

## Disaster Preparedness and Risk Mitigation: Lessons learnt by micro finance institutions

By Hans Ramm, intercooperation, Bern, March 2005

The recent devastating tsunami in the Indian Ocean has again highlighted the need for micro finance institutions (MFIs) to be prepared for natural disasters so as to mitigate their impact on MFIs, clients and the micro-finance sector at large. The nine following conclusions and recommendations<sup>1</sup> can be drawn:

1. **Disaster preparedness by MFIs is a prerequisite** for mitigating effectively the impact of disasters on MFIs and their clients and to safeguard a national micro-finance sector in the case of disasters of great magnitude.
  - a. Disaster preparedness by MFIs encompasses the **elaboration of policies, procedures and action plans** on how to cope with selective disaster scenarios, their regular review and update and, most importantly, the corresponding training at all staff levels, including regular test runs of selected disaster action plans. Disaster risk management is a continuous process.
  - b. Depending on the probable disaster scenarios, disaster mitigation policies and procedures relate to many different issues starting from the **fire, water and theft safe storage of accounting backup files and client contracts up to readily prepared financial services in times of the aftermath of disasters**. Noteworthy are emergency funds set up by MFIs (that are fed by a clients' loan fee) that would cover loan instalments of clients whose repayment capacity has been affected temporarily by disasters or interest-free emergency loans to clients. MFIs may also have in place logistical support arrangements with national or international relief organisations for the event of selected disasters.
  - c. **Donors** should encourage MFIs to become prepared for disasters by **co-financing institutional disaster preparedness programmes** and linking them e.g. with access to a disaster liquidity emergency facility.
    - SDC and DFID have granted Buro Tangail in Bangladesh a liquidity loan in the aftermath of the 'century' flooding in late 1998 that had undergone a donor co-financed institutional disaster preparedness programme.
    - Seco and other donors set up an Emergency Liquidity Facility in response to the experience of the hurricane Mich in Central America that offers technical assistance in disaster preparedness and limits access to emergency loans to qualified MFIs that have undergone an institutional disaster preparedness programme.
2. **MFIs require access to 'external' emergency liquidity facilities** to overcome their liquidity shortages in the aftermath of disasters that are caused by their clients who:
  - a. Withdraw their savings to meet food and other survival expenses of their families.
  - b. Request emergency loans (beyond their savings) to ensure the survival of their families without driving them into the dependence from usurious moneylenders.
  - c. Request prolongation of their outstanding loans as they lost the income from which they would have paid their instalments.
  - d. Request medium-term investment loans to rehabilitate destroyed fields and other assets.

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<sup>1</sup> The main reference material is the report of the Prevention Consortium of IBRD, UNDP and UNCDF by Enrique Pantoja entitled: Microfinance and Disaster Risk Management Experiences and Lessons Learnt, July 2002.

As other financial institutions face also a run on their deposits in the case of major regional or nationwide disasters, a **(foreign) 'lender of last resort' is required**. Eligible MFIs should prequalify and adhere to minimum general quality and disaster preparedness standards so as to reduce the risk of moral hazard.

3. It is essential that MFIs can maintain their lending operations in the aftermath of disasters in order not to reinforce a downturn of the local economy. Rehabilitation and reconstruction efforts of the clients should not be hampered by the cutting back on lending operations. **Continuous lending is essential for the recovery of clients and the MFIs.**

However, new loans (e.g. emergency loans) are not sufficient to cope with major disasters where the clients have lost all or most of their assets. **Clients (as well as non-clients) would first need food and grants from relief organisations** so as to rehabilitate their basic income generating capacities. After that they may start first to save again to **build up their own emergency savings before they may become creditworthy again.**

4. MFIs need to strike a cautious balance between the need to maintain credit discipline and humanitarian concerns for their clients. They should not risk operational and financial viability and undermine their long-term efforts in having created a culture of repayment and financial discipline. **Client and institutional discipline should remain as key pillars of any disaster risk management effort.** Most MFIs do therefore not consider debt forgiveness as part of their post-disaster efforts.
5. **Disasters may call for loan rescheduling** to help protect the portfolio by allowing clients to repay in a flexible manner. MFIs can counteract the probability of defaults and reduce financial losses by giving disaster affected clients the option to delay loan instalments for a specific time. The effectiveness of loan rescheduling depends among others on the clients' losses attributed to the disaster and their track record as borrowers. Rescheduling works better for loans that have tangible collateral.
6. Disasters may demand that the **MFI expedites the clients' withdrawal of their savings and reschedules their contributions for compulsory savings.** The latter helps the clients smooth consumption and attend immediate needs of their families and, at the same time, helps the MFIs protect their portfolio by increasing client satisfaction and the likelihood of loan repayment. The MFIs face the challenge in determining the adequate time periods for such temporary arrangements.
7. **MFIs may limit specific disaster related services to their existing clients**, as new clients may not be able to distinguish between temporarily 'subsidised' services and 'regular' services. Furthermore, not yet matured MFIs need to be cautious in offering new loan products (e.g. housing loans) even to their existing clients, if they lack relevant experience and proper management systems. They may face an immediate increase in operating costs and a future increase in delinquency costs.
8. As an important contribution to disaster relief, **MFIs may offer channelling remittances and donations also to non-clients.** This may have a significant impact on disaster-affected people who required financial support so as to ensure their immediate survival.
9. MFIs should not turn into disaster risk management agencies assuming full responsibility for disaster response and clients' recovery needs. They need to **partner with concerned relief organisations, identify gaps in disaster risk management capacity and bridge these gaps through advocacy, partnership and effective actions.** They may assist relief organisations (e.g. in networking and local area information) rather than delivering relief services themselves so that their clients understand the difference between relief work and micro-finance services.