

**Beyond 'Ethical' Financial Services:
Developing a Seal of Excellence for
Poverty Outreach and Transformation
in Microfinance**

Draft concept document for discussion
(Version 3.0)

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The Interim Steering Committee

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Preface

This concept note on developing a Seal of Excellence for Poverty Outreach and Transformation in Microfinance is very much a work-in-progress. Initial discussions began in April 2010 and the concept will continue to evolve throughout 2011 and beyond. We are committed to receiving input from a broad range of stakeholders as we seek to recognize those institutions doing the most to help families lift themselves out of poverty. We are working to build on the Smart Campaign's client protection principles and the work of the Social Performance Task Force and discussing ways to implement the Seal that would use the systems that are already being developed to understand and assess the social performance of microfinance institutions. Please provide your feedback and help us improve this concept by answering our short [online survey](#).

Sam Daley-Harris, Member, Interim Steering Committee for the Seal of Excellence for Poverty Outreach and Transformation in Microfinance

Executive Summary

The goal of the proposed Seal of Excellence for Poverty Outreach and Transformation in Microfinance is a microfinance sector that is responsible, genuinely inclusive (including the poor, the bottom 30-40% of the population) and contributing to positive change.

The Seal would add value to existing initiatives in social performance by supporting recognition of MFIs which combine financial sustainability and responsible practices with, in the first place, significant poverty outreach and secondly a strategic approach to poverty reduction and transformation.

This Seal of Excellence would be for MFIs, investors and other funders whose mission is for financial inclusion that includes the poor, and the delivery of financial and supporting services that effectively contribute to poverty reduction and transformation.

This draft concept document sets out the rationale for the Seal, reviews related experiences in developing certifications in other fields (such as NGOs, fair trade, impact investing, sustainable agriculture), profiles other initiatives around financial and social performance in microfinance, shows what this Seal adds and how it fits, and maps out a process for taking this initiative forward.

The idea of this Seal in microfinance is to set a vision for the sector in terms which highlight the potential of microfinance to serve the poor and to contribute to positive transformation in the lives of clients, their families and communities; and to provide a means of recognizing MFIs that are implementing this vision.

How did this Initiative come about?

This underlying philosophy of microfinance for poverty outreach and transformation is repeated in hundreds of mission statements, websites and case examples – by MFIs and investors (and indirect investors), and is the social basis for much of the funding that has gone into microfinance in the past two decades.

While funding in microfinance has increased, and the sector has grown, performance measures – and rankings of MFIs - have tended to focus on scale and financial indicators.

Alternative measures and standards of performance are needed as recent developments have shown the limits to growth and raised concerns of headline risk - around mission drift, irresponsible lending and more obvious financial benefits to the MFI (and promoters and investors) than to intended clients.

This is a time of reflection and reassessment in the sector. It is a time when all stakeholders recognize the need to put clients at the centre of microfinance; and to demonstrate that microfinance is responsible, inclusive and effective.

Lessons from certification in other fields

- Aim – to improve standards, motivating service providers to improve, or demonstrating the direction of future development
- Stakeholder engagement in setting standards – to build buy-in
- Clear indicators with verification
- Evolution –modifications over time
- Supporting improvement
- Modular approach – steps towards excellence
- Public reporting mechanisms
- Continuing challenge – to measure end results or impact

How Would the Seal Relate to Existing Initiatives in Microfinance?

Other ongoing initiatives to set standards in microfinance include:

- the Smart Campaign focusing on principles of client protection – ‘*do no harm*’.

Smart Campaign:

Six principles of client protection

- 7 Avoidance of over-indebtedness
- 8 Transparent and responsible pricing
- 9 Appropriate collections practices
- 10 Ethical staff behavior
- 11 Mechanisms for redress of grievances
- 12 Privacy of client data

- the Social Performance Task Force (SPTF) focusing on universal (minimum) standards for social performance – *double bottom line commitment*

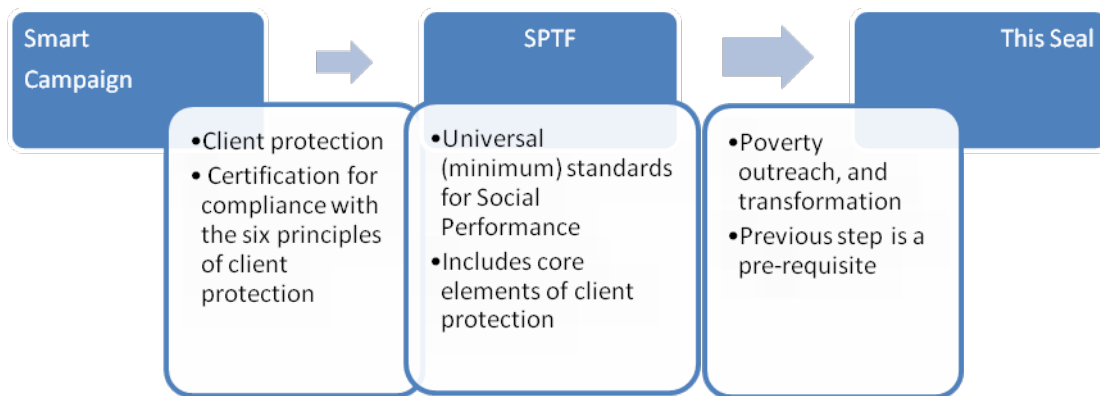
SPTF: Proposed universal (minimum) standards for social performance, relate to

- 6 Responsible financial performance
- 7 Governance & staff commitment to social goals
- 8 Products and services that meet clients’ needs
- 9 Social responsibility to staff
- 10 Client monitoring (related to stated social goals) & Client protection (minimum elements)

This Seal would not be an alternative standard, but would encompass the other standards. Financial sustainability, responsible practices and double bottom line commitment would be a prerequisite for the Seal.

In other words, a Seal of Excellence for Poverty outreach and Transformation would require responsible and ethical practices at all levels of the institution, as well as a financially sustainable bottom line. The Seal would be for those who aspire to do more – and is intended to serve as an inspiration, and recognition of what microfinance can achieve.

Mapping the sequence: proposed standards in microfinance



What would be the Content of the Seal?

This proposal is for a set of practical standards that support what microfinance can realistically achieve in poverty outreach and transformation. The scope of the Seal would reflect recent research which has questioned the old automatic assumptions about the poverty outreach and poverty reducing effects of microfinance.

Recent research emphasizes the limitations of a focus on micro-credit per se, the benefits of savings accounts for the poor, the challenge of responding to the diverse needs of poor households who use a range of mechanisms to manage their fluctuating cash flows, and the importance of non-financial services in supporting the needs of poor households.

The issue of ‘what it would mean for microfinance to work: how, for whom, was articulated in the article “In microfinance, clients must come first”.¹ The article challenged the assumption of ‘institution-centered’ microfinance: that building financial institutions that provide financial services to large numbers of people in and of itself enables (poor) clients to improve their businesses and in turn their socioeconomic standing. This seminal article advocates ‘client centered microfinance’ and a more realistic theory of change based on an understanding of the client situation, the

factors that keep households in low income and poverty and therefore the range of services that are relevant to poverty reduction.

Another important dimension is the issue of governance structures that support member ownership – and sharing in profits.

Proposed Dimensions for the Seal

6. Outreach to less developed/poorer regions within a country
 7. Outreach to poor and excluded people (specified in country context)
 8. Client retention
 9. Gender equity – opportunities for women as clients and as staff
-
10. Additional strategies (including linkages) to contribute to client development (e.g. enterprise/livelihoods, support, health, education); significant access by clients, and evidence of client feedback/response
-
- * Evidence of positive change occurring in the lives of clients over time – when/if this becomes practical to measure
 - * Effective structures for client ownership (where part of the institutional model)

SME lending can contribute indirectly to poverty reduction, particularly through wage employment of poorer people in financed enterprises. This is an important though separate category of microfinance.

The dimensions proposed above are an indicative list for the proposed Seal. There would need to be a process to develop consensus on the indicators and the benchmarks for each indicator

¹ S Datar, M Epstein & K Yuthas, *Stanford Social Innovation Review*, Winter 2008.
http://www.ssireview.org/articles/entry/in_microfinance_clients_must_come_first/

What is the Expected Demand?

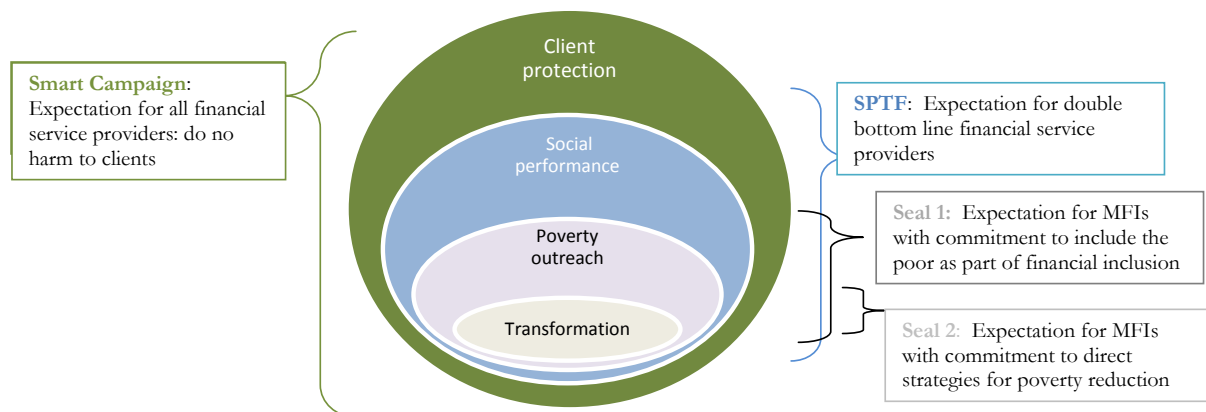
This proposed Seal is structured to complement the current initiatives for standard setting, and recognizes the challenges to achieving excellence at each level. Client protection, or ‘do no harm’ which is the focus of the Smart Campaign, represents a basic standard for all financial service providers and is seen to be a pressing concern in the current context of microfinance. The SPTF standards for social performance add further elements of ethical/responsible finance and social performance management, which are expected to be applicable to financial service providers that have a double/triple bottom line. This seal adds the poverty focus and transformational potential – which is applicable to MFIs and other stakeholders

that aim for financial inclusion that includes the poor, and have a mission that aims for poverty reduction.

If this proposal goes forward, we would expect market uptake of the Seal to be initially by a sub-set of MFIs who clear the SPTF standards.

In the longer term, the aim would be for the Seal to become more broadly based across the microfinance sector. As the examples are documented and standards are better defined, this would provide a demonstration effect of what is possible, and sustainable. This would demonstrate practical achievement of poverty outreach and strategies for transformation, with evidence for social returns in microfinance.

Integrating standards in microfinance – and expected demand



Investors (Microfinance Investment Vehicles, MIVs) are already making the business case for client protection in terms of risk mitigation. Some are also beginning to make the longer term business case for ethical double bottom line standards. In other words there are signs of change in the investor calculus, mainly following and as a direct result of the difficulties in the microfinance sector in South India and elsewhere, as well as the questions around what microfinance is actually achieving in practice.

There is no obvious business case for the Seal. Nevertheless it has relevance for

investors depending on how they ‘sell’ microfinance as an investment and how they define and measure ‘social returns’. There is likely to be interest from a subset of indirect investors (those who invest in MIVs) and social investors or ‘impact investors’ who are looking for a social return which they define with reference to poverty outreach and poverty reduction.

Access by poor and vulnerable populations is included in the Principles for Investors in Inclusive Finance launched in January 2011, with 41 signatories. The full principles and list of signatories is at <http://www.unpri.org/piif>

What would be the Benefits?

Expected benefits for social investors (direct and indirect), the public, regulators social investors

- More and better information on poverty outreach and approaches to poverty reduction
- Evidence of MFIs who are not only financially sustainable and responsible but are achieving significant poverty outreach, and strategically contributing to transformation

Expected benefits for MFIs who achieve the Seal

- Recognition of their focus and strategic approach
- Interest from social investors – and potentially, reductions in cost of funds, terms of investment

Expected benefits for poor people (in the bottom 40% of the population)

More access

- To appropriate and affordable financial services, and
- to linked services that contribute to improved quality of life

What are the Next Steps?

A broad based consultation process to

- review the demand for and scope of the Seal.

Then, if the proposal goes forward, to

- reach consensus on the dimensions and indicators, and develop benchmarks for each indicator, some of which will be country-specific

Implementation would include:

- Establish a Technical committee
- Conduct *Alpha* tests drawing on social ratings or assessments completed in the past year in different global regions, including those undertaken by the specialist rating agencies
- Decide on administration of the seal
- Pilot – *Beta* tests
- Engage with the MIX to ensure linkage with SPS reporting
- Define the process for verification and certification
- Develop a business model.

Beyond 'Ethical' Financial Services: Developing a Seal of Excellence for Poverty Outreach and Transformation in Microfinance

Draft concept document for discussion

1 Introduction and rationale

1. The idea of a seal of excellence in microfinance is to set a vision for the sector in terms which highlight the potential of microfinance to serve the poor and to contribute to positive transformation in the lives of clients and their families and communities; and to provide a means of recognizing MFIs that are implementing this vision.
2. All agree that poverty outreach and transformation (for poverty reduction) was the vision with which microfinance started. This ideal is well set out in the statement of the Asian Development Bank that defines microfinance and its potential (Box 1).²

Box 1: Definition of microfinance and its potential

- a. **Microfinance is** the provision of a broad range of financial services such as deposits, loans, payment services, money transfers, and insurance to poor and low-income households and, their microenterprises.
- b. **Microfinance can be a critical element of an effective poverty reduction strategy.** Improved access and efficient provision of savings, credit, and insurance facilities in particular can enable the poor to smoothen their consumption, manage their risks better, build their assets gradually, develop their microenterprises, enhance their income earning capacity, and enjoy an improved quality of life.
- c. **Microfinance can provide an effective way to assist and empower poor women,** who make up a significant proportion of the poor and suffer disproportionately from poverty.

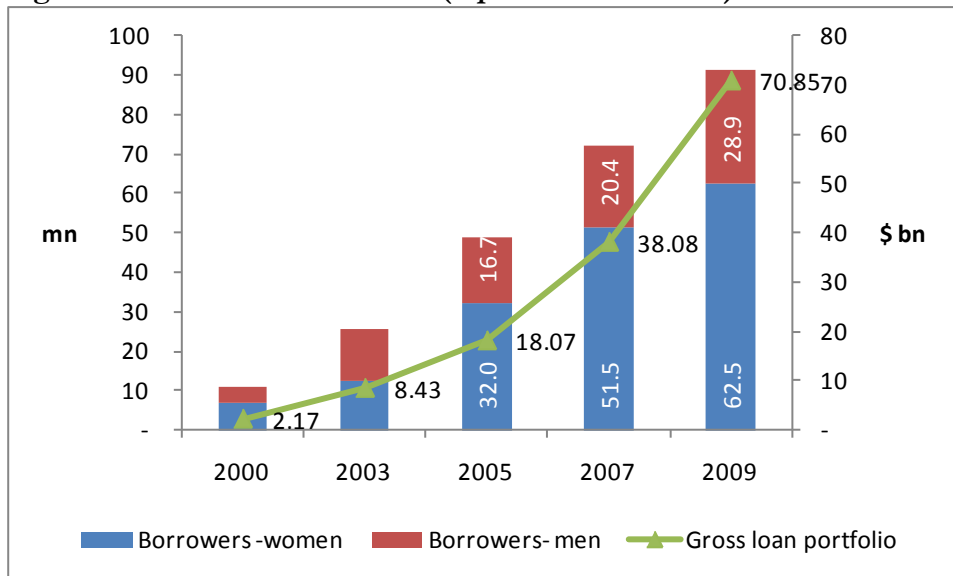
Asian Development Bank

3. This underlying philosophy of microfinance is repeated in hundreds of mission statements, websites and case examples – by MFIs and investors, and is the social basis for much of the funding that has gone into microfinance in the past two decades.
4. But whilst funding in microfinance has increased, and the sector has grown, performance measures – and rankings of MFIs - have tended to focus on scale and financial indicators. Growth has been significant. Data reported by over 1,100 MFIs to the Microfinance Information Exchange (MIX Market) shows that by end 2009 there were globally 91 million borrowers, 68% of whom are women, and over 78 million depositors. The total gross loan portfolio (reported by 1,121 MFIs) was nearly \$71 billion and total deposits (reported by 619 MFIs) were \$27 billion (Figure 1, next page).³

² <http://www.adb.org/documents/policies/microfinance/microfinance0100.asp?p=policies>

³ <http://www.mixmarket.org/mfi/trends/> These figures do not include microfinance by banks and the 80 million or so women in Self Help Groups in India.

Figure 1: Growth in microcredit (reported to the MIX)



5. Growth has led to transformation in the institutions delivering financial services, as many MFIs have adopted a different legal structure (banking, non-banking finance companies instead of NGOs or societies) to enable them to raise capital for their growth, and in order to provide a broader range of products and services, notably savings services that require regulated status in many countries.
6. With growth too have come other developments that whilst maintaining the broad vision of microfinance have involved a redefinition of strategy, as many stakeholders (MFIs, their investors, CGAP) reframed their social goals in terms of financial inclusion, promoting access for the largest number of people previously excluded from formal financial services; emphasizing the importance of growth in access per se contributing to overall economic development, which in turn can lead to poverty reduction.
7. Thus growth – both in microfinance clients and portfolio, along with on-time loan repayment – appeared to many stakeholders (especially investors and transformed MFIs) as ‘win-win’. It was good for business – enhancing the profits of the MFI and the financial returns to promoters and investors, leading to further growth. It was also seen as a social good, since more loan accounts means more people with access to financial services – in other words, more financial inclusion, and all the other benefits that have the potential to follow. Investing in microfinance became popular, safe and profitable, with an accompanying halo effect since the sector was seen as contributing to development and poverty reduction.
8. However, impressive growth in microfinance at the global level has been accompanied by signs of stress in a few countries in the past two years. A recent CGAP focus note analyses the reasons for regional or national level delinquency crises in microfinance in four countries (Nicaragua, Bosnia and Herzegovina, Morocco and Pakistan) which have all experienced a repayment crisis after a period of high growth. The case studies indicate that although the global economic crisis was among various reasons affecting borrower capacity to repay in these countries, the primary cause of the problem lay in the institutional limits to growth, reflected in concentrated market competition with multiple borrowing by clients, overstretched MFI systems and controls, and an erosion of lending discipline.

9. India is facing a similar crisis, with rapid microfinance growth combined with increasing evidence of clients borrowing from more than one MFI, particularly in the two southern states of Andhra Pradesh and Karnataka. These two states account for around one-third of

...one of the main lessons from India today is that scale and growth can go too far. It is possible to provide too much credit into too highly a concentrated market. And it is likely that the high levels of profitability contributed to the greater credit saturation. It makes us wonder whether the objectives of scale need to be revisited and similarly whether the lure of high profitability into a single product credit market is desirable. The evidence from Andhra Pradesh suggests we need to re-think or evolve what might qualify as "good" or "responsible" microfinance.

Greg Chen, CGAP

MFI loan accounts in India, and are home to the largest MFIs in the country, including SKS Microfinance Ltd which had its IPO during 2010. At the time of writing, loan repayments are practically at a standstill in Andhra Pradesh. And negative publicity around allegations of suicides by over-indebted clients, misbehavior by MFI staff, high interest rates charged to clients and profiteering by MFI promoters has undermined the reputation of the sector as a whole, raising questions around governance, cost structure, strategic planning, mission drift and regulation.

10. Beth Rhyne cautions now against the ‘hypnotic mantra of scale, scale, scale’ with increasing evidence from some regions of the world, that behind the overall numbers of micro-credit accounts and million dollar portfolios we may find, not growing numbers of happy, enterprising women and men working their way up out of poverty, but on the contrary, evidence for mission drift, irresponsible lending and more obvious financial benefits to the MFI – and its investors - than to intended clients.⁴ In 2008, Alex Counts paved the way for ‘Reimagining Microfinance’⁵ and last year, close to the events in India, Sanjay Sinha talked of the need to ‘Calm the Charging Bull’.⁶

11. Rethinking is taking place across the sector, largely in terms of putting clients at the centre of microfinance. This is an aspect that is beginning to be referred to as “fair trade microfinance”.⁷ It has implications for responsible and ethical microfinance, social performance management; as well as reflecting a need to look more closely at the role of microfinance and related services in serving poor people effectively, enhancing opportunities for women, and including clients in governance structures. These issues apply both to MFIs as practitioners and to investors who are playing an increasing role in microfinance (the Microfinance Investment Vehicles or MIVs).

It is high time for the launch of “Fair Trade Microfinance.” The broader world, including international media, investors and donors, will only have confidence in microfinance if the industry can in turn provide confidence that its members are genuinely working on behalf of their clients.

Beth Rhyne,
Centre for Financial Inclusion

12. Drawing on these developments, the starting point for the design of a seal of excellence in microfinance is to ask: how can we think of ‘top performers’ in a different way? Not in terms solely of the number of borrowers and the return on assets of a MFI, nor indeed the highest figures for these indicators, but also (and equally) with reference to social values – which needs to include indicators for responsible and ethical finance, as well as indicators that can be related to the contribution of microfinance to development. Being a top performer in microfinance means top performance in the ‘double bottom line’, in other words, balancing the financial goals of efficiency and profitability with social goals and values that relate to

⁴ ‘Microfinance, Scale and Financial Inclusion: The End of the Scale Mantra’, Microfinance Insights, Mar/Apr 2010.

⁵ http://www.ssireview.org/articles/entry/reimagining_microfinance/

⁶ <http://www.microfinancegateway.org/p/site/m/template.rc/1.1.5515/>

⁷ http://blogs.cgdev.org/open_book/2010/12/recalibrating-microfinance-a-six-point-program.php#comment-5275

responsible and ethical practices, inclusion and effectiveness. Both financial sustainability and social values are relevant and important.

13. How that balance works out can differ in perception and in practice, depending on the mission, legal structure and governance of the MFI. The different institutional models (banks to NGOs) reflect different orientations, systems, expertise and liabilities. Whilst the sector recognises a double bottom line component, and the orientation to responsible and effective financial inclusion is reflected in mission statements and websites, whatever the model of microfinance, the balance of the double bottom line may tilt more one way or the other (financial or social). This initiative is in response to a perceived tilt more towards commercial goals in the sector, and a need to define social values and the vision of microfinance.
14. Increasingly, we have the tools and metrics to define and measure ‘social performance’ in microfinance, alongside financial performance. These come from a variety of global initiatives that have included, since 2004, the development of social audits and social ratings, pilot reporting on social performance standards in the industry, the development by social investors of social score cards (to match financial due diligence for investment), tools for poverty assessment and benchmarking, and an international campaign to define and implement client protection principles as part of responsible financial services. Regionally and at country level, some networks of MFIs are beginning to put in place a Code of Conduct for the Board and management of their members.
15. In all these initiatives, the focus is on practical tools – on what can be measured, and on what can be managed by an MFI to improve its social performance and to demonstrate social and development value, alongside the conventional indicators of growth and profitability. The range of initiatives related to the ‘double bottom line’ in microfinance is discussed in **Section 3**.
16. The proposed seal is intended to complement other ongoing initiatives related to responsible, ethical and double bottom line finance (being promoted by the Smart Campaign and the Social Performance Task Force).

First we turn to a review of approaches to developing seals of excellence in other related fields.

2 Seals of Excellence in Other Fields

17. What can we learn from the experience of developing certifications or seals of excellence in other sectors? This section aims to draw lessons that are relevant for the microfinance industry, and will link in to the draft design and implementation of a seal of excellence for microfinance later in this paper (**sections 4 and 5**).
18. There have been similar concerns and developments globally around ‘strategic performance’ measuring non-financial elements, as well as the double/triple bottom line applied to businesses and non-profits in different sectors. The main fields of certification and reporting that hold relevant lessons for microfinance include: NGOs, management performance, ‘impact investing’, fair trade, environmentally sustainable forestry, fisheries; organic agriculture, health services and education.

19. In the context of preparing this concept note, we looked at many examples and categorized them broadly according to purpose, as shown in **Table 1**. (The purposes may overlap, and there may be more, but these seem most relevant to compare with or align to a proposed seal of excellence in microfinance).

Table 1: Purposes and examples in designing a seal of excellence

	Purpose	Examples
1	Respond to a recognized need for more information and transparency; Supports credibility of a sector accessing public funds, or looking for donations or ‘social’ investment	Charity Navigator: NGOs GIIRS/B-Lab: companies seeking mission aligned capital
2	Public accountability and improvement of services provided	Maryland Association of Non-Profits Public standards in health services, education
3	Minimum expected standards of quality for a specific product	ISO – manufactured products Food safety standards
4	Differentiate a service or product that represents development value in terms of e.g. environmental sustainability or working conditions/benefits to producers	Many in: fisheries, forests, organic agricultural products, fair trade in various items
5	Support excellence in any field through public recognition and profiling of outstanding examples	Many – from organisational management (Baldrige) to handicrafts (UN)

20. Common features of these examples include the following:
- 20a. All are seeking to improve standards in their sector, either to motivate companies/service providers to improve their performance so as to receive certification or a seal of excellence; or to demonstrate new standards that may set the direction of future development
 - 20b. Stakeholder engagement in setting standards (to build buy-in, recognize different concerns;
 - 20c. There is evolution of standards to allow for some modifications and improvements over time
 - 20d. In some cases, the approach involves both setting standards and supporting improvement in organizations so that they are able to achieve those standards
 - 20e. Standards may be linked to a public reporting mechanism (for example Charity Navigator is based on public accountability reporting to US Form 990); an agreed set of reporting indicators makes it easier to collect information, standard reporting can reinforce standards. The Global Reporting Initiative (GRI) is relevant here. It is not a certification or seal of excellence but a set of guidelines for public reporting that is applicable to and adapted to different sectors.
 - 20f. The content of the standards represents similar features – in terms of governance and accountability, social responsibility and development value.
 - 20g. Where this is relevant, (mainly related to purposes 1,2 and 4) there is a common challenge to define and measure end results, in other words the positive benefits or changes (or ‘impact’) for local people and communities, beyond more readily available information on policies/systems and outputs in terms of numbers of participants
21. In setting out the concept of a seal of excellence in microfinance, it is interesting to select a couple of the initiatives to map out their process of development and implementation, as a guide to what may be possible in microfinance. For this we have selected three which seem close to this idea for microfinance, having a graded seal (not just pass/fail certification) with

related indicators. These three are: Maryland Association of Non-profits, Charity Navigator, GIIRS/B Corporation and their key features are summarized in [Annex 1](#).

22. Considerable expertise has developed with some emerging lessons. These have been brought together in a series of publications by the International Social and Environmental Accreditation and Labelling Alliance (ISEAL). ISEAL is: “an international non-profit organisation that codifies best practice for the design and implementation of social and environmental standards systems”. ISEAL has created an international system of reference for setting social and environmental standards. The belief is that the credibility of social and environmental standards can be strengthened by the way the standards are set. ISEAL members are committed to improving the way they set their standards by complying with the Code of Good Practice for Setting Social and Environmental Standards developed by ISEAL.⁸ The Code sets out systematic principles and guidelines for setting standards as well as setting up systems to implement. It draws on the ISO/IEC⁹ Guides 2 and 59 Code of good practice for standardization whilst adding practices that are relevant to social and environmental standard setting.
23. Two key elements of the Code relate to building on what already exists, and engaging with relevant stakeholders:
 - 23a. Determine the need for the standards: consider existing standards, how to complement these standards and avoid duplications or contradictions. This means understanding which standards already exist and the extent to which they overlap with the proposed initiative. (If there is a possibility to direct energy to further development of an existing standard, this should be carefully considered as an option).
 - 23b. Know your stakeholders and communicate with them: stakeholders include all individuals and groups that are impacted by or have a potential interest in the standard. Identify different interest groups, as well as key organizations that are representative of these interest groups. (Better to err on the side of too much participation rather than too little).

The next section maps out key stakeholders in microfinance and reviews what is already out there.

⁸ www.isealalliance.org The ISEAL alliance has nine full members setting standards for fair trade, sustainable natural resources, and ‘socially accountable businesses’. There are also (two) associate and (five) affiliate members – who subscribe to the ISEAL Code of Good Practice – and are in the process of meeting requirements for good practice in international standard setting participate to share information and raise awareness (ISEAL has invited the entity that may set up a seal of excellence in microfinance to join the alliance).

⁹ The International Organisation for Standardization is widely known as ISO. Established in 1946 as a nongovernmental organization, ISO headquarters are in Geneva with representatives from country standards organizations, working through 2,700 technical committees, sub-committees and working groups. The ISO produces international standards that are widely accepted for their application to commercial manufacturing and trade.

3 Related Initiatives in Microfinance

24. The aim of this section is to review the initiatives that contribute to setting standards in microfinance. This provides the basis for engaging with key stakeholders to design a seal of excellence, in such a way that it builds on and integrates with existing initiatives.

Microfinance stakeholders are listed in **Table 2**.

25. The work of several groups of stakeholders and associated networks is relevant here. The initiatives reflect both financial performance (for which indicators and ratios are mostly well established) and social performance (which are more recent development, largely work in progress).
26. The following discussion focuses on the developments in social performance as an emerging field.

Table 2: Stakeholders in microfinance

- > Clients of MFIs
- > MFIs – microfinance banks, non-banking financial institutions, NGOs
- > Associations/networks of MFIs – global, regional, country
- > Regulators, policy makers
- > Investors/MIVs – social, commercial
- > Indirect investors (who fund MIVs) – institutional/private
- > Banks – lending to MFIs
- > Donors
- > Aggregators (such as MIX)
- > Rating agencies – specialist to microfinance, corporate
- > Researchers
- > Media/public

3.1 Financial Performance

27. During the 1990s, initiatives in microfinance emphasized and promoted practices relevant to building strong financial systems with an emphasis on the growth and financial sustainability (efficiency, portfolio quality, profitability) of microfinance institutions (MFIs).
28. The specialist rating agencies, which first emerged in 1997/8, developed a set of indicators (quantitative and qualitative) to measure governance, management and financial performance as part of their performance assessments or credit ratings of MFIs. Ratings of larger MFIs are now also undertaken by the corporate rating agencies (Standard and Poor, Moody's, Fitch, CRISIL).
29. The SEEP Network, in 1995, published 16 ratios for financial analysis, with updates in 2002, 2005 and 2009 through the Financial Services Working Group.¹⁰ These are a widely-adopted basis for measuring financial performance and are reflected in the organizational and financial indicators that have been reported to the MIX Market website since the late 1990s. MIX data is publicly available online for all reporting MFIs.¹¹ Benchmarks are also created annually for key operational and financial indicators using peer groups for legal status, target market, age, region, country, scale, outreach and other factors.
30. Financial and operational data was reported by over 1,000 MFIs globally in 2009. Benchmark data for the main peer groups is presented in Annex 2. These reflect the key indicators and ratios used to measure financial performance and efficiency: and show the variation by peer groups. They provide a reference point for potential financial benchmarks (the 'financial bottom line) as part of a seal of excellence for microfinance.

¹⁰ <http://www.seepnetwork.org/resources/Measuring%20Performance%20of%20MFIs%20Framework.pdf>

¹¹ <http://www.mixmarket.org/mfi/indicators>

3.2 Social Performance

31. Sector initiatives to capture the second bottom line in microfinance started in the early half of this decade. These were brought together through the **Social Performance Task Force (SPTF)**, an informal group of interested stakeholders who held their first meeting in 2005, with annual meetings since then. The SPTF has expanded to more than 850 members in 2010, including all main stakeholder groups and quite active sub-committees.¹²
32. A core concern initially of the SPTF was to define social performance (Annex 3 provides the definition)¹³, and to build consensus around a conceptual framework that presents the key elements of social performance for the industry. This was agreed through an interactive process during 2006, drawing on the experience at that time and linked to the concurrent development of social ratings and audit. A current area of concern in the SPTF – which overlaps with this idea of a seal of excellence – is to set some agreed criteria for social performance. (We refer to this later).
33. Annex 4a sets out the conceptual framework – or pathway - for social performance. This framework represents substantial consensus in the sector: the organizational processes and systems at MFI level as well as the outputs and results at client level. There are dotted lines around impact to the far right of the pathway. ‘Impact’ here is used in the technical (or academic) sense of the term to mean ‘change that can be attributed to an intervention’. The dotted lines denote the complexity and costs of assessing impact – as already noted for other related standard setting initiatives. But the framework underlines the importance of understanding and measuring the steps to achieve impact.
34. The social performance framework provides the reference point for understanding different initiatives. Current initiatives – all of which are linked to the SPTF - have focused on one or more steps in the pathway, as outlined in Annex 4b.

The following is a brief description about each initiative, following the order of the pathway. These initiatives are at varying levels of development.

35. Initiatives with focus on specific aspects of social performance (following the order in the pathway):
 - 35a. **Microfinance Transparency – costs to clients** - started in 2008, profiles costs to clients of micro-credit for different products of individual MFIs by country, relative to loan size and costs of delivery.¹⁴ Clear, robust reporting, closely verified, helps to build evidence for what is ‘responsible’ pricing. This is important for understanding and analyzing a complex area which otherwise MFIs can represent in different ways. Microfinance Transparency is working now in seven countries, with plans to expand into another 11 during 2011. The work and approach of Microfinance Transparency is publicized and accepted by stakeholders – including MFIs – worldwide.
 - 35b. **SMART Campaign – client protection** - also started in 2008 (by the Center for Financial Inclusion at ACCION International).¹⁵ The campaign has built consensus around six principles of client protection: and is in the process of developing

¹² <http://sptf.info/>

¹³ <http://sptf.info/page/sign-on-letter>

¹⁴ <http://www.mftransparency.org/>

¹⁵ <http://www.smartcampaign.org/>

guidelines for good practice and assessments at MFI level. The campaign is also exploring certification, which may or may not be linked to social rating (below). Specific indicators for client protection are becoming established.

The principles of client protection are publicized and well received by MFIs and other stakeholders worldwide, and are increasingly recognized as a non-negotiable across all models of microfinance. There are over 1,000 signatories who have endorsed the Campaign – MFIs, investors, donors, networks, support organizations as well as individuals. The campaign is actively moving beyond endorsement to establishing examples and guidelines of good practice in client protection, including the difficult area of what counts as ‘responsible costing’ in microfinance.

- 35c. **Women’s World Banking (WWB); Women’s Empowerment Mainstreaming and Networking (WEMAN) - Gender equity** - are developing indicators for MFIs to report on gender equity, with training modules and case studies on integrating a gender focus into microfinance programmes.¹⁶ Whilst women’s empowerment through microfinance is a stated value in microfinance, and has been one of the core principles promoted by the Microcredit Summit Campaign, it lacks consensus, clear definition and attention. There are opposing views between those (especially male leaders in the sector!) who see having women as microfinance clients as sufficient for gender equity, and others who point out that having women as clients because they accept small loans, pay on time and more humble is more opportunistic than empowering. The latter see having women as clients as just the starting point for gender equity, given the socio-economic barriers that women face. Since those barriers differ in different contexts and regions, the elements of gender equity have proved difficult to define in a practical way and to implement.

As these elements become more practically defined, then they will serve an important part of the promise of microfinance. This is work in progress

- 35d. **FMO – health, safety and the environment** – has developed a set of guidelines and a training module for implementation by MFIs in relation to financed enterprises (2009).¹⁷ These are important questions, though MFIs find it difficult to add such questions onto everything else they are expected to do. There is, nevertheless, growing awareness of environmental risks in micro-financed enterprises that depend on the natural resource base (agriculture, fisheries) as well as larger scale enterprises (small and medium enterprises, SMEs, larger than the typical micro-enterprises financed by microcredit). Work in progress – probably with selective application.
- 35e. **ILO - microfinance for decent work** - survey with 16 MFIs globally to identify issues related to working conditions of MFI clients (including child labour and safety) and test strategies to address.¹⁸ The survey has not focused on wage employment specifically, but seems to have expanded to include general issues related to client awareness, appropriate products and managing income fluctuations. The ILO is currently supporting programme interventions (e.g., client training) along with Randomised Control Trials to assess the impact of the interventions. If the impact is positive, then it is expected that the MFIs will continue the interventions. Work in progress – and seems particularly applicable for hired (non-family) workers in Small and Medium Enterprises.

¹⁶ <http://www.swwb.org/>

¹⁷ <http://www.fmo.nl/smartsite.dws?id=1670>

¹⁸ http://www.ilo.org/asia/whatwedo/projects/lang--en/WCMS_114241/index.htm

- 35f. **Poverty assessment of clients:** There have been various types of tools developed to measure the poverty level of microfinance clients. These include, for example, FINCA's client assessment tool, Freedom from Hunger's food security index, CASHPOR's housing index and CGAP's poverty audit. Most recent developments include the development of score cards statistically derived from national survey data sets, and benchmarked to specific poverty 'lines'.
- 35g. **Progress out of Poverty Index (PPI)** – a tool developed since 2006 by Mark Schreiner of Microfinance Risk Management and supported by Ford Foundation, CGAP and the Grameen Foundation (US). The PPI is now available for 34 countries worldwide.¹⁹ It is a practical tool to assess the likelihood that a household is living below a poverty line. The tool comprises 10 easy to collect indicators, linked to a poverty benchmark, statistically derived from national survey data for different countries, where the data is relatively recent, robust and available. The PPI score cards are benchmarked to different poverty lines (national, \$1 at purchasing power parity, \$1.25, \$2 \$4) and for each country there is data on poverty rates (the percentage of households living below each line). This is important to help set the poverty outreach of MFIs in context.

The tool is relevant for implementation by MFIs as part of their targeting and MIS, enabling the collection of data on poverty levels of clients at entry to profile depth of outreach. The PPI is beginning to be piloted and applied by a small number of MFIs in each country covered. Poverty profiling of clients at entry provides a baseline with which to compare possible changes in poverty level over time. The Grameen Foundation has been driving the adoption of the PPI as an industry standard, recently introducing certification for basic, standard and advanced use of the PPI (to reflect extent of application of the PPI by an MFI, and integration into monitoring and management systems). The Grameen Foundation has also developed an Access based data base for MFIs to manage PPI data.

There has been a mixed response to the PPI. MFIs with a clear poverty focus in their mission (and similarly oriented social investors/funders) are motivated to try out and apply the PPI. There have been some glitches in application (quality control, doubts about indicators based on relatively old national surveys that are five years old or older, difficulties of integrating with the existing MIS) and MFIs are still to develop clear systems to analyse and report the data. But the PPI remains the most cost-effective tool to benchmark poverty. Application and reporting issues are being resolved as more experience develops.

- 35h. **Poverty Assessment Tool (PAT)** – promoted by USAID, developed by the IRIS centre at the University of Maryland, US and developed for 33 countries, so far.²⁰ The PAT has a similar purpose as the PPI – benchmarking poverty levels – and similar basis, statistical regression from national survey data sets. A difference is in the larger number of questions (up to 24). Used by recipients of aid from USAID, including some MFIs, the tool is specifically intended to enable reporting on outreach to clients living below '\$1 a day' as part of reporting to the Millennium Development Goals.

¹⁹ <http://www.progressoutofpoverty.org/>

²⁰ <http://www.povertytools.org/>

35i. **STEP UP - Strengthening The Economic Potential of the Ultra Poor** – drawing on the experience of graduation programmes for the extreme poor, this is a very recent initiative (2011) of the Poverty Outreach Working Group (POWG) of The SEEP Network to generate, share and replicate lessons learned to design economic strengthening activities aimed at those living in extreme poverty. The STEP UP concept paper states that one of the greatest remaining challenges for microfinance and microenterprise development is to reach those living in extreme poverty²¹ with affordable products and services that can assist them in building and protecting their assets. Very poor households constitute a unique market segment different in many ways from moderately poor people. Experience has demonstrated the relevance of a cross-disciplinary approach to be effective for the economic strengthening of very poor people requires, and this initiative aims over the next few years to promote learning initiatives and partnerships bringing together practitioners, donors and researchers from different specialties (microfinance, enterprise development, value chain development, livelihoods promotion, health and social safety nets).

36. Initiatives with overall coverage of social performance issues

36a. **Social audits** (Cerise Social Performance Indicators – SPI),²² Imp-Act consortium/MFC SPM Quality Assessment Tool - QAT)²³ and **social ratings** (by the four specialist rating agencies: M-CRIL, Microfinanza Rating, Planet Rating, MicroRate) cover the main steps of the social performance pathway, including: mission, governance, strategy, products and services, client protection; as well as gender approach, responsibility to staff, community and environment. Social ratings may also include client level profiling (poverty level at entry, vulnerable groups) as well as client awareness and client feedback on products and services.

Social ratings were piloted and developed from 2005-8. These are now provided by the four specialist rating agencies. As was earlier the case to support the development of financial ratings, the cost of social ratings is partially funded by a Rating Fund, currently the ADA fund based in Luxembourg. Around 100 social ratings were completed during 2009. The corporate raters too (Moody's) are beginning to show an interest in developing their own social rating tools.

The social ratings apply quite well established indicators – quantitative and qualitative. These have evolved to incorporate different developments in social performance, for example, the six client protection principles; and use of the PPI to profile depth of outreach as part of a rating survey. The raters are well placed to verify social performance indicators, as reported to the MIX – and to verify a seal of excellence for microfinance.

36b. **Social Performance Standards (SPS) on the MIX** – A set of indicators has been developed and piloted through a consultative participatory process of the SPTF during 2006-8. The questions are linked to different components of the SP pathway. They are divided into 'Part 1' which asks straightforward questions which all MFIs should be able to directly report. 'Part 2' requires a poverty assessment tool for some indicators (such as the PPI), information on policies (such as responsibility to the

²¹ POWG defines extreme (or absolute poverty) as *absence of enough resources to secure basic life necessities* with reference to the estimated 1.3 billion people living below the international poverty line of \$1.25 at 2005 purchasing-power parity (PPP).

²² <http://www.cerise-microfinance.org/-impact-and-social-performace->

²³ <http://www.mfc.org.pl/publication.html>

environment) and other demographic information on MFIs clients.²⁴ In 2009, 208 MFIs reported on the SPS. The numbers have increased during 2010 to 349 MFIs with data collection continuing for 2010.

The MIX SPS provide a taxonomy of questions and indicators that reflect current state of practice in social performance reporting. After two years of reporting, the SPS indicators have been reviewed by the SPTF and are streamlined for 2011 data collection. A seal of excellence in microfinance should build on and reflect the reporting indicators that become standard for social performance reporting by MFIs.

- 36c. **Reporting by social investors in microfinance** – Investment fund managers with a focus on microfinance are beginning to develop a set of reporting indicators called ‘Environmental, Social, Governance’ (ESG) indicators alongside existing indicators that cover financial risk assessment and organisational profiling of their MFI investees. Social investors are developing social score cards that they use to screen potential investments, as a social due diligence alongside the financial due diligence. The score cards reflect social performance criteria that become part of the monitoring and reporting requirements to MFI investees.²⁵

In 2010, as a sub-committee of the SPTF, a group of social investors have started to discuss the possibility of coordinating their tools. The aim is to explore a consistent set of indicators and reporting requirements from MFIs, to align with the SPTF framework and MIX indicators as much as possible, and also to include the emerging concerns in MFI round governance, client protection and Human Resources systems.

Indicators are under development both for MIVs to assess their investments/MFIs and for potential funders (indirect investors) to assess MIVs.

- 36d. **Associations’/networks’ codes of conduct** – At the national and regional level, networks of MFIs are beginning to draw up Codes of conduct for their members. These cover very similar areas and questions as are covered in the different initiatives listed above, with some additional indicators and methods of verification. India is an example of this.²⁶

The review in this section serves to highlight the substantial work and development of indicators and reporting systems related not only to financial performance but to an understanding of the elements of social performance and social value. Much of it is work in progress. Nevertheless, there is a solid depth of work which can contribute to the development of agreed standards for ‘excellence’ in microfinance.

²⁴ <http://www.mixmarket.org/social-performance-data>

²⁵ The latest developments are reported in the latest European Dialogue (3) published by the European Microfinance Platform (2010) <http://www.e-mfp.eu/resources/european-dialogue>.

²⁶ <http://www.sa-dhan.net/Resources/Sa-Dhan%20Code%20of%20Conduct%20final.pdf>

4 Setting Standards of Excellence in Microfinance

37. At the time of writing, a few initiatives are moving towards the development of a set of standards in microfinance. These are:

- the Smart Campaign focusing on principles of client protection.
- the Social Performance Task Force which intends to focus on universal (minimum) standards for social performance.

Both initiatives see their standards as relevant to multiple stakeholders – MFIs, networks and investors/donors.

38. Investors in microfinance increasingly recognize their role in supporting responsible and inclusive financial services, and have very recently – in January 2011 – agreed to a list of Principles for Investors in Inclusive Finance.

39. These initiatives are work in progress and are described in this section which sets out to capture current thinking around the elements of ‘excellence’ in microfinance, to map out the different standards, and to propose a Seal of excellence that builds on the existing initiatives. The approach recommended by this concept paper, and reflected in discussions so far, is to seek to complement and reinforce the different initiatives and to support the different initiatives to become operational.

4.1 Stakeholder Engagement to Define the Standards

40. In different sectors, the experience of standard setting is that:

Standards are not difficult to write. The difficult part is reaching agreement among a diverse group of stakeholders about what issues to cover and what to say about each issue.

There are also challenges in measuring, monitoring and establishing compliance.

41. The ISEAL Code of Good Practice on standard setting starts from this statement to recommend a process as follows:

41a. Bring together a critical mass of stakeholders: to determine common interest in developing the standard and to define the benefits. A core group will likely drive the process of developing the standards. The balance within this core group needs to represent potential interests in the standard – to establish legitimacy.

41b. Have clearly defined objectives: *Define objectives in concrete terms as the change you would like to see.* What change will be introduced through compliance with the standard – in terms of practice and performance of institutions involved – MFIs/investors? What are the desired outcomes – in terms of change for clients? Clear objectives from applying the standard help to underpin the process of developing a standard. Requirements are included in the standards if they lead directly to achieving those objectives.

41c. Define the structures and procedures for the standards development process: stakeholder mapping, participation, and documented response. Make it clear how stakeholders can input and how decisions are made: and maintain records of activities to develop the standards

such as the following - list of stakeholders contacted, involved at different stages, comments received and a synopsis of how comments were taken into account

- 41d. Decide the end use of the standards:
Are they intended as voluntary guidance on good practice? Are they intended to be widely applicable across the industry? Determining the end use relates to what issues should be included and how the standard is set (compliance, major and minor non-compliance, or a scoring approach).

42. The core group initially consisted of leaders of the Microcredit Summit Campaign, the Grameen Foundation, Freedom from Hunger, Microfinance Transparency, Kiva and World Vision. A process of stakeholder consultation was begun through teleconferences from July 2010 onwards, a meeting with key players at the India Access microcredit summit in November 2010, and a meeting in Washington DC in December 2010 to discuss the first draft of this concept note. The revised, second draft was circulated to 100 stakeholders for their inputs in January/February 2011. At the same time, the core group was expanded to form an interim steering committee, including representatives from MFIs, other social investors, donors/networks, and other certification initiatives. The composition of the interim steering committee is given in the Appendix. The process of consultation is continuing with the dissemination of this revised third draft.

4.2 Defining What We Would Like to See

43. Recent public statements by leaders in microfinance state the social value of microfinance in terms of responsible and ethical principles and benefitting poor people. Social investors are beginning to apply Principles for Inclusive Finance to themselves (**Box 2**). The full principles and list of (41) signatories are at <http://www.unpri.org/piif>.

44.

Box 2: Public statements of social value in microfinance (*key words* – this author’s italics)

1. **The Pocantico declaration 2008:** “Without firm commercial foundations, microfinance cannot become the profitable business that it needs to be in order to survive,” said Elizabeth Littlefield, [previously] CGAP CEO. “But without *firm ethical principles and a commitment to benefit poor people’s lives first and foremost*, it will no longer be microfinance. What Pocantico established is a common vision amongst microfinance leaders that a positive impact on the lives of the poor is at the essence of microfinance and that principles need to be established to clearly uphold that.”
<http://www.bouldermicrofinance.org/POCANTICO/index.htm>
2. **Principles for Investors in Inclusive Finance**, launched at a Responsible Finance Forum in late January 2011 in the Netherlands, and supported by Princess Máxima of the Netherlands, UN Secretary-General’s Special Advocate for Inclusive Finance for Development): Inclusive finance, which includes but is not limited to microfinance, focuses on *expanding access of poor and vulnerable populations*, micro- and small-enterprises, and those otherwise excluded *to affordable and responsible financial products and services*. This encompasses a wide range of financial services including savings, credit, insurance, remittances, and payments. These services should be provided by a variety of sound and sustainable institutions. Inclusive finance carries with it the responsibility for all actors in the value chain - investors, retail financial service providers and other relevant stakeholders - to understand, acknowledge and *act in accordance with the interests of the ultimate client*.
<http://www.minbuza.nl/dsresource?type=pdf&objectid=buzabeheer:271118&ver>

45. Reflecting on recent discussions with sector leaders and stakeholders, and drawing on the public statements of value in microfinance, **Table 3** sets out some of the elements of social value in microfinance (or the social bottom line). Those listed first (i-v) are generally accepted as part of good organizational practice, and they tend to represent positive synergies between financial and social performance: what is good for clients - and for staff – is ultimately good for business. The other elements (vi-xiii) are more likely to represent a trade-off with financial performance. They are also generally accepted but are more challenging to measure and benchmark, particularly with variations between countries and context.

Table 3: Elements of social value in microfinance

- i. Sound governance
 - ii. Client protection – six principles (credit and all financial services)
 - iii. Strong HR systems – and social responsibility to staff
 - iv. Design and provision of products appropriate to the financial requirements of client markets – based on effective mechanism for market research and client feedback
 - v. Financial services that support improvements in quality of life – education, health, housing, sanitation, clean water, renewable energy
- [The following are *more challenging - to implement and/ or to define and measure*]
- vi. Financial sustainability but with ‘*optimal*’ rather than maximum profits
 - vii. ‘*Responsible*’ or *fair* pricing – on all microfinance services provided: credit, savings, insurance, remittances
 - viii. Targeting and outreach to under-developed regions
 - ix. Outreach to the poor – (not just growth in numbers but who is being reached, are the poor included, defining who is meant by poor relative to poverty levels or indicators within a country)
 - x. Client retention
 - xi. Gender equity – in terms of opportunities for women as clients, and as staff
 - xii. Effective linkages (or direct provision) to optimize the potential of financial services through non-financial services that support e.g. livelihood sectors that are financed, health, education
 - xiii. *Contribution to poverty reduction*

4.3 Addressing What We Do Not Want to See

46. Negative experiences in microfinance – the ‘opposites of excellence’ - have emerged most recently in the events in southern India during 2010 (and earlier) and also in some other countries. The experiences have demonstrated the reputation risk and potential political backlash that can arise.
47. Current and pressing concerns relate to the following:
- 53a. An approach to growth that is fuelled by standard ‘vanilla’ products’ and has resulted in supply-driven competition between microfinance service providers: pushing multiple borrowing onto clients, leading to potential over-indebtedness of clients, and aggressive collection practices
 - 53b. Pursuit of high profits that are generated through high costs to clients; failing to reduce costs to clients when MFI business costs reduce
 - 53c. Mission drift – moving ‘up market’, excluding those (the ‘poor’) who were the intended target population

- 53d. Short cuts to growth that include less staff training and less client training/education,
 - 53e. Increases in efficiency (higher client/staff ratio) at the cost of opportunities for client interaction and building the client relationship
 - 53f. Institutional claims to be pro-poor without evidence of a strategy that includes the poor beyond having ‘small ticket size’
 - 53g. More emphasis on profits used for very high executive pay or very high dividends to outside investors, instead of making less profit but offering better services or ploughing profits back into the institution to improve services to clients
 - 53h. Staff incentives orient staff to scale and growth over portfolio quality and superior client service
 - 53i.
48. The initiatives to support social value in microfinance aim to bring clients back to the centre, building a client-focused approach and including poor people as clients, whilst recognizing that financial sustainability is essential.

4.4 Excellence in Microfinance & Interlinking the Different Initiatives

49. This proposal for a Seal of Excellence in microfinance aims to set out the elements that can distinguish what microfinance as a sector aspires to - reflecting the social value and potential of microfinance, whilst recognizing that microfinance also aims to be financially sustainable.

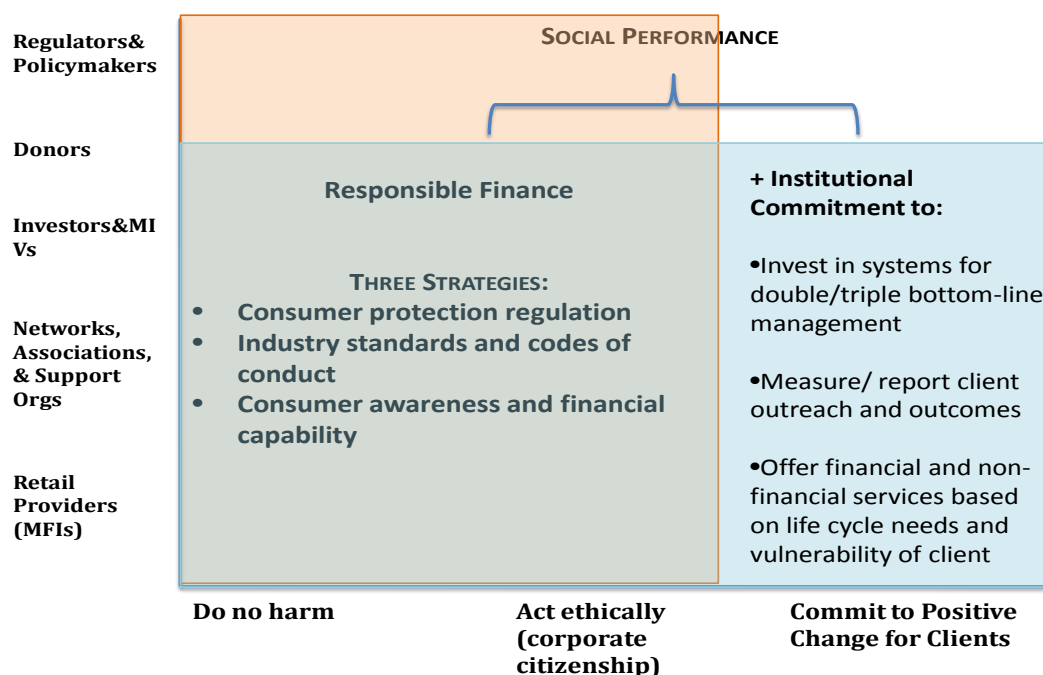
50. The overall goal of the proposed Seal is a microfinance sector that is responsible, genuinely inclusive (including the poor, the bottom 30-40% of the population) and contributing to positive change. Compliance with the Seal will support recognition of MFIs which combine financial sustainability and responsible practices with (in the first place) significant poverty outreach and secondly a strategic approach to poverty reduction and transformation.

51. The concept has evolved over the past few months, and will continue to evolve alongside the progress being made by other initiatives – the Smart campaign, the SPTF, and Principles for Investors in Inclusive Finance. An important practical issue is to consider how the different initiatives inter-relate so that they can complement each other to promote social value. At the level of MFIs, we map out the dimensions being covered and explored by the Smart campaign and the SPTF, and the dimensions proposed to be added through the Seal.
52. Reporting and certification of dimensions at MFI level will provide the basis for investors, and indirect investors, to apply principles for inclusive finance.

Client protection and social performance

53. The Smart campaign is planning to introduce certification of compliance with the six client protection principles; and the SPTF is setting standards for social performance.
54. The value framework is illustrated in the ‘spectrum’ of microfinance diagram (**Table 4**) that was presented at the June 2010 annual meeting of the SPTF. This framework suggests a minimum bar to ‘do no harm’ (interpreted in terms primarily of client protection), and higher level bars related to ‘acting ethically’ and committing to positive change for clients.

Table 4: SPTF – Spectrum of social performance in microfinance (June 2010)



55. The six principles of client protection have been well established by the Smart Campaign (**Table 5** below). Guidelines for best practice and for certification are under development, along with work to relate these not only to microcredit but to other financial services (savings, insurance etc). The ‘universal (minimum) standards for Social Performance’ are currently under draft and consultation, and are likely to be finalized as part of the next annual meeting of the SPTF in June 2011. The present draft adds another five dimensions of social performance, to the six principles of client protection as outlined in **Table 6**.

Table 5	Smart Campaign: Six principles of client protection
1	Avoidance of over-indebtedness
2	Transparent and responsible pricing
3	Appropriate collections practices
4	Ethical staff behavior
5	Mechanisms for redress of grievances
6	Privacy of client data

Table 6	SPTF: Proposed universal (minimum) standards for social performance, relate to
1	Responsible financial performance
2	Governance and staff commitment to social goals
3	Products and services that meet clients’ needs
4	Social responsibility to staff
5	Client monitoring (related to stated social goals) & Client protection (minimum elements)

56. The SPTF is drafting the indicators as the universal (minimum) elements of practice that double bottom line institutions should meet. They basically examine whether or not there is activity within the organization that backs up their social claims. “If you say you care about social goals, what is the evidence to show that that is reflected in your staff, governance, product/service offerings to clients, and systems to monitor/evaluate effects on clients?” The list of standards is intended as pointers to ways for MFIs to demonstrate a double bottom line. The list includes important reference to ‘responsible’ levels of profits, growth and remuneration to the CEO – as was suggested in earlier drafts of this concept note. The SPTF is coordinating with the Smart campaign on the minimum indicators for client protection, and MFIs will be encouraged to look at the entire guidelines developed by the Smart Campaign.

Poverty outreach and transformation

57. This seal of excellence links into both these initiatives as providing the base for responsible and double bottom line microfinance.
58. Looking back at the elements of social value outlined in Table 3, we can see that the indicators listed as i-vi are covered by the Smart campaign and the SPTF initiatives. What this seal aims to add is coverage of the remaining indicators. The Seal would add recognition of those MFIs who firstly, address issues of poverty outreach, who can demonstrate that financial inclusion specifically includes the poor, and, secondly, who put effective strategies in place to achieve transformational change in the lives of the poor.
59. The scope of the Seal would reflect recent research which has questioned old automatic assumptions about the poverty outreach and poverty reducing effects of microfinance. This proposal is for a set of practical indicators that support what microfinance can realistically achieve in poverty outreach and transformation.
60. When microfinance started – and of course up to the UN Year of MicroCredit - microfinance was more or less assumed to be serving poor people with small amounts of capital, and contributing directly to poverty reduction and other Millennium Development Goals – However, recent research in microfinance, particularly since 2005, has begun to modify the expectations from microfinance. Findings come both from quantitative impact assessments (including randomized controlled trials or RCTs) and from qualitative assessments, (such as financial diaries, recently documented in the publication *Portfolios of the Poor*²⁷). They emphasize the limitations of a focus on micro-credit per se, the benefits of savings accounts for the poor, the challenge of responding to the diverse needs of poor households who use a range of mechanisms to manage their fluctuating cash flows, and the importance of non-financial services in supporting the needs of poor households.
61. The issue of ‘what it would mean for microfinance to work: how, for whom, where or when’ was most clearly articulated in the article “In microfinance, clients must come first”.²⁸ The article challenged the assumption of ‘institution-centered’ microfinance: that building financial institutions that provide financial services to large numbers of people in and of itself enables poor clients to improve their businesses and in turn their socioeconomic standing. This seminal article advocates ‘client centered microfinance’ and a more realistic theory of change based on an understanding of the client situation, the factors that keep households in low income and poverty and therefore the range of services that are relevant to poverty reduction.
62. “To make microfinance work ... MFIs need to think clearly about how their practices will bring about the changes they seek [for clients]. This may mean making fewer microfinance loans and incurring more costs to support the loans they’ve already made. ...The challenge is finding ways to provide these additional services efficiently.” And effectively.
63. The pointers from the research underline the following issues (both challenges and opportunities) if microfinance is to serve the poor effectively:
 - 63a. Targeting less developed areas within countries (more remote rural areas, difficult urban slums)

²⁷ Collins, Morduch et al, *Portfolios of the Poor, How the World's Poor Live on \$2 a Day*, Princeton University Press, 2009.

²⁸ S Datar, M Epstein & K Yuthas, “In microfinance, clients must come first”, *Stanford Social Innovation Review*, Winter 2008. http://www.ssireview.org/articles/entry/in_microfinance_clients_must_come_first/

- 63b. providing more varied and flexible financial services to support the varied needs of poor and low income households (poverty means not only low income but fluctuating income); adapting financial services to different livelihoods and levels of income; the importance of savings for the poor;
 - 63c. recognizing that the needs of poor people are not only about capital for micro-enterprises but also relate to consumption smoothing, managing available finances, meeting family/social obligations, maintaining the health of family members, keeping children in school
 - 63d. to build successful enterprises, financial services per se are often not sufficient; MFIs need to look at other ways to support enterprises e.g. aggregating , linkages
 - 63e. looking beyond microcredit – and microfinance; microfinance provides an infrastructure in terms of access for poor and low-income people – if there is to be positive change in the lives of poor people; for example linking in with other non-financial services to support client capacities, especially when serving poor people;
 - 63f. indirect outreach to poor people through more wage employment in SMEs (financed through SME lending).
64. SME lending is (usually) a separate category of MFI. This is an important area of financial services supporting employment and market development, that target the (non-poor) owners of small businesses and benefit poor people indirectly through employment of (usually poorer) hired workers. This category of lending is outside the scope of this proposal at present, but a set of indicators can be developed that reflect the social value of SME lending related to employment (numbers employed), conditions of work; and Health, Safety and Environmental issues, since this is a sector where such issues are likely to be particularly relevant.
65. Another relevant and important dimension is the issue of governance structures that support member ownership. Cooperative structures can directly support intended values, through member participation in decision making and allocation of profits to member owners. Such participatory structures, if effective, can be both responsible and transformative. It will be interesting to include reference to effective member ownership – as well as representation of members in governance – perhaps as an additional star of the Seal.
66. The key dimensions proposed for the Seal are listed in **Table 7**.

Table 7: Proposed Dimensions to Assess Poverty outreach and Transformation

1. Outreach to less developed/poorer regions within a country
 2. Outreach to poor and excluded people (defined in local context)
 3. Client retention (client exit < 20%) [link to MIX formula]
 4. Gender diversity – in terms of opportunities for women as clients and as staff (at different levels of the institution)
-
5. Additional strategies to contribute to client development (e.g. enterprise/livelihoods, health, gender equity) through services that are directly provided or linked; with robust evidence of value of services to clients (i.e. not just existence of services, but evidence for significant access by clients (at least 20% linked to identified need), responsible provision and evidence of client feedback/response to the services.
-
- * Evidence of positive change occurring in the lives of clients over time – when/if this becomes practical to measure
 - * Effective structures for client ownership (where part of the institutional model)

67. In considering the selection of indicators for the Seal, there are two caveats in measuring social performance: these relate to the attraction of simplicity and of impact – and the ambiguities inherent in both.
68. Firstly, there is a general tendency to assume ‘social’ must be ‘simple’ and easy to implement if the industry will accept. Certainly, the ideal is always to be practical – to be as simple and easy to implement as possible. But the simplest/easiest indicators are not necessarily useful.

One example of this is average loan outstanding which has been quite widely used as a proxy for depth of outreach, when stated as a percentage of GNI per capita. Other proxies include % rural clients, % women clients. These are relatively straightforward indicators that all MFIs can routinely report on (though there are also issues with defining ‘rural’). They do say something interesting, but should not be used to measure poverty outreach. Where direct data for poverty level of clients at entry has been collected and compared with the proxies, the findings do not support a significant correlation. (In other words, small average loan size is not directly associated with substantial poverty outreach when directly measured.²⁹ Anyway, an indicator that reflects the entire portfolio at a moment in time is clearly limited when the question of interest is whether clients are improving over time. This can only be addressed by examining differences between clients at different loan cycles or time periods with an MFI, rather than an overall average.³⁰

With a practical tool now available to benchmark poverty levels (such as the PPI and the PAT), it is proposed that the Seal will include a direct measure of poverty levels of entering clients as evidence for depth of outreach.

69. The poverty analysis will have to be country specific, linked to the appropriate poverty line for each country, and reflect the poverty rate in each country (the poverty rate is the proportion of households in a country below a specified poverty line). An MFI serving the poor will not be expected only to be serving the poor (or “very poor”) but the % (and number) of new clients at entry below the poverty line should be assessed relative to the average appropriate poverty rate for the country (so not 100%, nor even 50%, but for example, at least 20-25% in a country such as Cambodia where the poverty rate is 26% or 30-35% in Ethiopia where the poverty rate is around 39%).³¹ The standard can be in terms of % of new clients at entry who are poor, as well as the number of poor clients at entry. The Seal will recognize those with deeper outreach than the country average poverty rate, or with outreach to significant numbers of poor people.
70. The MFI should have robust evidence for poverty outreach. By ‘robust’ evidence we mean direct evidence of client poverty level (not the proxy - and misleading - indicator based on average loan outstanding – discussed further below). The evidence for poverty outreach can be collected using the Progress out of Poverty Index, the Poverty Assessment Tool or other tools if they are well applied. The Grameen Foundation standards for use of the Progress out of Poverty Index (PPI) are also a useful reference for the Seal, and include tracking poverty level of clients over time, to assess change.

²⁹ Data for nine MFIs across the world is presented in the review report “Promoting the development of social ratings of Microfinance Institutions” by M-CRIL and Microfinanza Rating, 2009. <http://www.m-cril.com/BackEnd/ModulesFiles/Publication/TheDevelopmentOfSocialRating.pdf>

³⁰ Information on loan disbursed by cycle would be a more dynamic indicator

³¹ These are the rates below \$1.25 or the national poverty line, as reported in the Human Development Report, 2010. <http://hdrstats.undp.org/en/indicators/38906.html> Mapping of the relevant poverty lines and poverty rates by country has to be done systematically as part of applying this standard. This will help to define the context in a way that is relevant to assessing the depth of financial inclusion.

71. Secondly, the attraction of impact: ‘impact’ has become a ‘weasel word’ which sounds good but is often used ambiguously. Technically, ‘impact’ is the change that can be attributed to an intervention. Its general use, by investors and some rating agencies, has been expanded when they talk about ‘impact investment’ and ‘measuring impact’. In this wider sense it includes for example serving (poor) people with quality products, working in less developed areas and supporting the environment. In other words, activities that are likely to support positive change, but are not by themselves evidence for the end results – whether outcomes, or technically impact.
72. Increasingly there is pressure to give evidence for the end results. ISEAL is starting to look at measuring impact in terms of the end results, and has recently published a Code of Good Practice for Assessing the Impacts of Social and Environmental Standards Systems. The Code sets out the basic principles and methodologies well, and this could be included in a future phase. At present, it remains a difficult task in practice.
73. For this reason, and until such time as it may be worked out, the Seal will not expect technical measurement of the impact of microfinance on client lives. As and when methods are developed and applied to measure change – with a high positive correlation, even if not technically impact – positive contribution to transformation such as improvements in quality of life and reduction of poverty in all its dimensions, will be included in the Seal.
74. Currently, the proposed Seal aims to apply the combination of services (specifically linkages with non-financial services) that a theory of change indicates is most likely to support transformation – such as services related to enterprise development, access to medical care, education.³² To qualify for the Seal of Excellence in transformation, the MFI should include information on how many clients access such non-financial services, together with evidence of how client use and value the services provided.
75. A draft of indicators related to the proposed seal is given in [Annex 5](#). There will need to be a process to develop consensus on the indicators and the benchmarks for each indicator, including identifying which indicators should be country specific (likely for poverty outreach, and probably too for the gender indicators), with technical guidelines for assessing the standards as well as ensuring consistent definitions (for example for client exit/retention).
76. All the indicators match questions included in the SPS for reporting to the MIX. Largely, however (as noted in Table 3) they represent a new set of data for MFIs to collect, or a new way of analyzing available data. Systems for data collection and reporting by MFIs will need to be developed. We expect that for the proposed seal, the initial application will be on the first two dimensions related to poverty outreach (to poorer regions, to poor people). Client retention and gender related issues should also be included depending on the quality of data, the transformational effects represented by the fifth (and potentially the sixth) dimensions, may be considered as an additional seal. And indicators related to member ownership or client representation in governance may also be applied to be highlighted as a part of the Seal.

³² Refer – earlier footnote 26

77. **Financial performance** (with standard indicators of profitability, efficiency and portfolio quality), is also important to reflect the ‘double bottom line’. Discussions on this aspect have indicated that the analysis of financial performance need not be directly part of this proposed seal. Nevertheless, our suggestion is that this Seal should include reference to key agreed indicators (as in Box 3) and their reporting by an MFI, to capture sustainability issues. This would introduce a social/ethical perspective on financial indicators linking to the idea of optimal profitability and efficiency, rather than maximum. Guidelines for these need to be worked out, and are now part of the discussion of draft indicators for social performance being developed by the SPTF.

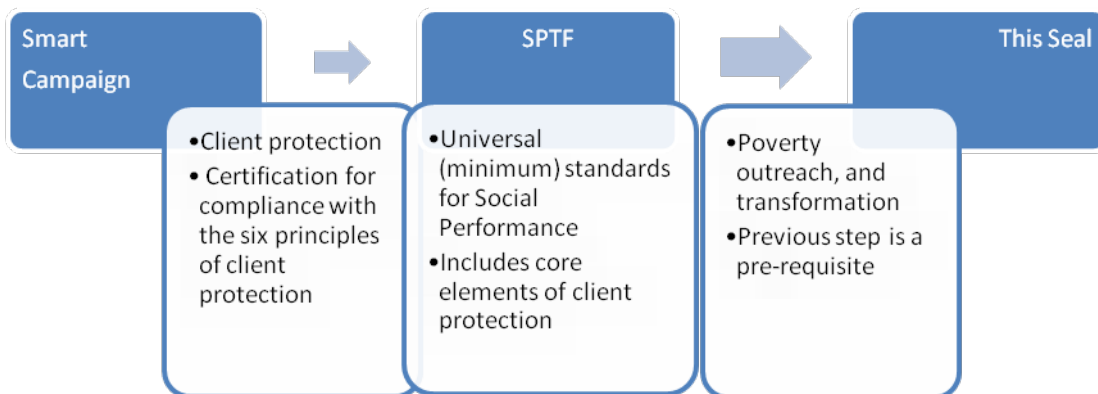
Box 3: Financial indicators

- 1 Two years’ audited financial statements publicly available
- 2 Return on Assets positive (or Operational Self Sufficiency > 90%) for two of three most recent years and within ‘reasonable’ levels (‘optimal’ rather than ‘maximum’)
- 3 APR in line with competition, depending on country context
- 4 Portfolio at Risk

78. This proposed Seal would not be an alternative standard, but one which would encompass the other standards. The various standards can be seen as a hierarchy - client protection, social performance/double bottom line commitment, poverty outreach, transformation. Financial sustainability, responsible practices and double bottom line commitment are a prerequisite for the Seal. In other words, a seal of excellence in poverty outreach and transformation would require responsible and ethical practices at all levels of the institution, as well as a financially sustainable bottom line. The Seal would be for those who aspire to do more – and is intended to serve as an inspiration, and recognition of what microfinance can achieve.

79. **Table 8** maps the sequence between the proposed standards.

Table 8: Levels of excellence in (social performance in) microfinance

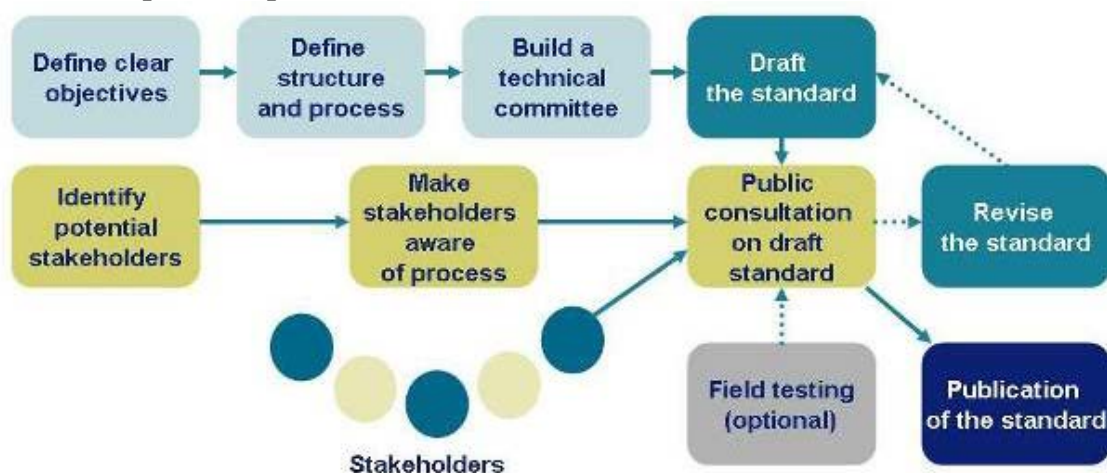


4.4 Supporting a Process of Consultation

80. The starting point in developing a seal of excellence is the decision on the content of the standards. The process of that decision-making will in turn affect future implementation. This note and the discussions being held around it are intended as a process of stakeholder consultation so as to invite feedback, encourage different initiatives to become operational and to generate a consensus on the overall content.

81. ISEAL: Ideally, voluntary standards are decided by consensus. *Consensus is generally defined as the lack of sustained opposition to a decision and need not imply unanimity.* However, consensus may be difficult to achieve if you have many stakeholders representing diverse interests. *Decisions on the content of the standard are probably the most important decisions in the standard and certification development process; an appropriate decision-making process is essential.*
82. The consultation process that is already underway broadly follows the steps recommended by ISEAL (shown in **Table 9**). An expanded interim sub-committee is now in place, and a technical sub-committee will be formed to review the indicators.

Table 9: Steps in the process to set standards [ISEAL]



5. Applying and Implementing Standards in Microfinance

83. Application of standards raises questions of building demand for the seal and the benefits of compliance. Implementation requires consideration of governance, reporting and verification. The issues involved are briefly reviewed in this section, including reference to the other initiatives for standards in microfinance (the Smart Campaign and the SPTF).

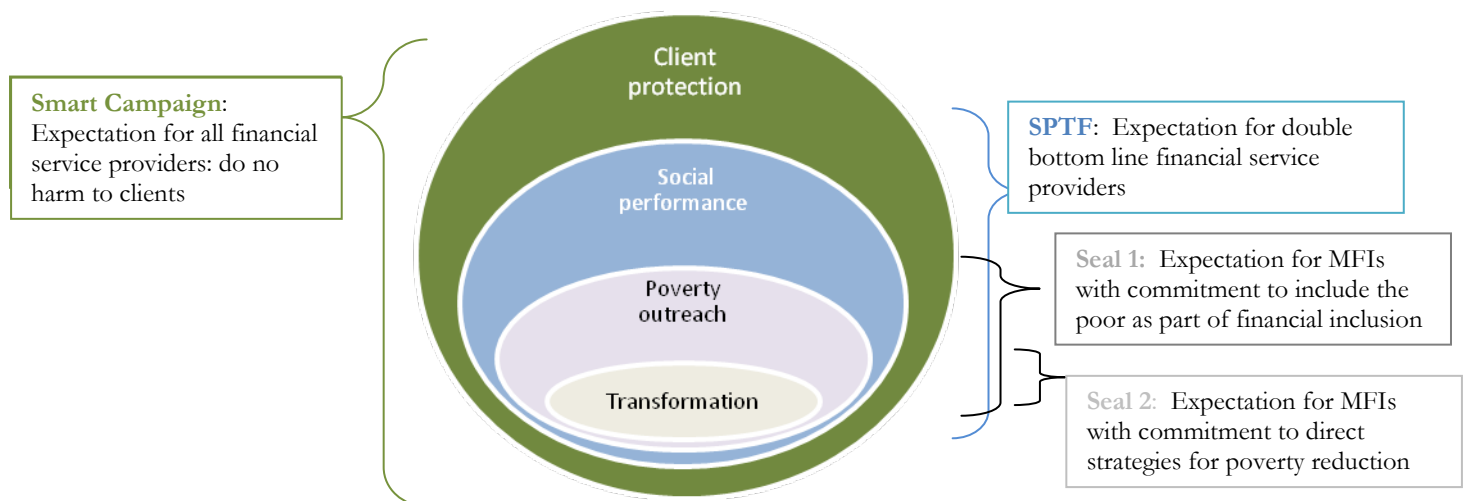
5.1 Building Demand for a Seal

84. The considerations include:
- 86a. Who will support application of the standards?
 - 86b. What will compliance with the standards lead to? What will be the motivation for MFIs?
 - 86c. What is the desired level of market uptake? A broad-based standard that applies to all MFIs? And/or opportunities for top-performing MFIs?
 - 86d. Is there a role for socially responsible investors to reference or support the standard?
 - 86e. Is there a role for regulators in promoting uptake – country level?
85. The answers to these questions are interlinked to the scope of the different initiatives for setting standards for social performance in microfinance. All are work in progress – with the Smart campaign the most established with a focus and consensus on client protection principles developed over the past two years. The SPTF has begun a process of consultation and consensus building around draft standards for ‘double bottom line commitment’ to be reviewed at the next annual meeting of the SPTF in June 2011. This initiative for a Seal adds

a focus on poverty outreach and strategies for transformation – and is at an early stage of proposing the indicators and developing a process for implementation.

86. This proposed Seal is structured to complement the current initiatives for standard setting, and recognizes the challenges to achieving excellence at each level. Client protection, or ‘do no harm’ which is the focus of the Smart Campaign, represents a basic standard for all financial service providers and is seen to be a pressing concern in the current context of microfinance. The SPTF standards for social performance add further elements of ethical/responsible finance and social performance management, which are expected to be applicable to financial service providers that have a double/triple bottom line. This seal adds the poverty focus and transformational potential – which is applicable to MFIs and other stakeholders that aim for financial inclusion that includes the poor, and have a mission that aims for poverty reduction. The different levels can be represented as in **Table 10**.

Table 10: Integrating standards in microfinance and expectation of demand



87. This framework represents a series of steps in certification, linking in and reinforcing existing moves towards certification (SPTF, Smart Campaign) and current reporting and verification systems (MIX, specialist ratings – see further below).
88. Why the Seal? The Seal represents a fundamental vision of microfinance: to serve the poor and to contribute to positive change. The Seal would recognize those MFIs that 1) include the poor; and 2) demonstrate a strategic approach to support their clients moving out of poverty. Acknowledging other certification initiatives in the sector, and depending on how they evolve, we expect that to achieve this Seal, MFIs would need to meet the universal principles of double bottom line finance to be established by the SPTF. The Seal itself would have two levels of recognition, the first for those MFIs that serve significant numbers of the poor and excluded (as defined in their country), and the second for those that can demonstrate a strategic approach to transformation (including movement out of poverty) for these clients. (A third piece of this – contribution to poverty reduction - may be added in future as systematic tools for measurement become available.)
89. The Seal in terms of poverty outreach would be directly relevant for all stakeholders who talk of financial inclusion. From a financial inclusion perspective, lack of poverty outreach represents a failure to serve the excluded. Poverty outreach is key if the microfinance sector is to be transparent and accountable for financial inclusion. As noted earlier, poverty outreach under the Seal will be defined specifically with reference to national poverty rates in

different countries. It would not require outreach only to the poor (defined as the lower 30-40% of the population), nor would it necessarily require special programmes targeting the ultra poor (the bottom 5-10% of a country's population) though such programmes do in themselves have value. The Seal would of course recognize poverty focus, but is also intended to have wide relevance to distinguish microfinance services that are indeed inclusive of poor populations.

90. The Seal in terms of transformation would be directly relevant to stakeholders (MFIs, networks, investors – direct and indirect) who include poverty reduction as part of their mission through a client-centred approach.³³ A strategic approach to poverty reduction and transformation is challenging for a financial service provider and the application of the transformational Seal is likely to be to smaller numbers of MFIs, at least initially.
91. Presently, we would expect market uptake of the Seal to be by a sub-set of MFIs who clear the SPTF standards. In the longer term, the aim would be for the Seal to become more broadly based across the microfinance sector, as it demonstrates practical achievement of poverty outreach and strategies for transformation.
92. Investors (Microfinance Investment Vehicles, MIVs) are already making the business case for client protection in terms of risk mitigation. Some are also beginning to make the longer term business case for ethical double bottom line standards. In other words there are signs of change in the investor calculus, mainly following and as a direct result of the difficulties in the microfinance sector in South India and elsewhere, as well as the questions around what microfinance is actually achieving in practice. There is no obvious business case for the Seal. Nevertheless it would have relevance for investors depending on how they 'sell' microfinance as an investment and how they define and measure 'social returns'. There is likely to be interest from a subset of indirect investors (those who invest in MIVs) and social investors or 'impact investors' who are looking for a social return which they define with reference to poverty outreach and poverty reduction.
93. Country level regulators are most directly concerned with issues of responsibility and governance. Poverty outreach and transformation is unlikely to be part of regulation, nevertheless it would be of interest since it represents the core of why microfinance is allowed to function in the first place.

5.2 Benefits of the Seal

94. The overall goal of the proposed Seal is a microfinance sector that is responsible, genuinely inclusive (including the poor, the bottom 30-40% of the population) and contributing to positive change. Compliance with the Seal will support recognition of MFIs which combine financial sustainability and responsible practices with (in the first place) significant poverty outreach and secondly a strategic approach to poverty reduction and transformation.
95. Compliance with the standards would have the following benefits for different stakeholders (**Table 11**).

³³ This will not apply to those with an institution centred approach, whose mission if it includes poverty reduction, assumes this as an automatic result of financial inclusion.

Table 11: What will be the benefits from compliance with the Seal?

Stakeholders	Benefits
Public, regulators, indirect social investors, direct social investors	<ul style="list-style-type: none"> ➤ More and better information on poverty outreach and approaches to poverty reduction ➤ Evidence of MFIs who are not only financially sustainable and responsible but are achieving significant poverty outreach, and strategically contributing to transformation
MFIs who achieve the Seal	<ul style="list-style-type: none"> ➤ Recognition of their focus and strategic approach ➤ Interest from social investors – and potentially, reductions in cost of funds, terms of investment
Poor people (in the bottom 40% of the population)	<ul style="list-style-type: none"> ➤ More access to appropriate and affordable financial services, and to linked services that contribute to improved quality of life

96. Having the guidelines and parameters clearly set out by the Seal would support a ‘brand’ which initially may involve a smaller proportion of MFIs – relative to those focusing on meeting standards of client protection and social performance. But as the examples begin to be documented and standards are better defined, this would provide a demonstration effect of what is possible, and sustainable.

5.3 Reporting and Verification Options

97. Current reporting systems

The following tables map existing information sources relevant to indicators for standards and a seal of excellence in microfinance. **Table 12** lists some of the main sources of reported data on financial and social performance of MFIs, self reported or verified, with the number of MFIs covered in 2010.

Table 12: Current and potential sources of data for the microfinance sector and coverage

Potential sources	Coverage (number of MFIs, 2010/annual)	Observations
MIX – financial/operational	>1,200 MFIs	Voluntary reporting, data may be verified against third-party sources (audits, ratings).
MIX – social performance standards (SPS)	~350+ MFIs	As above SPS indicators streamlined for 2011
Ratings financial	>350 MFIs	Verified data – scored
Ratings social	~100 MFIs	Verified data – different scope between rating agencies; scored
		In 2011 specialist rating agencies to pilot ‘double bottom line ratings = financial + ‘key’ social indicators
GIIRS/B-Lab	-	About to apply to (75) MFIs – different from specialist rating agencies since does not involve visit to MFI
Smart Campaign assessments	<10	Planning to increase: may link certification to rating agencies
Microfinance Transparency	MFIs in 8 countries, (+20 countries in 2011)	Detailed and streamlined reporting format and analysis
Grameen Foundation	-	Planning certification of application of the PPI

98. **Table 13** is an overview summary of scope and reliability of data for different parameters of performance, as covered by the different sources.

Table 13: Current sources of information for different parameters - scope and reliability

Parameter	Availability and reliability					
	MIX-Financial	MIX-social	Rating financial	Rating Social	Smart Campaign	MFTransparency
Financial sustainability	**		***			
Governance		*	*	**		
Client protection		*	*	***	***	
Responsible pricing	**		**	(***)		**
HR		*	*	***		
Product design		**	*	**(*)		
Depth of outreach		**		(***)		
Non-financial services		**		**(*)		
Gender analysis	*	**		(***)		
Environmental sustainability		*		**		

KEY: *available though not fully covered or not verified; **available, better covered

***available, fully covered and verified

() brackets refer to differences in methodology with variation in coverage

99. Microfinance reporting is beginning to involve a combination of financial and social indicators. This is envisaged by the MIX. And currently, there is an initiative involving the specialist microfinance rating agencies to enhance the scope of financial ratings by adding selected/core social values to the ‘main’ rating product.

100. **Monitoring compliance – and verification:** There are three options to monitor compliance with any proposed standards:

- a. Self reporting
- b. Third party verification
- c. Self reporting with third party verification

101. These are options that reflect a trade-off between cost and credibility. A very clear lesson from all standard setting initiatives is that verification of standards is required for credibility. Verification involves a cost. The first option of self reporting by the MFI without verification is lowest cost, but has least credibility. The second is higher cost, with highest credibility (depending on reputation and accreditation of the entity that carries out the verification).

102. The second option is ideal in terms of credibility, but the third is also possible, where self reporting by the MFI is verified, with or without on-site visits. For example, under the GIIRS approach, B-Lab reviews 50% of the data in reports for all companies, and does on-site checks (that take less than a day) for 10% of reports. Interestingly, so far they say the on-site checks do not result in substantial variation. Random audits on a specified proportion of self-reported data can encourage accuracy.

103. Off-site verification may be an option for but only where the reporting indicators and guidelines are very clear and unambiguous, there is adequate public reporting (including audited financial statements, annual reports, government compliance documents), there is no qualitative assessment involved, and other certification may also have been applied. This would not be recommended for first time application of a standard, but could be applicable for subsequent applications by an institution.
104. The Smart Campaign with its detailed guidelines for the six client protection principles is developing a system for Certification of compliance with the Client Protection Principles. The SPTF is considering its approach, probably building into the self reported data to the MIX SPS, with random audits. Standards for the Seal also are linked into indicators covered by the MIX. And the emerging system of Certification of use of the PPI by the Grameen Foundation will also be a resource for verification. Integration by all three initiatives – both for reporting and with rating – would help to reduce the load of participation for MFIs.
105. In addition to subject specific certification (Client protection, PPI application), rating provides an obvious resource for verification (on-site or off-site). Microfinance specialist raters have the expertise, both for financial sustainability assessment and social performance assessment. Others too are getting involved: the corporate raters and GIIRS are becoming interested in this field. This will help to widen the market opportunities for verification to support the seal worldwide. Note the rating agencies would be agents of verification. They would not have the authority to award the Certification – or the Seal.
106. A link with the specialist rating agencies will reinforce the current initiative to develop a ‘double bottom line rating’ which would cover financial performance and should ideally overlap the issues of responsible and ethical microfinance and social performance. Accordingly, such a rating can be used to verify the ‘universal standards of social performance’ being developed by the SPTF as well as covering the client protection principles. (Both the Smart Campaign and the SPTF are beginning to engage with the rating agencies to build consistency).
107. Where an MFI has information on its poverty outreach and transformational services, this data can be reported to the MIX and also be verified through the normal process of a social rating. In cases where MFIs do not have their own information, but nevertheless are interested to assess their poverty outreach, this information can be covered through a social rating that includes a client survey. Or through a separate client survey.
108. Accreditation of the specialist rating agencies would be covered by the existing ADA Rating Initiative. Involvement of others would require accreditation, and this would be undertaken as part of governance of this seal. .
109. The tenure of the seal: microfinance performance ratings are usually valid for one year, reflecting the changes that can take place particularly in financial performance; social ratings may be renewed every other year. For this seal, the tenure for poverty outreach (and transformation) could be for 2 or 3 years, in terms of certification/verification, but with annual self-reporting.
110. What would the seal consist of? MFIs may receive a certification or approval letter that can be shown as proof when required. In addition, the entity that awards the seal would list all approved organizations in the public domain (website, integrate announcements with ongoing conferences).

5.4 Costs

111. Costs relate to: MFI time in reporting as well as changes in operations and systems to achieve the standards; verification; and oversight and governance.
112. For the MFI, the expectation is that the reporting indicators would match those already in place for both financial and social performance reporting, as reported to the MIX for example, so there are no additional costs over and above the systems that are developed for full reporting. Similarly, when on-site verification is linked to a rating, the costs of verification would be covered as part of the cost of the rating. A rating report would be expected to cover the indicators necessary to comply with the seal, and can be the basis for certification by the entity that grants the seal.
113. Currently, ratings are paid by MFIs (or, in some cases, through MFIs, with funding support from the ADA Rating Initiative, though ADA funding is reducing). MFI payment does represent a conflict of interest issue. (If MFIs don't like the rating result, they try another rating agency). Raters are beginning to work on a subscription-based financing approach – with regular funding from some investors as the ultimate users. This could be a funding model that fits well with the idea of a Seal that is relevant to social investors, and would link in with the existing process of ratings. This also fits with the UNPRI Investor Principles.
114. The advantage of linking in to ratings would be to ensure credibility based on on-site visits with a holistic perspective which covers financial performance and responsible finance (particularly as is to be covered in the proposed 'double bottom line ratings'). At a lower cost, and as experience develops, there could be self-reporting (linked to GF certification) with a process of off-site verification that could be provided by a specialist rating agency (for a fee) or by trained staff of the Certifying entity.
115. The Certifying entity would require funding – for oversight of the raters or other agencies, collation of the data for certification, and ensuring transparent reporting.

5.5 Governance

116. Governance would involve the following responsibilities:
 - 114a. Specification of the seal and link with other standards
 - 114b. Review and evolve the standards covered by the seal
 - 114c. Oversight of implementation (next sub-section)
 - 114d. Final arbitration of any disputes
117. The current mechanism is the steering committee that has been expanded to include a wider range of stakeholders (see Appendix).
118. To some extent there may be overlap with the existing steering committees of the Smart Campaign, and the SPTF which consist of respected industry leaders representing different constituencies and models of microfinance. The focus of this seal is different however from both initiatives and therefore justifies a separate committee.

5.6 Implementation - Administration

119. Implementation would involve the following responsibilities:

- 119a. Develop reporting guidelines and formats (linking in with the MIX)
 - 119b. Coordination and accreditation of third parties - for verification
 - 119c. Coordination with related initiatives – SPTF, Smart Campaign, Grameen Foundation (PPI certification)
 - 119d. Award the Seal
 - 119e. Oversight (quality control, consistency of application) and transparency
 - 119f. Arbitration
 - 119g. funding of own activities
120. These tasks would require a specific entity to carry them out. It should be possible to house the Seal within an existing institution – rather than create a new one. The criteria for assigning implementation responsibilities would include alignment of interest, capacity and credibility within the microfinance sector. Different options considered so far are as follows:
- the SPTF secretariat, so as to combine the certifications within one entity.
 - the Microcredit Summit Campaign, given its specific orientation to poverty reduction linked to high visibility conferences, annual reports
 - CGAP, as a highly respected and neutral sector player, though it may not be willing to take on such a role.

5.7 Next Steps – For this Seal

121. A broad based consultation process to reach consensus on the indicators and develop benchmarks for each indicator:

- 121a. Continue rounds of consultation and feedback – on-going
 - 121b. Establish a Technical committee
 - 121c. Engage with the SPTF standards committee to provide inputs for the development of ‘universal standards’ of social performance
 - 121d. Review the terminology to be used for this Seal (or Seals)
 - 121e. Conduct *Alpha* tests drawing on social ratings completed in the past year by the specialist rating agencies, for selected MFIs in different global regions who are likely to qualify for the Seal.
122. Once a consensus is reached: implementation would involve:
- 122a. Decide on administration of the seal
 - 122b. Develop definitions and guidelines for each indicator
 - 122c. Review indicator values, including specific benchmarks by country, as appropriate
 - 122d. Engage with the MIX to ensure linkage with SPS reporting
 - 122e. Engage with the specialist rating agencies to review process of verification related to the indicators to be covered by the Seal
 - 122f. Define the certification process – involve the specialist rating agencies and others (B-Lab, corporate raters if interested)
 - 122g. If involving other agencies, develop accreditation and standards for accreditation
 - 122h. Pilot – *Beta* tests
 - 122i. Develop a business model.

Appendix

**Seal of Excellence for
Poverty Outreach and Transformation in Microfinance**

Interim Steering Committee

Susy Cheston, World Vision

Alex Counts (Steve Wright), Grameen Foundation

Sam Daley-Harris, Microcredit Summit Campaign

Susan Davis, BRAC USA

*Frank DeGiovanni, The Ford Foundation

*John de Wit, Small Enterprise Foundation

Chris Dunford, Freedom from Hunger

*Laura Foose, Social Performance Task Force

*David Gibbons, CASHPOR Financial and Technical Services

Tim Hassett (JD Bergeron), Kiva

*Antonique Koning, CGAP

Larry Reed, Consultant

*Ben Simmes, Oikocredit

*Carmen Velasco, Pro Mujer

Chuck Waterfield, MicroFinance Transparency

*Special Technical Advisor: Scott Gaul, MIX

**Joined the Interim Steering Committee in January 2011*