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.

Using Compulsory Savings For Natural Disaster Response[1]

INTRODUCTION

Very few microfinance institutions (MFIs) are licensed to mobilize savings. But many MFIs require clients to make regular deposits to build loan collateral and inculcate financial discipline. These funds are typically called "compulsory" or "obligatory" savings. In normal times, clients are unable to access their compulsory savings funds unless they pay their loan balance in full and leave the microfinance program. However, in areas facing frequent rapid-onset natural disasters such as Bangladesh, it is a common practice for some percentage of an MFI's compulsory deposits to be earmarked for "unexpected emergencies," including natural disasters or personal crises. This amount would be available to clients as a cash advance should the need arise. 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."

DISRUPTION OF SAVINGS INFLOWS

Natural disasters significantly disrupt compulsory savings activities. After disasters strike, many clients cease making regular deposits, reducing an MFI's expected cash inflows. For 24 urban NGOs affected by the 1998 Bangladesh flood, only 48 percent of clients continued making required savings deposits after the disaster.[2]

CLIENT REQUESTS FOR SAVINGS WITHDRAWALS

Compulsory savings are also an obvious source of post-disaster emergency capital for hard-hit clients. The Bangladesh flood of 1998 provides examples of the demand for withdrawals. Grameen Bank reported that 95 percent of compulsory savings were withdrawn during the massive 1998 flood, while two-thirds of BRAC clients withdrew more than half of their compulsory savings.[3]

COPING WITH THE RESULTING LIQUIDITY SHORTAGES

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. Following the 1998 flood in Bangladesh, for example, many smaller MFIs discovered that clients' compulsory savings had been fully invested in the revolving loan portfolio. Thus, MFIs only had sufficient cash on hand to release 25 to 50 percent of clients' savings.

RECOMMENDATIONS

To support clients while protecting the MFI from a liquidity crisis, an MFI can undertake two actions:

1. Immediately after a disaster strikes, MFIs should lift compulsory savings requirements in affected branches until their clients have passed the emergency stage and begun reconstruction. This pause also allows the affected MFI branches to secure and re-open branch offices, assess damages, and locate clients. The appropriate date to recommence required savings depends on the severity of the crisis. For smaller disasters in Asia, clients have been able to start making deposits after only three weeks. After the massive 1998 Bangladesh flood, however, MFIs halted compulsory savings for three to four months.

2. MFIs should decide what amount—if any—of compulsory deposits they can advance to clients to cope with the crisis. The first consideration is the MFI's ability to access the necessary liquidity to make the savings available. At a bare minimum, the MFI must be able to find sufficient liquidity to meet any previous promises about use of compulsory deposits as "emergency funds." The second consideration is client demand. Demand varies greatly among clients: some clients go to significant lengths to leave their savings untouched; others (perhaps those with fewer alternative sources of funding) make significant withdrawals. Demand also varies by the magnitude of the disaster. If large numbers of clients are affected and request even small amounts of withdrawals, the overall demand on the institution can be sizable. This was the case after the far-reaching 1998 flood in Bangladesh, where MFIs had to spread available liquidity across a heavily affected population. To do so, many MFIs limited advances against compulsory savings to a maximum of 50 percent of savings and required that withdrawn savings be replaced within one month of receipt.

PERVERSE INCENTIVES TO WITHDRAW COMPULSORY SAVINGS

Before setting policies for withdrawals of compulsory savings, MFIs should consider a finding set out in Brown and Nagarajan (see Endnote 1): MFIs offering access to compulsory savings after a disaster show significantly higher withdrawals than programs holding clients' voluntary savings. The reasons for this phenomenon lie in the long-term incentives in compulsory versus voluntary savings. Clients know that compulsory savings are rarely made available and may soon become unavailable again. As a result, when withdrawal restrictions are lifted, there may be a mass movement to withdraw these compulsory savings "just in case" they are needed and to keep them within the household as long as allowed. Voluntary savings programs, on the other hand, make savings available whenever clients need them. As a result, clients tend to leave their savings in the bank until they are really needed. In fact, some MFIs mobilizing voluntary savings report an inflow of capital after a disaster strikes, as clients and non-clients alike seek ways to safeguard their assets in a difficult environment.[4]

WAYS TO ENSURE SAVINGS REPLENISHMENT

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. Institutions in chronic disaster areas have become experts in retrieving these deposits to get their programs back to normalcy. The key steps to their approach are:

1. Make compulsory savings available as a loan, with clear terms and conditions for replenishment. Because compulsory savings eventually do revert to clients, there is the post-disaster risk that clients will consider the money as theirs to do with as they wish. By treating the advance as a loan, clients are reminded that the replacement of savings serves to guarantee their continued participation in the microfinance program.

2. Use information on the size of the disaster to set an appropriate date by which savings must be replenished.

3. Stop interest payments on an individual's interest-bearing savings until his savings are restored to the pre-disaster level.

4. Make client standing (and access to future loans) contingent upon replenishment of his savings.

There is little information to show how many clients achieve full replenishment or how quickly, but specific institutions attest to a more rapid programmatic recovery (and a more rapid end to the liquidity crisis) if such measures are taken.

It seems likely that the stricter the terms and conditions of accessing compulsory savings, the more likely that clients turn to other sources of emergency funding or, if they do use compulsory savings, to replenish them promptly. For example, although some MFIs provide advances against savings at no interest, others charge clients interest on the amount withdrawn (such as BRAC's practice from 1991 to 1994 of charging 6 percent interest). One can assume that the higher the interest rate, the more determined the client will be to replenish her savings. But there are other issues to consider: as terms and conditions stiffen, the number of clients accessing their own savings may decline as they choose to go elsewhere to meet their emergency needs. Although this may lessen the MFI's liquidity crisis, it may also put clients under greater long-term financial pressures as they turn to informal lenders for money with fewer strings attached but a much higher pricetag. And MFIs should certainly consider internal ethical questions as well as operational questions: is it appropriate to charge clients interest on advances against their own savings, particularly if the MFI does not pay interest to clients on those savings deposits?

IMPORTANCE OF ADVANCE PLANNING

The Bangladesh experience points out the importance of advance planning for successful use of compulsory savings deposits in times of emergency. Advance planning allows the MFI to determine the amount of compulsory savings to hold in highly liquid forms. Advance planning also allows the MFI to develop a policy on preconditions for release of funds, as well as the incentive system the MFI will use to return compulsory savings accounts to pre-disaster levels.

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.

[2] CARE/Bangladesh, "Effects of Flood 98 on 24 Partner NGOs of Care," mimeo, October 1998.

[3] Sources of information presented on the 1998 Bangladesh Flood and specific programmatic responses: www.bangladeshflood98.org and Barua, Dipal, C., "The Grameen Strategy to Combat the Flood of 1998," prepared for the SEEP 1998 Annual Meeting, Washington, D.C., and personal communications with BRAC staff.

[4] Stories from the field tell of women bringing jewelry and animals to financial institutions, asking the bankers to safeguard their assets until they have a secure home. (Source: Development Finance Network posting by Dave Coster, CARE International, September 1998).