



# KEY FACTS STATEMENTS FOR CREDIT: DO THEY WORK? THE EXPERIENCE OF ARMENIA



# CONTENTS

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ABSTRACT	3
1 EXECUTIVE SUMMARY	4
2 IMPLEMENTING A KEY FACTS STATEMENT	5
3 IMPLEMENTING A KEY FACTS STATEMENT FOR CREDIT IN ARMENIA	6
3.1 Good Practices	6
3.2 The KFS Effectiveness Assessment Study: Methodology	6
3.3 Findings and results	7
4 POLICY RECOMMENDATIONS	8
ABBREVIATIONS AND REFERENCES	9
APPENDIX: THE CENTRAL BANK OF ARMENIA'S KEY FACTS STATEMENT FOR CREDIT	10

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## ABSTRACT

Rapidly developing digital credit products and aggressive credit sales have impelled financial authorities to help financial consumers make more informed and effective credit decisions. One of the tools many countries are using is Key Facts Statements (KFSs), which aim to improve financial decisions in the pre-contract stage of the credit process and to promote healthy competition among financial institutions.

### **However, many authorities want to know: do Key Facts Statements work?**

This research shows that a KFS can have a significant positive effect on consumer credit choice and comprehension if the timing, content, design and delivery methods are appropriate and effective.

The study combines qualitative analyses from three experiments in Armenia and presents insights from international experience. The findings show both positive and negative effects of implementing credit KFSs and policy recommendations are made based on these findings.

# 1. EXECUTIVE SUMMARY

Poor financial knowledge can lead to poor credit choices and encourage unhealthy competition between financial institutions. This is often exacerbated by aggressive credit sales and irresponsible lending. With new technologies, financial institutions are reaching more consumers with credit advertising than ever before, and as consumer credit sales rise, there is a high risk that many financial institutions will concentrate on credit volumes rather than quality. Financial authorities are therefore seeking tools that empower consumers to understand and compare credit products, and select ones that best meet their financial needs.

One of the challenges credit consumers face is navigating the ways in which financial institutions disclose credit information. Financial authorities should ensure that communication between financial institutions and consumers is never misleading,<sup>1</sup> as misinformation can lead to over-indebtedness and seriously undermine the stability of financial systems. This misinformation largely occurs in the pre-contractual stage, and financial authorities are actively seeking tools that balance the power dynamic between consumers and financial institutions.

One of the tools that financial authorities and international organizations (e.g. World Bank, OECD) consider is a Key Facts Statement (KFS) – a standardized form that includes all fees, charges and other important credit information that consumers need to make financial decisions. With a KFS, financial authorities can help consumers understand the total cost they would incur with a certain credit product and compare it with other offers.

However, at the international level, financial authorities have voiced concerns about the effectiveness of KFSs. Assessing this is an important regional issue that has been raised by ECAP members. Some countries (Kazakhstan, Uzbekistan and Tajikistan) are in the process of introducing KFS and want to know how and when to introduce it. Meanwhile, Russia already has standardized forms similar to KFSs, but their impact has not yet been assessed.

In 2017, the Central Bank of Armenia (CBA) conducted an in-depth qualitative study to evaluate the effectiveness of a KFS it had implemented three years earlier. In 2014, the CBA introduced a KFS to support informed decision making, product comparison and shopping around. However, when it was being implemented there were ongoing indications, via complaints and other information sources, that the KFS might not be working as intended.

Thus, the CBA conducted an effectiveness assessment study to understand the situation and what was causing the KFS to have such a weak impact. The study includes a multi-component qualitative analyses conducted through focus group discussions (FGDs) with consumers, in-depth interviews (IDIs) with financial institution representatives and mystery shopping.

In short, the study found that a KFS is an important comprehension tool, but only if the timing, content, design and delivery method are right. A KFS does not work as a comparison and shopping tool when there is a “collection cost” in terms of time and resources.

Consumers prefer gathering information quickly and online. Based on findings from CBA, we recommend that financial authorities ensure that when financial institutions provide a KFS that it is a learning moment for consumers. Financial authorities should also ensure that the way in which KFSs are provided obligates consumers to read the terms of the KFS and make a decision in a comfortable atmosphere. A KFS should also be designed to be user friendly and easily digestible.

This case study captures the results of the KFS effectiveness assessment study in Armenia as well as global insights on KFSs to contribute to the dialogue on the proper implementation of KFS policy. Insights from the pre-contractual information disclosure practices of several CIS countries (Russia, Kazakhstan, Uzbekistan and Tajikistan) are also considered.

The case study is organized as follows:

- > **Section 2** provides background information and an overview of KFS implementation practices around the world;
- > **Section 3** examines the KFS implementation process in Armenia; and Section 4 presents policy recommendations.

1 World Bank Group. 2017. Good Practices for Financial Consumer Protection, 2017 Edition.

## 2. IMPLEMENTING A KEY FACTS STATEMENT

When financial authorities implement a KFS, it is important that they pay attention to its core objectives: to improve the comprehension and ability of consumers to compare and choose appropriate financial products (World Bank Group, 2018).

Timing, content and delivery are all essential components of implementing a KFS, and design and format are crucial. A KFS usually includes only the most critical information about a credit product in a standardized form that includes boxes, bold type and graphics. Simple language and verbal communication with consumers are also important (World Bank Group, 2018).

Standardizing how information is delivered is important as it allows consumers to easily understand and compare products from different financial institutions. Specific disclosure mechanisms, including possible warnings, are essential when providing information on complex products (OECD, 2011).

There is rich information on the global use of KFSs. Many countries have adopted principles on the provision of key pre-contractual information before a consumer signs a contract. Twenty-seven EU countries, as well as the US, Australia, Peru, Chile, Mexico, Philippines, Kosovo, Serbia, Bosnia and Herzegovina, and several other countries, all use KFSs and deliver information about financial products in a variety of ways.

In many European countries, financial institutions are required to complete the Standard European Consumer Credit Information (SECCI) sheet before signing credit agreements (European Parliament, 2008). The European Associations of Consumers and the European Credit Sector Associations (ECSAs) also developed the European Standardized Information Sheet (ESIS), which provides a recommended format for pre-contractual information on home loans.

In the US, the Truth in Lending Act includes models for the “Schumer Box”, a summary of credit card costs in a standardized leaflet very similar to a KFS. There are also approximations of KFSs in Peru (Hoja Resumen) and Ghana (Pre-Agreement Truth in Lending Disclosure Statement).

In CIS countries, the experience is diverse. Some countries are in the early stages of implementing KFS in their financial systems (e.g. Uzbekistan and Tajikistan). In Russia, there are several disclosure requirements for consumer credit at the pre-contractual stage. While there is no standardized form for financial institutions to disclose general credit information to consumers, terms and conditions for individual credit products are presented in table format (established by an ordinance of the Bank of Russia) that is very similar to a KFS.

Armenia has been implementing a KFS for credit since 2014.

When implementing a KFS, policymakers have certain expectations. First, information disclosure should correct the power imbalance between credit consumers and financial institutions, and it should also deliver the benefits of competition. (Campbell 2011) (Loewenstein, 2014). Interestingly, a multi-country World Bank study in Mexico and Peru showed that simplified credit KFSs significantly improve consumer choice compared to other marketing materials provided by financial institutions (Xavier, 2017). However, consumer testing has some disadvantages because an artificial environment may not accurately reflect real-life effects. Complex interests and a lack of consumer focus can also weaken the significant impacts that may appear in a lab (Bhargava, 2015). Moreover, some consumer studies show that financial behavior exhibited during experiments may contradict what they think is right (Adams, 2016).

## 3. IMPLEMENTING A KEY FACTS STATEMENT FOR CREDIT IN ARMENIA

### 3.1 GOOD PRACTICES

In 2012, the World Bank conducted a survey of the Armenian financial system to assess levels of consumer protection and financial literacy. In line with several policy suggestions, it recommended that the CBA implement a standardized KFS for consumer loans based on good practices.

In particular, the format, content and delivery method should not be misleading, the key terms and conditions of the credit contract should be provided before signing, and provided at the right time to ensure consumers understand credit products and have the opportunity to compare it with other offers.

The CBA tailored the World Bank recommendations to Armenia's reality, and in 2014 introduced the KFS for consumer credit, which aimed to meet consumer needs and expectations. Before implementing it, the CBA conducted focus group discussions (FGDs) to evaluate consumers' general attitudes about KFSs, and to gather opinions on the proposed design, structure, content and effectiveness. FGDs were conducted with participants who had credit experience.

The CBA also investigated the views of banks and credit organizations and found that financial institutions had completely different views about KFS design, content and the time required to deliver it to customers. Financial institutions usually seek to sell as many products as possible at once, but KFSs make this difficult. Time spent on minimum required verbal communication and cooling-off periods incur high expenses for financial services providers, and there is a significant risk that financial institutions may not be motivated to implement KFSs effectively.

Based on the findings and recommendations of the majority of participants and stakeholders (consumers, banks, credit organizations, private consulting companies and NGOs), the CBA launched two types of KFS: a **general KFS** and an **individual KFS** (see Appendix) with a standard format and design for all financial institutions.

#### GENERAL KFSs

include general terms of consumer credit (e.g. range of interest rates and APRCs, range of fees). They are required to always be available on financial institutions' websites and provided to consumers as soon as they ask.

#### INDIVIDUAL KFSs

are tailored terms and conditions required to be provided to consumers on credit applications before they sign credit contracts. Individual KFSs include terms and conditions of a particular loan agreement. General KFSs do not require financial institutions to provide credit, while Individual KFSs are binding.

Both types of KFSs were intended to have a positive effect on consumer decision making and serve as a comparison tool for credit products. However, some complaints began arising about the effectiveness of the KFSs, and in 2017, two years after being implemented in Armenia, the CBA conducted a KFS effectiveness assessment study.

Following the study, the CBA amended the regulation to exclude General KFSs. Instead, it regulated the disclosure of key terms of credit, which had to appear in the first pages of booklets describing credit products. The CBA also amended the design of Individual KFSs based on the findings of the study.

### 3.2 THE KFS EFFECTIVENESS ASSESSMENT STUDY: METHODOLOGY

The KFS effectiveness assessment study employed three methods: 1) FGDs with consumers; 2) in-depth interviews (IDIs) with experts at financial institutions; and 3) mystery shopping.

#### FIRST, FGDs WERE CONDUCTED WITH CREDIT

**CONSUMERS** – a random sample of individuals of a certain age, sex, education and two-year credit history. Forty-four consumers in low- to middle-income brackets were invited from cities and rural areas to participate. Fifty percent of FGD members had solid credit histories and the others had poor credit histories. An equal number of males and females were equally distributed across six FGDs.

Three discussion sessions were held. The first session aimed to determine participants' level of financial education and expected consumer behavior through credit history checks and the amount of attention they had paid to KFS and credit contracts. In the second discussion session, participants shared their experiences obtaining credit in the last two years.

The third session consolidated the results of the first two. Participants were then divided into groups to share their credit documents and discuss whether their real-life experience with KFS differed from the scenarios they had discussed earlier.

**SECOND, IN-DEPTH INTERVIEWS (IDIS)** were conducted with front office credit experts from banks and credit organizations to detect supply-side problems. The study controlled for possible conflicts of interest with the financial institution representatives.

Twenty-five experts from 20 financial institutions were invited to be interviewed. The interviews revealed how prepared experts were in delivering KFSs to customers and the main factors that made KFSs less effective. Experts were also to make suggestions to improve the existing KFS regulation.

**THIRD, A MYSTERY SHOPPING EXPERIMENT** was conducted. The aim of the exercise was to detect practical problems in delivering KFSs. Mystery shoppers made 47 visits to seven banks and eight credit organizations in cities and rural areas of Armenia.

The mystery shoppers visited financial institutions as potential customers, checking the availability of general KFSs at financial institutions and walking through the entire credit application process. They then took individual KFSs and signed credit contracts.

Immediately afterward, the mystery shoppers completed a questionnaire and sent the results to the study's process coordinators. The coordinators analyzed the information and checked whether the financial institutions had complied with existing laws and regulations.

### 3.3 FINDINGS AND RESULTS

#### 3.3.1 FGDs WITH CREDIT CUSTOMERS

- a) Awareness of Key Facts Statements was low. Participants' knowledge of both general and individual KFSs was very low before the FGD. Only 25.6 percent of participants were aware of the existence of credit KFSs, and in 37.8 percent of cases there was no individual KFS in the participants' credit documents. It is essential to note that none of the participants were aware of general KFSs. Everyone in the focus groups stated that they did not remember whether they had signed an individual KFS or not. After participants reviewed their credit documents, many of them found an individual KFS with their credit contracts and other credit documents.
- b) The FGDs showed that consumers reacted positively to KFSs as a tool for getting information quickly and effectively. Participants indicated that they liked the information included in the KFS, but that minor

changes in design and formatting would be "a good thing to see".

- c) Credit products were chosen based on the monthly payment amount rather than the overall cost of credit. The FGDs revealed that participants were primarily interested in monthly payments and less interested in percentages (including APRC) of credit. Participants were inclined to choose credit products that compared monthly payments rather than APRCs.
- d) Participants made better credit choices when they used a KFS. In a laboratory setting, participants were asked questions about general and individual KFSs. Following these discussions, participants were given different scenarios and asked to choose the most beneficial credit product. This session showed that the presence of a KFS significantly improved customer choices.
- e) Most participants will read a KFS if it is delivered at the right time. The FGDs revealed that most participants did not notice the KFS in their stack of credit documents. One of the reasons was bad timing; many financial institutions provided a KFS after contracts were already signed even though they should have been provided long before that stage. Long queues and peer pressure, as well as pressure from credit officers, were other barriers preventing customers from reading the KFS. Therefore, when purchasing a credit product in person at a financial institution, consumers are motivated to sign credit agreements as quickly as possible. In contrast, when consumers receive a KFS digitally prior to signing a contract they have more time, privacy and read it more carefully.
- f) Consumers did not notice KFSs because of the way financial institutions provided it. FGDs showed that financial institutions were not providing KFSs appropriately, as none of the participants remembered seeing one attached to their credit contract. The KFS was included with the other documents rather than being separated as an important item.
- g) Consumers are inclined to focus on numbers. Scenario testing showed that participants' intentions contradicted their actions; participants did not pay attention to all the key terms and conditions of credit described in KFSs, just the numerical ones.
- h) Terms and conditions are most comprehensive when KFSs are accompanied by a verbal explanation. The scenario test showed that participants' decision-making was more efficient if financial institutions provided a KFS with properly disclosed terms and conditions.
- i) KFSs are not an effective tool for comparing credit products and shopping around. FGDs showed that general KFSs are not working as a comparison tool, and the cost (i.e. time) of collecting KFSs from different financial institutions is very high.

- j) KFSs work effectively when they are delivered in a way that obligates a customer to read it before signing a credit contract. FGDs showed that participants who had experience with online credit applications were well aware of their credit KFS and the terms and conditions. Consumers who received a KFS electronically were required to read it and make notes before they could proceed to the contract-signing step.

### 3.3.2 IN-DEPTH INTERVIEWS WITH EXPERTS

This section summarizes the comments and suggestions made by experts from financial institutions in in-depth interviews (IDIs).

- a) Consumers tend to purchase credit products as quickly as possible. They usually do not become acquainted with KFSs and credit contracts.
- b) Consumers are usually interested in the amount they must pay every month rather than the total cost of the credit product or APR.
- c) General KFSs do not affect a consumer's decision-making process. Customers usually do not ask for a general KFS and do not read it if provided.
- d) Consumers primarily pay attention to colorful booklets, fliers, brochures and other advertisements for credit information. They usually do not pay much attention to standardized forms like general KFSs as a source of credit information.
- e) Financial institutions' technological solutions allow a KFS and a contract to be printed simultaneously.

### 3.3.3 MYSTERY SHOPPING

The mystery shopping experiment yielded the following results:

- a) Credit officers provide certain pieces of credit information verbally rather than in a KFS. During the mystery shopping, verbal communication was only a minor complement to the provision of the KFS.
- b) In 57.5 percent of cases, credit officers did not provide individual KFSs to the mystery shoppers.
- c) In the vast majority of cases, credit officers filled in all the fields designed for consumers to complete.
- d) The manner and haste with which KFSs are delivered create an atmosphere of rush and doubt. That is why, when signing a credit agreement, it was difficult to ask questions about consumer rights and dispute resolution mechanisms.
- e) In many cases, credit officers provided individual KFSs and credit contracts in one package to sign. In most cases, credit officers refused to provide individual KFSs as separate documents.

## 4. POLICY RECOMMENDATIONS

Financial authorities should focus on introducing KFSs as a tool for consumers to make more informed decisions about credit and significantly improve consumer choice. However, as a comparison and shopping tool, financial authorities should focus on online solutions instead.

When implementing a KFS, policymakers should ensure that the timing, design, content and delivery methods are effective. The following policy recommendations can help with:

- 1) **Timing:** Providing a KFS should be a learning opportunity for customers. The KFS should be provided long before they agree to the terms of a credit agreement. Policymakers should ensure that becoming acquainted with a KFS is a compulsory part of the process and must be completed before a consumer can move to the next stage of signing a credit document. Moreover, sufficient time should be allowed for customers to become acquainted with the KFS and understand the information.
- 2) **Content:** A KFS should include the key terms and conditions of a credit product. Monthly payments are an important piece of information to include, but numbers should not dominate text. Instead, numerical information should be presented simply and separately from written explanations.
- 3) **Design:** The design of a KFS should be simple, colorful and user friendly. It should not contain too much information. KFSs should have a standardized layout across all financial institutions.
- 4) **Delivery Method:** A KFS should be provided as a separate document that obligates consumers to read and understand every part of it. Consumers should receive enough verbal or written information about the terms of a KFS to make an informed decision about whether to accept or reject a credit proposal.



Our research failed to show that general KFSs have a significant positive effect on consumer credit choices and comprehension. Instead, our findings showed that general KFSs usually do not have a significant effect on consumers' decision-making processes, even if standardized forms are provided properly.

We also conclude that the implementation of a KFS requires effective supervisory tools (e.g. mystery shopping). Our findings show that financial institutions often prefer to spend time on aggressive sales pitches rather than disclosing credit information. There is a high risk that financial institutions will not provide a KFS to consumers unless proper controls are in place.

## ABBREVIATIONS

<b>AFI</b>	Alliance for Financial Inclusion
<b>KFS</b>	Key Facts Statement
<b>CBA</b>	Central Bank of Armenia
<b>CIS</b>	Commonwealth of Independent States
<b>ECAPI</b>	Eastern Europe and Central Asia Regional Policy Initiative
<b>FGD</b>	Focus Group Discussion
<b>IDI</b>	In-Depth Interviews
<b>APR</b>	Annual Percentage Rate

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# APPENDIX: THE CENTRAL BANK OF ARMENIA'S KEY FACTS STATEMENT FOR CREDIT

## Consumer Credit

Key Fact Statements № \_\_\_\_\_

Credit provider is obliged to give it to you

Expiry date \_\_\_\_\_

Read, think, then sign (Phone number \_\_\_\_\_) Creditor \_\_\_\_\_

### 1. Main terms

1.1 Title \_\_\_\_\_

1.2 Amount \_\_\_\_\_

1.3 Currency \_\_\_\_\_

1.4 Duration \_\_\_\_\_

1.5 Nominal percentage rate \_\_\_\_\_

1.6 APRC  
*Includes all the fees and charges*

### 2. Other terms

2.1 Payment frequency

Credit amount \_\_\_\_\_

Interest \_\_\_\_\_

Other Frequency \_\_\_\_\_

2.2 Prepayment \_\_\_\_\_

### 3. Your rights

3.1 Early repayment without fees:

3.2 Repayment schedule acquisition:

3.3 Communication method:

**\* The contract can be different from this KFS only in part of APRC due to the difference between the exchange rates and repayment schedule.**

### 4. Repayments

4.1 1st repayment date and amount \_\_\_\_\_

4.2 Total amount \_\_\_\_\_  
*from which*

4.3 Credit amount \_\_\_\_\_

4.4 Interest \_\_\_\_\_

4.5 Other charges \_\_\_\_\_  
*Including*

1. \_\_\_\_\_

2. \_\_\_\_\_

3. \_\_\_\_\_

4. \_\_\_\_\_

5. \_\_\_\_\_

6. \_\_\_\_\_

### 5. Credit back up

5.1 Collateral \_\_\_\_\_

5.2 Guarantee \_\_\_\_\_

### 6. Penalty

6.1 Credit overdue \_\_\_\_\_

6.2 Interest overdue \_\_\_\_\_

6.3 Other obligations overdue \_\_\_\_\_

6.4 Overdue obligations will be charged in the following sequence`

1. \_\_\_\_\_

2. \_\_\_\_\_

3. \_\_\_\_\_

4. \_\_\_\_\_

## 7. Remember

- 7.1 **You may damage your credit history**  
 Your credit history will be damaged if you have overdue obligations. That will create difficulties for getting credits in the future
- 7.2 **You may lose the collateral**  
 You may have to pay the credit through your other properties if the collateral is not enough to the credit.
- 7.3 **You can get your credit history once each year from ACRA credit bureau**

### You have the right to get noticed about your repayments

- 7.4 You have the right to get information about your repayments 1 day before the repayment via your preferred communication channel.

## 8. For guarantors

- Credit provider is obliged to
- 8.1 Inform you that you have to pay the credit if the creditor fails to do that
  - 8.2 Provide credit guarantee agreement and a repayment schedule
  - 8.3 Communicate with you via the communication channel you prefer
  - 8.4 Inform you about the changes of the credit contract terms 7 days before that changes:
  - 8.5 Inform you about each repayment 1 day before the repayment:
  - 8.6 Inform you about the overdue obligations in one day after obligations are overdue

### You have the right to

- 8.7 Require credit information from creditor any time you wish
- 8.8 Get your credit payments back from creditor.

## 9. I confirm that the information provided in this KFS is right

\_\_\_\_\_ Credit provider signature. \_\_\_\_\_ Credit provider name \_\_\_\_\_  
 \_\_\_\_\_ date \_\_\_\_\_ address \_\_\_\_\_  
 \_\_\_\_\_ phone, email \_\_\_\_\_

## 10. I confirm I understand all the information provided in this KFS

\_\_\_\_\_ Creditor signature  
 \_\_\_\_\_ Date

Creditor's name/surname \_\_\_\_\_  
 Address \_\_\_\_\_  
 Phone, email \_\_\_\_\_

Communication channel with credit provider \_\_\_\_\_

## 11. I understand all the consequences of my guarantee

\_\_\_\_\_ guarantor's signature  
 \_\_\_\_\_ date

Guarantor's name/surname \_\_\_\_\_  
 Address \_\_\_\_\_  
 Phone, email \_\_\_\_\_

Communication channel with credit provider \_\_\_\_\_

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