for this purpose also aims at quickening the process. The Ordinance also provides a forum (Banking Courts) of sorts for the borrower to file complaints against the financial institution for any default on their part in fulfillment of obligation.

The issue however is that, whether MFBs and MFIs are subject to this regulation, or can they gain access to it¹². The interpretation applied by the internal legal department of the SBP is that MFBs and

---

⁹ Claim industry sources.
¹² Definition of Financial Institution covered by Ordinance, Section 2 (a) reads : "financial institution" means and includes —
MFIs are outside the purview of the application of the Ordinance. On one hand a justifiable argument in favor of exclusion provided is that MFBs are not banks in their true sense. But then again, the act does apply to a variety of other financial institutions which are not banks in nature. Again, one would have to argue on the account of the cost and time effectiveness of such a procedure for the purpose of recovery of loans which are much smaller in size to the comparing monetary recoveries. Till date, no MFI has approached the SBP requesting a clear interpretation of the Ordinance, and requesting for inclusion in its framework. This would perhaps evidence that fact that MFBs are rather content with implementation of their own recovery procedures, and would rather not be regulated in that aspect, or conform to a supervised procedure.

**Laws providing for redress mechanisms:**

Presently, there is no consumer protection law addressing the microfinance sector exclusively. There are however concepts of consumer protection, applicable to the industry, in certain other legislative statutes and regulations. The important aspects of these statutes and regulations pertain to the provisions which bring into their scope microfinance activities and provide redressal mechanisms, forums and procedures.

There is no singular, territory wide Consumer Protection Legislation in Pakistan. The effort to bring a system of consumer protection legislation has been a provincial one, with statutes being passed in certain territories.

**Islamabad Consumer Protection Act (1995)**:

The territorial application of this Act is limited to the Islamabad Capital Territory. The Act extends to consumers of not only goods, but also services. It is under the purview of the term services that one would be able to apply the Act to the realm of microfinance activities. The definition permissibly includes banking and financial services as falling under its umbrella. It specifically attacks Unfair Trade Practices listed under it, which with specific relation to microfinance services, prohibits providing

(i) any company whether incorporated within or outside Pakistan which transacts the business of banking or any associated or ancillary business in Pakistan through its branches within or outside Pakistan and includes a government savings bank, but excludes the State Bank of Pakistan;

(ii) a modaraba or modaraba management company, leasing company, investment bank, venture capital company, financing company, unit trust or mutual fund of any kind and credit or investment institution, corporation or company; and

(iii) any company authorised by law to carry on any similar business, as the Federal Government may by notification in the official Gazette, specify;


14 Definition of services Section 2(5)
the consumer with misleading information regarding the need and usefulness of the service, amongst other misrepresentations which have also been condoned.

Two Consumer Protection bodies have been identified, one for the purpose of policy formation and the other for the purpose of operating as a specific redressal forum. The Consumer Protection Council formulated within the territorial limits shall be responsible for putting in place effective standards and policy formulation for the protection of consumers, and includes an obligation to provide for consumer education and policy formulation for ensuring access to essential commodities and services. The redressal authority in terms of dealing with complaints is the Court of Sessions in Islamabad. The Consumer Protection Council is enabled to receive complaints and submit them to the Court, as well as file complaints on a suo moto basis. Any Unfair Trade Practice is punishable with imprisonment of up to two years and or fine.

North West Frontier Province Consumer Protection Act (1997):

In certain aspects, this Act reads the same as the Islamabad Consumer Protection Act mentioned above. Services and Unfair Trade Practices carry the same definition as provided in the Islamabad Consumer Protection Act. However, the Act is more detailed in aspects of adding teeth and more specific objectives to the Consumer Protection Council’s policy framework guidelines. Through stronger wording, it lays more emphasis on consumer education, providing for a “right” to redressal forums, and the “right” to access goods at competitive prices.

The redressal Authority is the District Magistrate of the concerned District within the provincial limits. The complainant list is expansive, including aggrieved consumers, the Consumer Protection Council concerned, recognized consumer associations and government officials. The penalties entail imprisonment of up to 2 years and or a fine.

Punjab Consumer Protection Act (2005):

This Act was formulated on more specific lines that the general one’s we discussed above. It provides a different definition for services included, but would upon interpretation include those provided by microfinance providers. It also mandates a duty of disclosure on behalf of the service provider, if the information concerning the operation, modus operandi etc of the service provider would have a bearing on the decision making of the consumer. However, the concept of Unfair Trade Practices is a replica of the earlier acts discussed.

---

15 Definition of Unfair Trade Practice Section 2(6)
17 Section 10
18 Section 13
19 Section 2(k)
20 Section 16
The Act also provides for three separate bodies to deal with consumer related issues. The Authority in this case is specified as the District Coordination Officer of the concerned district. A complaint can be filed with this authority by the consumer, a consumer protection association or may take up a case suo moto. The penalty limit is set at a monetary amount of fifty thousand rupees. The Authority does not however function like a proper court.

Consumer Protection Councils are established in each district and there would be a hierarchy established with a council present at the Provincial level at the top of the pyramid. It can be viewed as the policy making and market augmenting authority, but the Act does not detail guidelines, and leave sit up to the Government to augment the Act.

A nouveau aspect of this Act is the establishment of Consumer Courts. This forum will be able to impose imprisonment penalties of up to 2 years and a fine that can go up to a hundred thousand rupees.

**Consumer Rights Commission of Pakistan (CRCP)**

This is one of the self initiated leading efforts in Pakistan in the realm of consumer protection. The CRCP is organized as an independent nonprofit, nongovernmental and nonpolitical organization. It is a right based civil initiative organized under the Trusts Act in Pakistan. The objective in its simplicity is to provide a comprehensive consumer protection body in Pakistan.

It aims at mobilizing a movement towards more consumer awareness regarding consumer rights and to provide for a complaint assimilation juncture, to be able to take up consumer causes, where the consumer is unable to access justice or redress on its own. It also provides online and in house mechanisms for registering complaints. Rendering legal advice on related matters is also one of its practices, taken care of by its Law and Governance Unit.

It can be used as an important instrument in the realm of microfinance consumer protection, through is knowledge dissemination mission and also its capacity capability and willingness to take up consumer issues in the process of lobbying for Government reform and regulation.

It is also at the forefront of knowledge sharing and creating access to information regarding pressing consumer issues through persistent publications. It has also taken up the cause of consumer financing related issues, and has an excellent publication on this matter titled "Consumer Financing in Pakistan: Issues, Challenges and Way Forward".

To conclude on the redressal discussion, it is evident that there is a lack of conformity in regulation regarding the procedure and authorities involved for this purpose. Some provinces are covered by consumer protection legislation, whilst others are left bare. At the same time, the burden of dealing with consumer complaints is placed on the shoulders of existing judicial bodies and the process is

---

21 Official Website: http://www.crcp.org.pk/index.htm
restricted to the lengthy and presumably costly court procedures in place. No mechanism for out of court settlements, arbitration or any alternative dispute resolution mechanism has been thought of. Only the Punjab Act provides for an establishment of special courts to deal with consumer complaints, which would at least deal with the issues of burden and expediency (presumably).

An important task for the CRCP should be to take up the cause of the microfinance consumer and to try and cultivate the awareness in need for alternative dispute resolution mechanisms amongst other things.

**Conclusion:**

This brief insight into the Pakistan microfinance industry has unveiled much and left a lot more to be witnessed in terms of consumer protection issues. The negative aspects exposed thus far, though not being defended, can be seen as a logical evolution of an industry in a developing set up. The industry watchdogs seem to be doing a decent job at assessing the situation and providing resolutions to the issues at hand.

Interesting to observe would be the resolution and disciplinary process which would be adopted by the PMN when participating members go against the established Code of Conduct or employ practices shunned by the network. One would have to wonder, if meager sanction in terms of removing a member from the network would serve as a sufficient and effective deterrent. Is the legal resort still left only to the borrower? Would it be more beneficial to have the PMN formulate a process whereby legal action can be taken against a defaulting member instead of applying social stigma as a weapon?

For MFBs, the SBP has a set of prudential norms. However, these do not, in all cases, translate to a control on the social implications or consumer protection. Should there then be a set of social indicators which should be prescribed by the SBP, which embody the principles of consumer protection to be followed by the MFBs? Perhaps have a set of social ratings to be applied by examiners and a minimum rating to be maintained by the MFB.

These are all ideas that stem up from a singular perspective on the situation at hand. What actually materializes depends upon how the consumer protection movement in the industry progresses and presents itself. Court cases, authority sanctions and consumer rights activism in the sector shall have to be closely watched to see what turn the industry takes on this accord.
IDLO seeks to further knowledge sharing among professionals from developing and transitional countries.

The IDLO Voices of Microfinance seek to foster discussion on current and emerging legal and regulatory challenges of the microfinance industry.

The views expressed in this document are those of the author, and do not necessarily reflect those of IDLO.