Policy Brief: Mystery shopping assessment of credit cost disclosures in Uganda

Innovations for Poverty Action

May 2020

Background

Between July and August 2019, Innovations for Poverty Action (IPA) conducted 1102 "mystery shopping" visits to Tier 1-4 lenders in Kampala, Mbarara and Gulu to document loan officer conduct related to credit product disclosure and pricing transparency.

For this exercise, a "mystery shopper" posed as a potential loan customer and visited lenders to document the loan application process. IPA recruited and trained shoppers fitting profiles reflecting typical Ugandan borrowers. These shoppers portrayed a range of personas and scenarios to measure how such differences would impact the products shoppers were offered and the information disclosed by loan officers. IPA also analyzed publicly available data on cost of credit published by the Bank of Uganda (BoU) in order to complement the mystery shopping data collected on interest and non-interest fees included in loan products.

The analysis was anchored around consumer protection obligations of lending set by the BoU and the Uganda Microfinance Regulatory Authority (UMRA). The 2011 BoU Financial Consumer Protection Guidelines oblige Tier 1 to 3 financial institutions to disclose the total cost of credit, provide consumers with a Key Facts Document (KfD) prior to taking a loan and the right to a 10-day cooling off period for loans of UGX 3,000,000 (about US$810) or more and of a duration of one year or longer. UMRA has similarly established an important series of consumer protection measures, including requirements to give the borrower a copy of the loan agreement, to display interest rates charges at all times at a conspicuous place and to disclose key product terms such as interest and other fees in the money lending contract.

Key policy implications of mystery shopping findings

The mystery shopping survey identified several areas where policy reforms could be considered to improve consumer protection standards and practices for Tier 1 – 4 lenders in Uganda.

1 Improve consistency in disclosure of interest, total cost of credit and other costs to loan customers

Most shoppers will only learn of cost of credit if they explicitly request this information.

Percentage informed about the interest rates:

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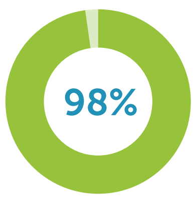
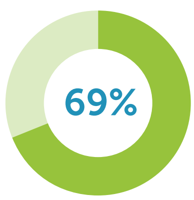


INEXPERIENCED



50%

of shoppers were provided the total cost of credit, despite this being a regulatory requirement

Many sales staff were not forthcoming on interest, fees and the total cost of credit to shoppers seeking loan products. Information on interest rates was provided to 98% of experienced shoppers, yet to only 69% of inexperienced shoppers. Furthermore, only 50% of shoppers were provided the total cost of credit, despite this being a regulatory requirement and despite 83% of loan officers interviewed by the research team being familiar with the concept of total cost of credit, meaning lack of knowledge is not an excuse for non-disclosure. Information on total cost of credit was only provided spontaneously—that is without the shopper prompting—in 36% of the cases where total cost of credit was mentioned. This means that most shoppers will only learn of cost of credit if they explicitly know to request this information.

The mystery shopping survey also revealed that women were less likely to be provided with information without prompting than men. Only 29% of women shoppers were spontaneously provided with the total cost of credit, compared to 41% of men, while 28% of women were spontaneously given information about interest rates, compared to 59% of men. Even more concerning, women were less likely to receive explanations about how these costs were calculated than men. Women were 33 percentage points less likely to receive an explanation of how interest was calculated, and 43 percentage points less likely to receive an explanation of the total cost of credit.

Regarding non-interest fees, an analysis of bank charges published by the BoU reveals that the average number of non-interest charges on loans have increased over time from just over 2 additional charges per loan in 2005 to more than 4 per loan in 2019. Yet in spite of their increasing prevalence in loan products, the survey demonstrated that these fees are not well disclosed to those seeking loans. Shoppers portraying the "experienced" profile—having some knowledge of loan products and interest in shopping around—were instructed to explicitly ask if there were other fees related to the loan. "Inexperienced" profile shoppers were instructed not to prompt for additional information, and would have to rely on the sales staff to voluntarily mention fees. As a result, experienced shoppers were told about more fees than the inexperienced shoppers, with an average of 3.58 non-interest fees disclosed to experienced profiles compared to 2.97 for inexperienced profiles. This speaks to the fact that shoppers in Uganda unfortunately cannot rely on sales staff to document all fees on loan products properly, and generally only receive this information when they know to ask for it. The most frequently mentioned fees during shopping visits were insurance (59%) and application fees (60%).

The findings on disclosure of interest, total cost of credit and fees point to deficiencies in the current disclosure of product information during loan shopping inquiries. This necessitates improvements in disclosure of terms by sales staff. This could be accomplished through a range of policy measures, such as:

- Mandatory trainings on responsible lending and product disclosure for staff.
- A checklist of loan information that staff would use for every initial visit of a potential borrower, to be filled out alongside the shopper, signed and handed to them at the end of the visit.
- Mystery shopping by providers of their branches to ensure compliance, which can be used to tighten staff compliance and could be reported out to the regulators.
- Adopting evidence-based approaches to improve knowledge and provision of just-in-time information to consumers, such as product comparison tools or other neutral financial advice interventions, to improve the capacity of borrowers to ask the right questions and effectively evaluate options. These efforts should incorporate the specific preferences and needs of women.

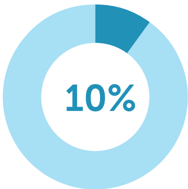
2 Expand access to Key Facts Document during loan visits and outside the branch

While all shoppers were instructed to ask for a payment plan, and experienced shoppers were also instructed to ask for a Key Facts Document using the term "summary document" to avoid suspicion, a payment plan was shown in only one of every ten visits, and a Key Facts Document was shown in only 5.9% of loan visits.

Shoppers were also instructed to collect any printed materials they could find in the branch. Yet in less than 40% of the institutions from which leaflets were collected did these materials state an interest rate, and very few institutions' printed materials stated the total cost of credit. This is despite the BoU's Financial Consumer Protection Guidelines requiring that if a printed material shows the interest rate, it should also show the total cost of credit, and the total cost of credit should be displayed more prominently than the interest rate.

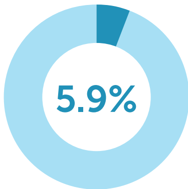
To improve the impact of Key Facts Documents, BoU can use a scientific approach to test existing documents with customers to evaluate the clarity and usefulness of information, using lab-in-the-field and rapid-fire testing techniques to inform the most effective design. Regulations could require lending institutions to make key facts documents available on first visits by loan applicants and allow loan applicants to take a hardcopy home to facilitate comparison shopping. Finally, the regulators could adopt the requirement to pre-approve standard formats for Key Facts Documents and other similar materials, to ensure proper disclosure of key information and compliance with current rules regarding disclosure of loan costs.

Payment Plan was shown in only



of loan visits

Key Facts Document was shown in only



of loan visits

40%

of the institutions did not reflect their interest rates in promotional materials despite this being a requirement

To improve the impact of Key Fact Documents, BoU can:

- Test and evaluate
- Regulate
- Provide pre-approved standard format

3 Expand coverage and awareness of cooling-off periods for loan products

To complement improvements in written disclosure of product information during initial visits, there could be a minimum number of days within which the Key Facts Document remains a valid loan offer, so the consumer can use Key Facts Documents from different providers to compare and shop around. This would align with the cooling off period currently allowed for larger value loans. This is important because the survey identified issues with disclosure of product terms across loan values and provider types, so the current restriction on cooling off periods may discriminate against lower-income consumers and others who seek smaller loan values.

By introducing a minimum number of days where Key Fact Documents remain a valid loan offer:

Borrowers can compare and shop around to compare terms across providers.

Regulators can reduce discrimination against lower-income consumers and others who seek smaller loan values.

4 Utilize mystery shopping as part of an expanded consumer protection monitoring agenda

A “mystery shopping” survey could be used in an ongoing basis to monitor and enforce proper disclosure of terms for loans. Mystery shopping could also be expanded to assess conduct in other sales scenarios, such as opening of current or savings accounts. Attention could also be given to issues such as the language version of the Key Facts Document given to shoppers, which was not covered in this study. The BoU has made Key Facts Documents available in 7 languages but it is unclear whether the local language version, or the English version (which could hamper understanding) is given to prospective customers.

5 Expand the use of pricing information to monitor interest and non-interest fees in the market

The mystery shopping data was analyzed alongside official pricing data reported by Tier 1 -3 providers to the BoU. However, cross-checking and comparing this data was challenged by the consistency and coverage of the pricing data reported. In some cases, this information was missing, and in others the information was reported in a range, not a fixed value. Finally, not all lenders across Tier 1-4 submitted information. To remedy this, four approaches could be considered:

- A new product-level template for reporting of fees that will provide more standardized reporting of fees by providers, including Tier 4 lenders.
- Introduce standardized names and definitions for fees in order to improve transparency and facilitate comparisons.
- Consider additional methods to monitor pricing such as analysis of provider administrative data to measure all fees linked to accounts in Uganda and the actual charges assessed, which can be matched with KYC information to segment treatment by borrower demographics.
- Connect pricing information to consumer complaints data to identify trends and spot problems more quickly for corrective action.

6 Harmonize BoU and UMRA policy approaches where possible

BoU and UMRA consumer protection policies cover similar principles and obligations for lenders and their customers. These rules currently reflect similar principles, but making them directly match would ensure equal protection for all borrowers and increased clarity on their rights across institution types. For example, BoU and UMRA could collaborate to test and develop a single set of Key Facts Document formats for loans across Tiers 1-4.

Harmonization could include not just consumer protection rules, but could also make information collected through the quarterly lending survey uniform across Tiers 1-4. This would help in the design of comparison tools consumers could use on costs of loans at different banks.

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