Microenterprise Best Practices
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Widening the circle, moving ahead

Rapid Onset Natural Disasters

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Eight briefs have been written addressing issues of rapid onset natural disasters for the Microenterprise Best Practices (MBP) project. The first five of these briefs are meant to guide microfinance institutions (MFIs) that respond to natural disaster scenarios. These briefs discuss the possible interventions and actions that MFIs could undertake in the aftermath of a disaster, based on experiences of MFIs from Hurricane Mitch and the Bangladesh flood of 1998. The final three briefs focus on natural disaster preparedness.

Brief #1: Loan Rescheduling after a Natural Disaster

This brief addresses the various ways in which MFIs can ease the impact of a natural disaster on MFI clients by rescheduling loans. 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. The other two methods involve deferring both principal and interest payments for a specified period. 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, and the final approach is to accept bulk repayment after a specific event (such as when the water recedes or after a harvest).

Rescheduling should take place immediately after the disaster and should be limited to geographic areas heavily affected by the disaster. 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. 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.

Brief #2: New Loans after a Natural Disaster

After a natural disaster, MFIs should make loans only to clients in good standing. In deciding whether to extend emergency loans, MFIs should consider whether clients are better served by new loans, rescheduling old loans, or by gaining access to compulsory savings accounts.

In disaster situations, MFIs can issue emergency loans that cover necessities such as food and water, or asset replacement and housing loans, which are longer term, larger loans. Some MFIs in Bangladesh

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who have dealt with disaster loans report that the best loan product for disaster recovery is the standard microfinance short-term working capital loan. Furthermore, asset replacement loans are only advisable when there is sufficient demand for the product; otherwise, development of a new product is not worthwhile.

Brief #3: Using Compulsory Savings for Natural Disaster Response

Using compulsory deposits rather than new loans to assist clients through emergencies can both maintain MFI repayment rates and help clients avoid falling into post-disaster "debt-dependency." The combined effect of reduced savings inflows and requests for savings withdrawals (compounded by post-disaster suspensions of loan repayments) can lead to a significant liquidity crisis for an MFI.

To support clients while protecting the MFI from a liquidity crisis, an MFI can undertake two actions: immediately after a disaster strikes, MFIs can lift compulsory savings requirements in affected branches until their clients have passed the emergency stage and begun reconstruction. Then, MFIs can decide what amount—if any—of compulsory deposits they can advance to clients to cope with the crisis.

Because most MFIs depend on the presence of compulsory savings for both lending collateral and regular program liquidity, getting the savings back into the program coffers is an important post-crisis objective that must be met before the MFI can return to standard operations. The key steps to their approach are: make compulsory savings available as a loan, with clear terms and conditions for replenishment, use information on the size of the disaster to set an appropriate date by which savings must be replenished, stop interest payments on an individual's interest-bearing savings until his savings are restored to the pre-disaster level, and make client standing (and access to future loans) contingent upon replenishment of his savings.

Brief #4: Non-Financial Emergency Services to MFI Clients

Poor households, including MFI clients, tend to be more vulnerable in natural disasters since they have a weaker economic safety net. In the absence of other relief actors, MFIs may step into the breach and provide emergency services until the relief organizations arrive on the scene. Emergency provisions might include moving families and animals to safe locations, helping people locate relatives, providing food, water, health supplies, and other essentials, and setting up emergency medical teams. MFIs typically must pay for provision of emergency services themselves, though much of this money may later be reimbursed by international relief organizations

MFIs should keep in mind that provisions of such services are not simple. MFIs should stress that their actions are temporary and unique, thereby establishing that the MFI is still fundamentally a financial services provider. MFIs need to take care to separate emergency funds from operational funds. Finally, not all MFIs are capable of providing relief efforts.

Brief #5: MFI Liquidity Problems after a Natural Disaster

In the wake of a sudden natural disaster, there are four potential ways that MFI clients may change their borrowing and saving behaviors: some percentage of clients will fail to make loan repayments, some percentage of clients may cease making deposits into compulsory savings programs, some percentage of clients will request advances against their savings, and some percentage of clients will demand emergency and reconstruction loans. Unfortunately, all of these behaviors reinforce one another to create a drain on the MFI's liquidity.

Liquidity crises hit almost instantaneously—within days after a disaster—when affected clients look to the MFI as a source of emergency financing. On such short notice, MFIs can expect to find liquidity from two internal sources: required cash reserves and funds committed for new loan outlays.

In addition, the MFI can search out loans (perhaps from commercial banks with whom the MFI has a long-term relationship) and grants (usually through international fund-raising efforts and emergency requests to donors). Donor disaster response monies usually require several weeks to access, which will be too late for clients' immediate emergency needs. Unfortunately, tapping all of these sources of funds may still be inadequate to meet requests for immediate withdrawals. MFIs working in chronic disaster areas have discovered that having adequate liquidity for disaster response requires setting aside program funds on a regular basis for use in times of unexpected emergencies. When disasters strike, funds are available to put liquidity in the hands of clients. But in areas that do not face chronic disasters, it may be hard to justify setting aside MFI operating funds for disasters that do not appear likely to strike. In such cases, developing client-funded contingency accounts (where clients make regular deposits into an emergency reserve account) may be a sound alternative that does not affect the MFI's bottom line.

MFIs can take internal steps to mitigate liquidity crises *before* they hit. First, they can strive to diversify geographically, ensuring that they also serve clients in areas less frequently affected by natural disasters. Second, MFIs can diversify their clientele, and third, MFIs can examine whether emergencies tend to be seasonal and plan accordingly.

Brief #6: Pre-Disaster Planning to Protect Microfinance Institutions

MFIs operating in chronic natural disaster environments have put ever-greater resources into disaster preparedness and mitigation activities, and they have shown a significant improvement in the quality and speed of their response to natural disasters, greater ability to deal with clients' post-disaster needs, and smaller financial losses.

With increasing environmental degradation and climate change, areas that faced infrequent natural disasters in the past may experience more frequent floods, droughts, and hurricanes. After a first crisis strikes, an MFI is at a critical juncture where staff can reflect on lessons learned and take initial steps to prepare for future crises. The nine steps outlined below are designed to achieve two purposes: first, to reduce the impact of a sudden natural disaster on the MFI's portfolio and solvency, and second, to allow the MFI to respond rapidly and effectively when disaster strikes:

1. Identify the potential population at risk and undertake financial projections
2. Update and store duplicate client records out of the disaster zone
3. Create a disaster fund
4. Develop disaster policies and procedures
5. Create a disaster mitigation team
6. Develop an internal and external disaster communication strategy
7. Train staff
8. Open discussions with donors and commercial banks for emergency capital
9. Form liaisons with early warning systems and relief organizations

Brief #7: Pre-Disaster Planning to Protect Microfinance Clients

MFIs have a range of tools to help clients cope with natural disasters. Post-disaster response tools are significantly more useful if combined with pre-disaster client preparedness activities. This brief examines eight disaster preparedness tools that MFIs can use to mitigate the effects of a sudden natural disaster on their clientele:

1. Meet with clients to discuss natural disasters
2. Create accessible emergency funds
3. Health training and vaccination programs
4. Support economic diversification
5. Encourage structurally sound housing
6. Consider insurance products that respond to aggregate crises
7. Locate relief services to use in case of disaster
8. Collect and disseminate early warning information to clients

These eight techniques cannot protect clients from unexpected natural disasters. They can, however, reduce the loss of life and improve the health of clients and their families, protect household

and business assets, and empower clients and their communities to prepare for and react to a sudden disaster.

Brief #8: Microfinance Donors: Preparing for Natural Disaster

Donors should keep a few key points in mind in preparing for natural disasters. First and foremost, MFIs should keep best practices in mind when planning for natural disasters. Second, the MFI should prepare a natural disaster policy that identifies the terms and conditions under which disaster funds will be made available as well as establishes a format for post-disaster resource requests. Third, MFIs should establish a fund to prepare for upcoming disasters with the knowledge that natural disasters can be very expensive to address. Furthermore, staff and systems need to be prepped for the eventuality of disaster. Finally, MFIs need to develop a consensus on disaster response in the microfinance industry. Issues such as reserve requirements and working with donor relief organizations should be addressed within the industry before the actual disaster strikes. Following these guidelines will help cushion the impact of natural disasters when they happen.

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