This brief is one in a series of five MBP Technical Briefs focused on MFI response to rapid-onset natural disasters. These briefs discuss the potential interventions and actions that MFIs could undertake in the aftermath of a disaster, based on the experiences of MFIs from Hurricane Mitch and the Bangladesh flood of 1998.

Loan Rescheduling after a Natural Disaster[1]

WHY RESCHEDULE LOANS?

Loan rescheduling in the wake of natural disasters has become a common practice among microfinance institutions (MFIs). MFIs are aware that clients hit by disasters are unable to repay loans according to a pre-disaster schedule. If the MFI insists on on-time repayment, the result for many otherwise outstanding clients may be default. Such actions would punish clients unduly, reduce long-term repayment rates, and force the MFI to remove otherwise good clients from its borrowing list. Moreover, it could mark the MFI as insensitive to its clientele and decrease long-term loyalty to the institution. Clearly, these outcomes are unacceptable to MFIs. This leaves two apparent options: loan forgiveness or loan rescheduling. Loan forgiveness cancels all remaining loan payments and removes the loan from the MFI's books. But this is not a real option for an MFI: it undercuts long-term client commitment to repay and results in losses to the program. Therefore, in the wake of a disaster, MFIs have only one choice that both serves its clients and is true to institutional goals: loan rescheduling for affected clients.

The 1998 Bangladesh Experience

The 1998 floods in Bangladesh illustrate why MFIs reschedule clients' debt. More than 30 percent of MFI clients were reported to have lost their houses and moved to flood shelters or other safe places; a few clients were reported to be dead or missing; about 65 percent of clients suffered losses or damages to their business assets; and over 90 percent of clients had to suspend their regular income generating activities for over three weeks. As a result, loans could not be serviced on time. Loan recovery rates declined from 92 to 43 percent. In addition, MFI staff could not locate the borrowers or mobilize them for group meetings for over three weeks, and were also drawn into providing relief activities. In this environment, loan rescheduling became essential.

(Source: Reza, Syed Ishtiaque, Financial Express, "Micro-financing activities suffer serious setback during floods," posted in www.bangladeshflood98.org, October 1998.)

WHAT IS THE FINANCIAL IMPACT OF RESCHEDULING ON THE MFI?

Overall, rapid and well-targeted restructuring appears to save an MFI from significant write-offs, at a short-term cost of delayed interest and principal payments. To illustrate the size of these short-term costs to the MFI, Brown and Nagarajan (see Endnote 1) provided the following calculation based on MFI experience from the 1998 flood in Bangladesh:

> "For a 3,000 Tk ($60) loan disbursed in March of 1998 and rescheduled for two months during the flood, the only financial impact on the MFI by May 1999 is a slight reduction ($2-3) in revenue that would have been earned by reinvesting the loan repayments expected in July and August of 1998. Only if clients defaulted on rescheduled loans did MFIs experience significant medium-term losses to their loan portfolios. This is a significant improvement on the losses that would have been sustained if the MFIs had written off the debts."

WHAT IS RESCHEDULING?

MFIs choose between three types of "rescheduling." The first method postpones payments of loan principal only for a specified period, while clients are expected to continue to make interest payments throughout the remaining contract period. This method of rescheduling has the least impact on the MFI's cashflow. The other two methods involve deferring both principal and interest payments for a specified period. In one form, interest continues to accrue over the period of deferment, but clients pay the accumulated interest at a later date. This, however, is not the usual practice. In the more common second form, the MFI temporarily stops the clock on interest accumulation during the period of deferment. This last form of rescheduling results in the least burden to the client but also in the lowest return to the MFI.

HOW ARE MISSED PAYMENTS COLLECTED?

MFIs choose between three different techniques to make up for missed payments. The first approach extends the term of the loan, adding missed payments to the end of the original loan term. The second approach maintains the original payment schedule but waives the immediate payments, resulting in larger final repayments (by the rescheduled principal and interest divided by the number of payments remaining). The final approach is to accept bulk repayment after a specific event (such as when the water recedes or after a harvest). The best approach varies by the type of product and size of disaster. For example, when loan terms are shorter (such as four to six months) and the disaster is more severe, extending the loan term may be more feasible than increasing the amount of unrescheduled final payments.

DOES LOAN RESCHEDULING REALLY PROTECT THE MFI'S PORTFOLIO?

The effectiveness of loan rescheduling in ensuring full repayment depends on how clients believe the institution will respond to defaults, how much the client values her long-term relationship with the MFI, and whether the rescheduled loan period is sufficient to avoid default. Established clients are more likely to value their relationship with the MFI and more likely to take repayment commitments seriously. It is not surprising, then, that established clients have higher repayment rates on rescheduled loans than newer clients. Although this finding does not suggest that MFIs should reschedule only the loans of long-term clients, it does point out that younger programs need to take additional steps to avoid higher default rates on rescheduled portfolios than more established MFIs.

WHEN AND WHERE SHOULD MFIS RESCHEDULE?

Rescheduling should take place immediately after the disaster and should be limited to geographic areas heavily affected by the disaster. To accomplish this, MFIs need rapid input from field offices, a difficult task when communication systems are heavily damaged. Training branch staff in emergency procedures before disaster strikes is key to the speed and quality of post-disaster information and is discussed in more detail in Brief No. 6. Those branches that have the highest levels of damage should receive rescheduling priority.[2]

> **Grameen Bank's Disaster Centers**
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> One method of rescheduling based on damage assessment is illustrated by Grameen Bank's "disaster centers": within days of a disaster, Grameen can identify which of its 65,000 centers are severely or partially affected by a disaster. In centers deemed seriously affected, all loan collections temporarily cease The success of Grameen's approach depends upon having a disaster preparedness plan and staff trained in disaster response.
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> (Source: Barua, Dipal C., "The Grameen Strategy to Combat the Flood of 1998," prepared for the 1998 SEEP Network Annual Meeting, Washington, D.C.).

Rather than the previously endorsed "blanket approach" to rescheduling all loans in hard-hit areas, current "sound practice" advocates rescheduling on an individual or borrowing-group basis. Although the customized approach requires tracking down and meeting with all affected clients as well as greater administrative and monitoring complexity, most MFIs agree that the customized approach makes better use of the MFI's limited supply of funds after a disaster hits and ensures that MFI staff are in the field meeting with clients throughout the emergency period. Individually rescheduling thousands of loans will require a lot of work on the part of the MFI's accountants, branch managers, and staff. To make the system moderately manageable, a specific policy should be established to give loan officers parameters for rescheduling, as well as some standardized choices among payment schedules.

WHAT SHOULD BE THE TERMS AND CONDITIONS OF RESCHEDULING?

The terms and conditions of rescheduled loans must match the realities of the disaster area. Specific issues to consider include:

- The disaster's breadth and depth of damage should be considered in setting the length of the rescheduling period. For disasters that affect larger numbers of the population and have a larger effect on infrastructure, productive assets, and agricultural production, longer periods of rescheduling are in order.[3]

- Timing of the disaster will also affect length of rescheduling. In Asia, floods that hit shortly after planting may not have a major impact on the final harvest, so clients dependent on agricultural income may be able to repay in the same crop season. But floods that hit just before harvest may wash away an entire crop, affecting not only agricultural producers but also households that provide agriculture-related products and services. In the latter case, loans may need to be rescheduled for a longer period.

- Timing of repayment should reflect an understanding of community cash flow patterns. Asking clients to repay immediately after the harvest is likely to be successful. Asking clients to repay when other large expenditures come due (such as during feast periods or when school fees are due) are bound to undermine the MFI's objectives.

- Finally, the MFI's need for liquidity is inevitably a variable that must be considered in deciding what form and length rescheduling will take.

Many other variables—often dependent on local conditions—can be brought into the decision. If clients can find alternative sources of income or employment (possibly by participating in reconstruction activities), they will be able to repay outstanding loans more quickly. Likewise, the level of remittances flowing into client households could affect the speed and level of repayment.

One element of rescheduling is constant across all clients: once the MFI sets terms and conditions for a rescheduled loan, staff must clearly communicate repayment expectations to the client and stay in touch with the client through the rescheduled period and until repayment is complete.

Terms of Loan Rescheduling after the 1998 Bangladesh Flood

The extent of the September 1998 Bangladesh flood induced MFIs to reschedule loans for longer periods than ever before. Larger MFIs (which had rescheduled for one month after previous floods) postponed collection on both principal and interest for a three-month period. About two-thirds of smaller MFIs (those servicing less than 5,000 clients) announced an average grace period of about 6.5 weeks on loan repayments. Of these smaller MFIs, some postponed payment of interest and principal by just a few weeks; less than 30 percent waived interest on the rest of the loan period. A few experimented with waiving a percentage of interest payments.

(Source: Zohir, Sajjad, "1998 Flood and its Implications for MFIs in Bangladesh," Dhaka: Bangladesh Institute of Development Studies, November 1998).

DOES RESCHEDULING WORK FOR ALL MICROFINANCE METHODOLOGIES?

Clearly, either group-based or individual loans can be rescheduled. However, programs need to think beyond the immediate emergency period and examine how their methodology will respond to rescheduling over time. An example comes from ProMujer, which was operating in Nicaragua when Hurricane Mitch hit in 1998. ProMujer rescheduled community-based loans to groups of 30 women in hard-hit areas. For each group of 30, it was not uncommon for roughly two-thirds to recover quickly and repay their loans on the original schedule, while the other one-third struggled to follow the slower rescheduled loan program. Unanticipated difficulties arose when all 30 members were required to complete loan repayments before any group members would qualify for the next round of credit. Smaller groups may be less affected by this phenomenon, and individual loans would obviously show no such effects.

CONCLUDING LESSONS

Rescheduling is an important post-disaster tool, to be implemented quickly and strategically, based on a desire to avoid disaster-induced defaults while maintaining a flow of repayments into the MFI. Successful rescheduling systems are based on pre-disaster planning and loan officer training.

ENDNOTES

[1] This document draws on information presented in two MBP papers, "Microfinance in the Wake of Natural Disasters: Challenges and Opportunities," by Geetha Nagarajan, 1998, and "Bangladeshi Experience in Adapting Financial Services to Cope with Floods: Implications for the Microfinance Industry," by Warren Brown and Geetha Nagarajan, 2000 (both available at www.mip.org/pubs/mbp-def.htm under "Managing Risk"). It also draws from web postings and e-mail discussions on the 1998 Bangladesh flood and 1998 Hurricane Mitch.

[2] Natural disasters create sudden liquidity crises within MFIs, as loan payments slow and clients withdraw savings. The MFI's need to continue a stream of cash repayments must be weighed against clients' ability to repay: if clients are heavily affected, the MFI may have no choice but to reschedule. If clients are only partially affected, they may be able to continue payments during the crisis. (See also Brief No. 5: "MFI Liquidity Problems after a Natural Disaster.")

[3] Even in extreme disasters, MFIs are often surprised to note the speed at which clients begin to repay—often between 3 and 10 weeks. Following Hurricane Mitch, for example, MFIs rescheduled loans for up to nine months, then noted that market activity and income-generating activities sprang up within three months of the disaster. As a note of caution, however, all clients will not follow the same path: the most vulnerable clients tend to recover from disaster at a slower pace.