HELPING MFIs OVERCOME DISASTERS

Lessons and Strategies for Donors and Donor-Funded Projects

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PREFACE

This report attempts to summarize the activities undertaken by local microfinance institutions (MFIs), the USAID/El Salvador-financed FOMIR/DAI project, and USAID/El Salvador in response to the Salvadoran earthquakes of 2001, and to extract the important lessons learned from this experience. The observations presented in the paper were drawn from personal interviews with managers and staff of the four MFIs participating in the FOMIR/DAI project that were most affected by the earthquakes, and from data provided by these four institutions to assess the relative impact of the earthquakes on portfolios, delinquency, income and savings mobilization.

Of the four most affected institutions, two – Centro de Apoyo a la Microempresa (CAM) and the Asociación Salvadoreña de Extensionistas Empresariales del INCAE (ASEI) – were non-governmental organizations that used a "village banking" approach of group lending. One institution – Fundación Calpiá – was a regulated financial intermediary that used an individual loan methodology, and offered savings and deposits. The fourth institution – Asociación Cooperativa de Ahorro y Crédito Vicentina (ACCOVI) – was a savings and credit cooperative (credit union) that offered a traditional credit union mix of savings and loan products.

Readers will note that the financial data and program statistics obtained from the four MFIs suggest that the earthquake had only a limited impact on the institutions, and the institutions emerged from the crisis in relatively good health. In the absence of a more exhaustive empirical study involving control groups and a more extensive and rigorous questionnaire, it is not possible to make assertions about the importance of various responses. In any case, USAID/El Salvador, the FOMIR/DAI project, and the partner MFIs did mount an intensive and coordinated response for a period of one year to understand the damage caused by earthquakes and to develop initiatives that addressed the needs of institutions and their clients. In the long term, collaboration among the institutions will continue to provide benefits to the emerging microfinance industry in El Salvador.

EXECUTIVE SUMMARY

A substantial percentage of the clients of the four microfinance institutions (MFIs) were severely impacted by the series of earthquakes that struck El Salvador in January and February 2001, which posed a risk to their financial solvency of stability. Coping with the crisis required a concerted effort on the part of USAID/El Salvador, the FOMIR/DAI project and the MFIs themselves.

FOMIR/DAI shifted to crisis management mode following the earthquakes: temporarily changing its role and mission to helping the MFIs understand and cope with the crisis rather than continuing to build outreach and expand the portfolios. USAID/El Salvador's flexibility in granting permission to assist the institutions outside of the original project design proved essential for carrying out this crisis management function. USAID/El Salvador requested FOMIR/DAI to establish a new element related specifically to managing the crisis, to engage a series of studies and consultancies to help the MFIs develop appropriate responses to the crisis, and to provide financial reports on approximately $1.7 million allocated to earthquake relief. USAID/El Salvador also allowed FOMIR/DAI to assist the institutions in all aspects of financial and crisis management, not just those loans or problems that involved rural clients.

FOMIR/DAI assistance included a series of workshops and meetings to discuss and plan strategies to cope with the crisis, assistance in planning client surveys and assessing damage, direct assistance in measuring and analyzing impact and identifying weaknesses and responses, and assistance in developing new products and services to meet the changed needs of the microfinance clients. FOMIR/DAI implemented a productive assets grants program that eventually helped 2,521 of the most affected clients rebuild their businesses.

The MFIs involved responded with positive and effective strategies to help clients rebuild while protecting the financial stability of the institutions themselves. All of the MFIs mobilized donations of food, clothing and minimal shelter for their most affected clients. No institution "forgave" loans. All institutions conducted intensive appraisals of their affected clients and developed specific strategies for reducing the immediate financial burden on their most affected clients, while not jeopardizing the portfolio or earnings of the institutions. Some gave grace periods on interest or principal repayments. Some reduced the interest rates on the loans of affected clients. Some offered new loans at reduced rates to meet reconstruction needs. All institutions rescheduled the loans of affected clients on a case-by-case basis.

Literature on disasters for microfinance (see bibliography) postulates that seven things might happen to an MFI in the aftermath of a major natural disaster. The experience of the four MFIs related to these seven consequences can be summarized as follows:

1. *Its clients will require immediate emergency assistance to cope with basic issues of shelter, clothing and food.* A major percentage of the MFI clients required such assistance, which was largely met by government and donor humanitarian assistance programs, and by the efforts of the MFIs to mobilize donations of food, clothing and other necessities separate from their microfinance program.

2. *Delinquency will rise as affected clients are less able to pay, and loan losses will increase.* Delinquency did rise in the short run, but was kept manageable by a close monitoring of the portfolios, careful attention to clients, and adapting loan schedules and payments to the needs of the clients. The clients, in turn, covered many payments with savings or remittances. And, as a result, loan write-offs were negligible.

3. *The institution's portfolio will decline as delinquencies rise and loans are written off.* Portfolios did decline for three of the institutions and remained at depressed levels for the first 11 months of 2001. This was due as much to a declining demand for credit as to delinquency. While CAM did not experience the drop in portfolio that the other three institutions did, it did see a decline in clients – along with the other village banking programs, ASEI – as a larger-than-normal number of groups were closed during the year.

4. *Income will decline as delinquency increases*. Income did fall, and then remain stagnant for three of the institutions, but not to the extent of jeopardizing their financial stability.

5. *Savings deposit growth will slow or turn negative, as clients use surplus cash to rebuild their homes and other assets; clients may withdraw savings*. Savings did fall in the village banking programs, as clients used their "internal savings" or "cuentas comunes" to cover delinquency problems in the short run. Calpiá's savings program, which had grown rapidly in the year prior to the earthquakes, stopped growing for the entire 2001 year. Only one institution – which served primarily employed persons – witnessed an increase in savings during the year following the earthquakes.

6. *Loan demand will increase, as clients need additional cash to replace destroyed or damaged assets*. Loan demand did not increase immediately following the earthquakes, as clients were reluctant to take on additional debt, and many waited for donations before beginning to reconstruct assets on their own.

7. *Because of the reduction in net savings and increase in loan demand, small financial intermediaries will face liquidity problems.* None of the institutions faced liquidity problems because of reduced savings and increased loan demand. Calpiá did need liquidity to cover its reserve requirements for rescheduled loans, but this was a very short-term need that was covered by a USAID guaranty.

As in any crisis, there are many lessons to be learned from this experience. Observations about the clients include:

- *Rather than a blanket response to the situation, clients needed assistance tailored to their individual needs*. Disasters, even widespread disasters, tend to have localized impacts. Some villages were severely damaged, while neighboring villages suffered hardly any damage at all. One building in a village would be completely destroyed, while the house next door was virtually untouched. Even in widespread disasters local damage may vary considerably. As a result, individual client needs varied considerably. Not everyone needed to rebuild their houses, not everyone had their businesses destroyed, and not everyone needed food and clothing. .

- *Good clients before the crisis were especially likely to be good clients during the crisis, and clients who received other benefits such as emergency supplies – especially from the MFI but also from other sources – tended to have better repayment records in the aftermath of the earthquakes than clients who had not received such benefits.* Clients became more conservative in their borrowing, and tended to delay borrowing and to request smaller amounts when they resumed borrowing. At least part of the delay in new borrowing resulted from the clients' waiting to see if grant disaster relief funds would be available.

- *Remittances increased significantly* in the months immediately following the earthquakes, and these remittances helped families rebuild, maintain their levels of consumption, and service their loans.

General lessons for MFIs encountering similar problems include:

- *Maintain client discipline prior to any disaster.* The programs with low delinquency rates before the disaster had fewer problems with delinquencies or loan defaults as a result of the earthquakes than those that were more relaxed in delinquency management prior to the disaster.

- *Ensure the credibility of your client database.* At least one institution found that it had not edited name and address information on a regular basis, and had difficulty locating its clients.

- *Quickly appraise the situation to understand the magnitude of the problem you are facing.* Understanding the nature of the problem you face is essential to overcoming it.

- *React quickly and appropriately to changing circumstances during the course of the crisis.* You must be prepared to take innovative responses to solve the problems that arise.

- *Renew contacts with your clients as soon as possible*. This action is valuable not just to collect outstanding monies, but also to understand the clients' situations and needs and to tailor services that improve their ability to cope with the crisis.

- *Work to mobilize donations of food, blankets, shelter, clothing and other critical survival supplies, and distribute these to affected clients.* Several of the MFIs interviewed reported that their clients considered this to be the best service they offered, and was very important in building their image with their clients. Freeing the clients from having to worry about basic survival needs allows them to start rebuilding their lives quicker. Donations should not be in the form of cash, however, as this might be confused with loan forgiveness or a subsidy.

- *Reschedule loan payments, but only when necessary.* An MFI should not rush into a massive rescheduling program, and should not automatically reschedule loans for everyone, but should be prepared to grant more flexible terms and conditions as individual cases require.

- *Work extra hard to support the integrity of the groups.* "Village banking" and other group-lending programs benefit from the energy and actions of loan officers to help rebuild and support the groups.

- *Do not forgive loans.*

The major lesson for projects and donors is that they should not panic in the face of a widespread disaster, but should take the time to appraise the situation and understand the nature and magnitude of the crisis before crafting a response. That response must be carefully designed to reinforce and strengthen the underlying business principles of the microfinance institutions.

In summary, although the earthquakes had a major and traumatic impact on the institutions and their operations, as well as their clients, they survived the earthquakes with no failures and in relatively sound financial health. Without a control group or a much more detailed study, we cannot say if the MFIs would have responded as well as they did, or if they would have suffered more severe consequences without the assistance they received during the crisis. We can, however, say that a sustained, coordinated effort helped the MFIs understand the nature of the problems they faced and develop strategies that proved effective for managing the crisis.

INTRODUCTION

Prior to January 13, 2001, El Salvador had a sound microfinance system that was, with USAID/El Salvador assistance, rapidly expanding into rural areas of the country. Through technical assistance, training, and limited financial support, the eleven microfinance institutions (MFIs) participating in the FOMIR/DAI program had an expanding client base, a growing portfolio of loans in rural areas, and a relatively low rate of delinquency.

The earthquake that struck El Salvador on January 13, 2001, caused widespread damage throughout the southern part of the country, with over 5,300 casualties, and nearly 200,000 homes were damaged or destroyed. The initial damage to the MFIs participating in the USAID/El Salvador-sponsored FOMIR/DAI project, while considerable, appeared to be manageable. Only two of the institutions reported a significant number of clients that were severely affected by the earthquake; the other nine could reasonably be expected to absorb the increased risk to their portfolios with their existing resources.

Then a second major earthquake struck the country on February 13, killing another 315 people and extending the damage to homes, public services and productive assets. A third substantial earthquake occurred on February 17, followed by three moderate earthquakes on February 23. This rapid succession of earthquakes from February 13th to the 23rd exacerbated the problems facing the MFIs participating in the FOMIR/DAI project – in particular Financiera Calpiá, CAM, ASEI, and ACCOVI. A substantial percentage of the clients of these institutions were severely impacted by the February earthquakes, and what originally appeared to be a manageable situation became much more tenuous, requiring a concerted effort to help the institutions cope with the crisis.

The FOMIR/DAI Rural Financial Markets project, which had been focused on expanding the availability of sustainable microfinance services to rural areas of El Salvador, needed to help the affected institutions survive. With USAID/El Salvador's approval, FOMIR/DAI immediately launched an effort to help its client institutions plan and manage an effective response to the crisis.

INSTITUTIONAL RESPONSES TO THE CRISIS

FOMIR/DAI Activities

Saturday brought the first earthquake. FOMIR/DAI's immediately verified the safety of its own staff. Though no employees or members of their immediate families had been injured and damages to employees' property was minimal, employees were nonetheless given permission to attend to family matters as needed.

By Monday morning, FOMIR/DAI staff had contacted all participating MFIs to verify initial damages and plan responses. Again, none of the MFIs reported serious injuries to staff members. But damage to MFI properties, while virtually nonexistent in the Eastern or Western departments of El Salvador (Adel Morazan, Cooperativa La Union, Cooperativa Acacsamersa), was substantial to the headquarters of ACCOVI and Financiera Calpiá. Clients were substantially affected in the cases of ACCOVI, Financiera Calpiá, CAM and ASEI, but minimally in other institutions. The commercial banks participating in the FOMIR/DAI project suffered minimal damages, either to their microfinance clients or to their premises.

FOMIR/DAI provided preliminary suggestions on how to assess damages, including a basic data collection form, which FOMIR/DAI eventually collected and evaluated.

First Disaster Workshop

During the first workshop, FOMIR/DAI staff presented an initial framework for analyzing client and institutional risks due to the natural disaster as well as designing and implementing a strategic response. This approach focused on obtaining information from affected clients and financial options for protecting the portfolio while helping clients rebuild their assets and businesses.

Several key issues emerged during this first meeting. First, the MFIs quickly understood the need for gathering information to assess their own situation and understand their clients' needs and problems:

- The MFIs were unable to report specific damage or reliable estimates, but recognized the importance of establishing contact quickly with their clients to identify real needs and to communicate their commitment to working together to rebuild their clients' assets.

- The MFIs understood the need to determine quickly the portion of their portfolios likely to be affected by the earthquake in order to define appropriate policies and actions, and to monitor this portfolio separately from their regular portfolio.

However, at the same time, the MFIs recognized the need to avoid creating false expectations for assistance or appearing too heavy handed with concerns over portfolio quality.

Second, FOMIR/DAI introduced practical tools to segment portfolios according to geographic location, and to develop an accurate assessment of the damage to the clients, which involved three separate steps:

- Separate the portfolio by zones;
- Identify the affected areas; and
- Assess specific damage to the clients.

Methods for estimating damage to clients identified in the meeting included:

- A personal assessment of affected client's conditions by the manager;
- A direct verification by credit officers, using a list of clients crossed referenced with information on the most affected zones; and
- A direct survey of clients in the damaged areas.

This process was designed to accomplish two objectives: contacting affected clients to investigate their well being and design services to meet their individual recovery needs, and obtaining the practical information needed to assess portfolio risk. The MFIs recognized the need to avoid generating expectations of loan forgiveness or giveaway programs during the initial contacts, and the need to avoid pressuring clients immediately for repayments.

Third, the MFIs recognized the risks from mishandling loans and possible government or donor responses to the earthquakes, including:

- Loan forgiveness or "debt wipeouts";
- A damaging flood of Subsidized credit; and
- Client over-indebtedness.

The MFIs agreed that they should not forgive loans and would work to restructure loans as needed based on information they gained from the client surveys.

While recognizing the importance of over-indebtedness and the possibility that delinquent borrowers may try to obtain financing from several different institutions, most of the MFIs were reluctant to share too much information about their clients.

FOMIR/DAI assigned staff to work directly with each affected institution to assess damages and design appropriate strategies for coping with the situation.

Second Disaster Workshop

FOMIR/DAI sponsored a second workshop on February 2 to provide the institutions with a chance to share experiences and to present additional information on disaster management strategies. The key topics discussed included:

- What has been learned about damages to clients?
- What is the current status of the MFIs, in terms of collections, delinquency, cash flow and income
- What risks other than credit risk do the MFIs need to prepare for?
- What role should FOMIR/DAI play to help the institutions manage the crisis?

The institutions reported that their estimates of damages to clients were less than originally projected, although the four most affected institutions still reported considerable damage.

As a result of information gathered during the meeting, FOMIR was able to respond to the needs of its partner MFIs with information and direct assistance from both long term and short term consultants.

Two Major FOMIR/DAI Efforts

FOMIR/DAI worked closely with USAID on two specific activities that had a major impact on the MFIs involved. First, FOMIR/DAI worked with AID's DCA program to secure a loan guaranty for Calpiá to cover reserve requirements for rescheduled loans. As a regulated institution, Calpiá was required to place an amount equal to 100 percent of its rescheduled loans into a loan loss reserve. Most of the loans appeared to be "good" loans that needed temporary rescheduling to allow affected clients more time to meet their repayment obligations. Calpiá needed to reschedule approximately $4.5 million in loans, and meeting the reserve requirements would have necessitated cannibalizing its loan portfolio. AID's DCA program responded rapidly to this innovative use of the guaranty fund, and approved a guaranty of $4.4 million, which the Superintendency of Banks accepted as reserves. In the end, Calpiá only had to write off about $125,200 in non-recoverable loans, of which $76,000 was covered by the DCA program.

In the second major activity, FOMIR/DAI worked with USAID/El Salvador to plan and implement a "Productive Assets Grants (PAG)" program, which made small grants to severely affected microentrepreneurs to replace assets needed for their businesses that had been damaged or destroyed by the earthquakes. This was part of USAID/El Salvador's larger rehabilitation program. Grants were "in-kind" only, to prevent the impression that they were being used to forgive loans or to subsidize interest rates. FOMIR/DAI distributed a total of $992,266 in grants to 2,521 individual clients of FOMIR/DAI institutions. FOMIR/DAI also administered some funds for distribution through non-project institutions for USAID/El Salvador. A recent study of the PAG program concluded that, within 24 months, the PAG program enabled beneficiaries to achieve sales levels consistent with sales achieved prior to the earthquake, and protected a total of 6,302 micro enterprise jobs.[1] The Comisión Nacional de la Micro y Pequeña Empresa (CONAMYPE), a semi-public institute attached to the Ministry of Economy, estimates that 47,050 microenterprise related jobs were lost as a result of the earthquake. Beneficiaries of the PAG program therefore accounted for 13 percent of the total number of jobs affected by the earthquake.

Although FOMIR/DAI was initially concerned that the grants may cause resentment among clients who did not receive them, MFIs reported that this did not occur. It was viewed as a positive and successful activity that helped them strengthen their relationship with their clients, and that helped those particular clients reestablish their income-generating activities.

Other FOMIR/DAI Emergency Responses

In the immediate aftermath of the earthquakes, FOMIR/DAI played a pivotal role in developing contacts between the affected MFIs and other institutions working in earthquake relief. These efforts included:

- *Attempting to coordinate with relief agencies and efforts to secure client access to emergency shelter, food, and clothing assistance, and rebuilding materials.* Although USAID/El Salvador organized a coordinating meeting of the projects and relief agencies, little or no coordination among the various projects in country and its relief efforts resulted. Direct contacts by FOMIR/DAI or the MFIs with agencies assigned to administer emergency housing, food and clothing assistance were not successful.

[1] FOMIR/DAI, "Productive Asset Grant Program: Final Report", September 2002.

- *Developed contacts with lending sources for back-up lines of credit.* FOMIR/DAI research and provided institutions with information on accessing the Central American Development Bank (BCIE)'s loan funds.

- *Worked with the Banco Multisectoral de Inversiones (BMI) to develop a credit line for rebuilding assets based on the Minister of Finance's pledge to provide $200 million in funds for microenterprises in the country.* FOMIR/DAI provided assistance to the MFIs to develop and launch housing and fixed capital products that could utilize this line of credit, and helped negotiate its terms and conditions. However, the funds never materialized, and ultimately BMI was unable to modify its procedures to deal with the non-regulated MFIs.[2] BMI did provide considerable funding to help larger businesses rebuild assets (450 loans for a total of $130 million), established a special microfinance line for its regulated clients[3], and dispersed $10.8 million through Banco Agrícola and Fedecrédito (two regular regulated clients) for housing. BMI felt that the effort to work with the non-regulated MFIs was useful because they were able to provide training and some equipment to these institutions, and were able to incorporate several of the institutions in its on-going microenterprise trust fund operations.

- *Maintained statistics and provided information to donor agencies, in particular USAID/El Salvador.*

Key Lessons from the FOMIR/DAI Experience

An active project is ideally positioned to channel assistance to the institutions and individuals that it is assisting. Having an active project provides the sponsoring donor organization with a knowledgeable staff, contacts, and infrastructure for reaching down to an affected population.

The key role of FOMIR/DAI in disaster-assistance was to help the institutions understand the nature of the problems they faced and identify steps that would reduce the risk and damage from the disaster. As an active project is an ideal coordinating body, FOMIR/DAI took on this important role.. The various seminars on crisis management, liquidity, client assessments, policies, and understanding the financial and institutional risks from a disaster provided all of the institutions with a common conceptual framework from which they could develop effective strategies to protect themselves and better serve their clients.

[2] BMI is limited to working with regulated financial institutions, except through special trust funds. Attempts to set up a special trust fund for this activity were not successful.

[3] This credit line did not perform well because BMI imposed a maximum spread of 2% on these funds.

Donor Agency Responses

International donor agencies responded with emergency assistance in the form of shelter, clothing and food to assist Salvadorans who were severely affected by the earthquakes. USAID/El Salvador sponsored the construction of temporary shelters, working through international NGOs. USAID/El Salvador later sponsored the construction of some 25,000 permanent houses in selected zones in a program that was coordinated through the municipalities. As part of the reconstruction effort, USAID/El Salvador sponsored the Productive Assets Grant (PAG) program through FOMIR/DAI to help affected microenterprises replace some of the assets they had lost in the earthquakes.[4]

Although USAID/El Salvador mounted a major effort of immediate emergency assistance followed by reconstruction assistance to help poor families in the most heavily damaged areas, all assistance to microenterprises was channeled through the FOMIR/DAI project. Other USAID/El Salvador projects also incorporated components of disaster assistance, but never reached this target group, or this set of institutions.

The IDB attempted to respond with a recapitalization programs for MFIs, but this program took about 18 months to develop, and few institutions participated. European donors concentrated on relief efforts in specific communities, while other donor assistance tended to focus on housing and humanitarian relief.

One of our key observations is that the absence of a project means that donor agencies have a difficult time identifying and assisting institutions. In microfinance, the safety of the institution is critical to sustained services to the clients, but humanitarian relief and reconstruction efforts are focused on individuals and families rather than institutions. Had the FOMIR/DAI project not been in existence, USAID/El Salvador would not have been able to provide assistance to support these institutions. Other institutions created or supported by previous USAID/El Salvador projects received no institutional assistance following the earthquakes due to the absence of an available funding vehicle. Mechanisms for responding programmatically to a disaster situation do not exist for donors because of planning, budgeting and approval processes.

At a minimum, donors should recognize the value of bringing industry players together as soon as possible after a disaster to share information and ways to obtain rapid assessments, define needs, and discuss appropriate program responses. To assist institutions in the absence of an on-the-ground project, a donor would need to initiate, on its own, a rapid response project or identify a local institution to serve as microfinance industry response coordinator.

[4] This report does not attempt to cover other earthquake assistance that USAID/El Salvador provided through other active projects.

GOES Responses

The Government of El Salvador (GOES)'s immediate response to the earthquakes was to launch a massive program of temporary housing throughout the affected region. Within about 3 months of the second earthquake, the government (through the military) had constructed some 60,000 temporary shelters that were designed so that the beneficiaries could use some of the materials in more permanent structures at a later date.

Shortly after the second earthquake, the Minister of Finance announced that the government would mobilize $200 million for housing and asset renewal for microentrepreneurs who had been affected by the earthquakes. USAID/El Salvador approved an experiment to channel some of these funds through participating MFIs, and FOMIR/DAI worked with the Banco Multilateral de Inversiones (BMI) to prepare and qualify several of the FOMIR/DAI participants in this program.

In the end, the funds never materialized, and the BMI could not find a way to work with non-regulated MFIs to implement the program. Through this exploration, however, BMI believes that it gained a better understanding of the microfinance sector and its needs, and incorporated several of the participating MFIs in an on-going trust fund arrangement. In addition, several of the MFIs that participated in the effort developed housing and reconstruction loan products that they then offered their clients.

IMPACT ON THE MFIs

With FOMIR/DAI assistance, the severely affected institutions – Calpiá, CAM ASEI and ACCOVI – took steps to identify and survey affected clients.[5] As part of the identification process, the institutions surveyed clients to determine extent of damage and needs, and used this information to plan specific measures, including loan followup, loan rescheduling and other assistance.

None of the institutions forgave loans to affected clients, but instead each of the four MFIs developed specific responses to help their clients cope with the financial burdens created by the earthquakes and to renew their relationships with the institution. Among the specific steps taken to help clients:

- Most of the severely affected institutions rescheduled loans to affected clients.
- Calpia developed three new credit lines: refinancing to reschedule existing loans, housing loans, and a supplemental loan program that carried an interest rate of 50 percent of their normal interest rate. The new products improved their image, and did not result in a significant loss of income. Only 5 percent of their clients actually used the subsidized credit line. Most clients preferred to continue servicing their existing loans
- ACCOVI offered to suspend interest and principal payments for three months, but only 150 clients actually took advantage of this offer. The MFI renegotiated the maturity dates, and gave additional loans for rebuilding. It also mobilized and disbursed donations from other credit unions in El Salvador and the surrounding countries.
- ASEI concentrated on managing its existing portfolio rather than on creating new groups or pushing new loans.
- CAM offered supplemental loans to good clients at subsidized interest rates. The loans were smaller than normal CAM loans, and were for a maximum of six months, to help clients get past the crisis. With some groups, CAM financed the "savings" collateral so that the group could continue to borrow at the previous level.
- CAM, ACCOVI and ASEI mobilized donations of food, clothing, and blankets, and distributed these to affected clients. CAM also received donations from sister organizations in the U.S. and Central America, and channeled these to needy members.
- CAM and Calpiá developed new housing products for microfinance.
- All four institutions took a very hard look at delinquency and made extra efforts to improve the quality of their portfolios.

[5] In at least one case, the institution found that its name and address files had not been maintained, so that finding clients became a major problem.

Anticipated Impact of a Disaster on an MFI

Literature on disasters for microfinance (see bibliography) postulates that seven things might happen to an MFI in the aftermath of a major natural disaster:

1. The microfinance clients will require immediate emergency assistance to cope with basic issues of shelter, clothing and food.

2. Delinquency will rise as affected clients are less able to pay and loan losses will increase.

3. The institution's portfolio will decline as delinquencies rise and loans are written off.

4. Income will decline as delinquency increases.

5. Savings deposit growth will slow or turn negative, as clients use surplus cash to rebuild their homes and other assets; clients may withdraw savings.

6. Loan demand will increase, as clients need additional cash to replace destroyed or damaged assets.

7. Because of the reduction in net savings and increase in loan demand, small financial intermediaries will face liquidity problems.

A large percentage of the MFI clients did require emergency assistance, which was largely met by government and donor humanitarian assistance programs, and by the efforts of the MFIs to mobilize donations of food, clothing and other necessities. MFIs do not need to provide direct non-financial assistance to help clients with emergency recovery, but linking clients to disaster relief efforts (particularly grant assistance) to rebuild assets and productive capacity will go a long way toward creating the stability needed to sustain the clients' relationships with the MFIs. Donor assistance, except for the resources of the FOMIR/DAI project, was not available to help the MFIs themselves cope with the crisis.

Measuring the Impact of the Earthquakes on the MFIs

Two years of monthly data on loan portfolio, income, savings, new loans made, and delinquency were collected for each of the four institutions that had a significant number of clients affected by the 2001 earthquakes to see if the earthquakes produced a major impact on the institutions' financial performance. The earthquakes in El Salvador occurred in January and February 2001. In the graphs that accompany this chapter, the **bold blue** line represents the year prior to the earthquakes, that is, from December 1999 through December 2000, while the **thin red** line represents the year of the earthquakes, from December 2000 through December 2001. The data has been verified, but has not been adjusted or standardized, as it serves as a preliminary description of what occurred. More data and a more vigorous verification and standardization of the underlying accounting principles would be required to test the significance of differences or explore causality.

In addition to the quantitative data, officials from each of the four institutions were interviewed to gain their insights into the crisis and their responses to it.

Delinquency and Loan Losses

One of the expected effects of a natural disaster is that delinquency and loan losses will increase. As can be seen in Figure 1,[6] however, delinquency statistics maintained by the four institutions did not seem to indicate a sudden increase in delinquency due to the earthquakes, Calpiá and CAM, which historically had maintained low delinquency rates, continued to have low delinquency rates during 2001. CAM's delinquency rate rose only very slightly during the year.

ACCOVI started out 2001 with delinquency rates in excess of 15 percent, but its delinquency was historically over 10 percent, and had increased during the last three months of 2000. The increased delinquency between December 2000 and January 2001 may have been a continuation of this trend. After January, ACCOVI's delinquency rates actually declined during 2001. ACCOVI noted that the delinquency problem arose about a year after the earthquakes, when many of those who left the region were also those who owed money. People who had homes and businesses in the area wanted to sell out and leave.

Interviews with MFI management indicated that delinquency did rise initially, but had not presented a serious long-run threat. ASEI did experience a spike in delinquency in January 2001, reporting that, as a direct result of the earthquakes, its average delinquency increased from 8 to 11 percent overall, but then its delinquency rates declined to well below its 2000 delinquency rates. Calpiá reported that its 1-30 day delinquency increased substantially, from around 6 percent to over 30 percent in the immediate aftermath of the earthquakes, necessitating a major loan rescheduling effort. CAM experienced an initial delinquency of about 21 percent, as approximately $667,000 of its outstanding portfolio of $3.2 million became delinquent. As a result, CAM closed some groups and refinanced 182 others. But most clients continued repaying despite the crises, using their internal savings and remittances to meet their payment obligations, and within 6 months most of the outstanding delinquency had been recovered.

Loan write-offs were uniformly low. ASEI wrote off about $21,000 in unpaid loans – or around 6.7 percent of its portfolio – which was about half of management feared it would lose shortly after the earthquakes. CAM wrote off about $22,000 eventually. Calpiá wrote off about $125,000 (2.7 percent of the amount placed under a USAID-funded guaranty program, and 0.4 percent of its total portfolio) as a direct consequence of the earthquakes. ACCOVI had not actually written off any loans, though it reported that 300 loans totaling $1.3 million were seriously delinquent and needed to be written off. Many of these bad loans were not the direct result of the earthquakes, however.

Several factors may have mitigated the impact of the earthquakes on delinquency rates. First, most clients had multiple sources of income, and although their microenterprises may have been damaged, they did not lose all income, and were able to continue servicing their loans – at least for a while. ACCOVI's clients were largely salaried government employees, and these salaries continued throughout the earthquake period.

Remittances played an important role in sustaining income levels. Calpiá estimated that as many as 40 percent of rural clients and 20 percent of urban clients received significant remittances in the months following the earthquakes. The other institutions reported the same general phenomenon.

[6] The delinquency rates used in Figure # are for loans over 30 days past due.

Group savings protected the group-lending institutions, as clients used their "cuentas comunes" to cover payments. As a result, these loans did not appear as delinquent, even though the groups were having internal delinquency problems.

Also, monthly data simply may not have captured the period of greatest delinquency. The two group-lending institutions indicated a problem in the first few weeks, as contact with clients and the institutions was disrupted, but that by the third or fourth week, the groups had begun to catch up on their payments. With the first earthquake occurring on January 13th, no loans would be more than 30 days overdue by January 31, and hence not recorded. It's possible that by February 28th, delinquencies had recovered and therefore not demonstrated – at least in the reports – the expected climb.This same situation existed for the February 13 earthquake.

Finally, accounting practices may have understated the magnitude of the delinquency in some cases. All of the institutions offered grace periods on principal and interest payments or offered programs to reschedule loans. In the accounting for these adjustments, it is not clear whether or not loans that received such treatment were ever counted as delinquent.

Outstanding Portfolio

The earthquakes appear to have had a major impact on the portfolios of ACCOVI, ASEI and Calpiá, as all three institutions experienced a reduction (or very little growth) in their loan portfolios in the period following the earthquakes, with a substantial recovery and growth in portfolio later in the year. As can be seen in Figure 2, ACCOVI's portfolio remained virtually unchanged from December 2000 through June 2001, a period that had witnessed rapid portfolio growth the year before. ASEI's portfolio declined significantly from December 2000 through September 2001 (the upturn in July was probably an accounting anomaly), losing nearly 50 percent of its value before recovering in the last three months of the year. Calpiá's portfolio declined in January, just as it had in the previous year, but then it continued to decline through April before recovering. At a minimum the earthquakes stifled growth in these three institutions, and - in the cases of Calpiá and ASEI especially - provoked a major contraction in the portfolio.

CAM, on the other hand, showed few effects from the earthquakes, as its portfolio in 2001 closely paralleled the pattern established in 2000. This suggests that seasonal fluctuations were far more important than the effects of the earthquakes. However, CAM also lost nearly 3,000 clients during the year, so its portfolio was maintained by granting smaller additional loans to existing clients and disbursing larger loans to fewer clients. CAM was able to accomplish this by accessing its traditional lines of credit.

Income

Income would normally be expected to decline in the period following a natural disaster, reflecting an increase in delinquency, and the MFIs participating in the project did experience a decline in collections in the period immediately following the first earthquake. ASEI, for example, reported that collections fell off to only about 25 percent of normal during the first week of the crisis. While most of the groups did not meet at all during the first week, so payments were not collected, over the next two or three weeks, most of the groups caught up.

As can be seen in Figure 3a, the experience of the four institutions varied considerably.[7] ACCOVI's monthly income fell noticeably from December to January of the earthquake year, compared to an increase the year before. From February through November income varied within a rather tight range, and was generally constant, before peaking sharply again in December. Apart from the two peaks in income, ASEI's income remained constant at approximately the same level as before the earthquakes. Calpia's income stream better illustrates the hypothesized pattern, falling sharply from December through February, then rising steadily throughout the rest of the year. CAM's income rose sharply in January in spite of the earthquake, possibly due to the fact that seasonal borrowers had paid off their Christmas loans just before the earthquake. It then dropped in February and remained relatively constant throughout the rest of the year.

These patterns suggest that the earthquakes moderated growth in income. However, there is little indication that increasing delinquency affected income. When we look at average monthly yield on portfolio (Figure 3b) we see that this remained relatively constant even though we expected to see a slight decline in the yields. Monthly variations in CAM and ASEI are probably due to the nature of village banking.

Although the data shown regarding monthly interest income (Figures 3a and 3b) are internally consistent, the data on outstanding portfolio (Figure 1) suggests that there should have been a significant and recognizable decline in interest income during at least the early part of 2001, followed by a recovery during the final months of the year for ACCOVI, ASEI and Calpiá. This does not appear to be the case. Unfortunately, additional information and analysis would be required to explain this paradox.

These institutions later began to experience financial problems and payments fell off again. At first they used their forced savings, or "cuenta comun," to meet their payment obligations, but they soon began to experience delinquency. Collections began to improve in subsequent weeks, however.

Savings Withdrawals

Another common effect of natural disasters is that clients withdraw savings to cover immediate expenses. But Calpiá and ACCOVI, the two institutions that did take deposits, did not witness significant withdrawals following the earthquakes (see Figures 4a and 4b). Short-term savings declined in both institutions in January, with Calpia also experiencing a net withdrawal of short-term savings in February. The overall decline in savings amounting to 6 percent for ACCOVI, and 9 percent for Calpiá. Fixed-term deposits initially rose in both institutions, then leveled off or declined.

However, the two institutions experienced significant overall differences in client savings patterns during 2001 (Figure 4b). ACCOVI's savings and deposits continued to rise through September, with deposits tapering off in October through December. Overall, ACCOVI's savings and deposits grew by 23.4 percent during 2001, even though ACCOVI served clients in one of the regions most affected by the earthquakes. Calpiá's savings base had expanded very rapidly (70 percent increase) in 2000, but grew only 0.2 percent during 2001. Calpiá showed virtually no change in savings balances at all through October, and, although savings grew rapidly after that, fixed-term deposit balances actually declined. Part of the difference might be explained by the fact that most of ACCOVI's members were salaried government workers, who continued to receive income during the earthquake period, while Calpiá's clients were largely microentrepreneurs whose incomes were disrupted by the earthquakes. ACCOVI did not notice a significant increase in withdrawals.

[7] The extreme peaks and valleys in some of the data are largely due to accounting adjustments.

Loan Demand

The demand for credit is generally expected to rise in the aftermath of a natural disaster as clients need cash to rebuild their homes and businesses. Interviews with MFI management, however, indicated an overall decline in loan demand in the months immediately following the earthquakes. Demand returned to normal levels later in the year.

ASEI normally created about 6 new groups per month, but that fell to only about 1 per month after the earthquakes. The organization noted that at least some of its groups had used their internal savings to meet repayment obligations, and could not qualify for larger repeat loans. Their outstanding loan portfolio fell by $5060,000 (about 15 percent). CAM experienced an overall decline of nearly 9 percent in its number of clients, from a total of 21,562 clients in December 2000 to 18,740 in December 2001. People who could not pay withdrew from the groups; individuals and groups that had used their internal savings to pay off their loans no longer had the savings component to take out new loans, and many of CAM's clients were afraid to take on additional debt.

ACCOVI reported that members affected by the earthquakes were reluctant to take out additional loans or become more indebted because they were afraid of other calamities. The earthquake exposed the fact that many clients were over-indebted, and weren't eligible for refinancing. Equally important, with the widespread destruction of houses in the area, many clients no longer had the collateral to secure loans. Loan demand shifted from larger to smaller loans.

Data from the financial reports and program statistics provided by the institutions generally confirm these reports (see Figures 5a, 5b and 5c).[8] For ACCOVI and Calpiá, the number of loans granted dropped sharply in January, and both the number of loans and total amounts disbursed generally remained below the previous year's level for most of the first six months of the year. ASEI's data actually shows an increase in the number and volume of loans during the first few months. CAM's data show a distinctly different pattern from the other institutions, as the number of loans granted and the amount disbursed closely paralleled the previous year's pattern. This effect could be attributed to the fact that CAM had been able to access funds from three different sources to maintain loan levels.

The average size of loans (Figure 5c) appeared to increase in the latter months for Calpiá and ACCOVI, perhaps reflecting an increasing need to replace damaged assets, such as houses, equipment, and other major items.

Meeting Liquidity Needs

Based on the literature on disasters and microfinance, we could have expected that the four MFIs would have experienced liquidity problems, but that was not the case. Withdrawal of savings was not excessive, delinquency was not that great a problem, and loan demand did not increase dramatically.

None of the four institutions discussed accessed temporary liquidity sources. Calpiá noted that lines of financing were available, but also that it took too long to access them, thus decreasing their usefulness. CAM drew down on its regular financing sources – the Central American Bank, Interamerican

[8] ASEI's data for 2001 is incomplete, and the figures shown for July onward were estimates.

Development Bank and a line of credit with Banco Agrícola – but as its regular business activities rather than as a crisis response.

Other Relevant Findings

Locating Clients

ACCOVI found that its database of names and addresses had not been maintained, and had difficulty finding its clients. ACCOVI credit officers had to go door-to-door to ask residents if they were members of the credit union. Many people who were badly affected by the earthquakes simply left, and could not be found. ASEI reported that a small number of clients simply disappeared; they had moved and stopped paying on their loans.

Valuation of Collateral

ACCOVI, in particular, had a large percentage of its loans secured with mortgages. Many of these houses and other buildings were damaged or destroyed in the earthquakes, rendering them worthless. Most clients did not have insurance, and the credit union found that the value of its collateral was insufficient to secure its problem loans.

Timing of Problems

Some effects of the earthquakes were not apparent immediately. ASEI noted that delinquency problems did not appear immediately, but began to build up after the first month or so. Initially clients could continue to pay, and used savings, or their "cuenta comun," to cover payments. But will a prolonged decrease in sales, many clients were unable to avoid delinquency. ACCOVI said the delinquency problems didn't really show up until about a year later. CAM reported that rising internal delinquency within groups caused the groups to use their "internal savings" to meet payment obligations. Delinquency was avoided, but later the groups did not have the savings collateral required to obtain further credits.

Managers' Conclusions

The earthquakes were a major, widespread disaster that affected a lot of families in El Salvador, but the effects on the microfinance clients were not as catastrophic as initially feared. Most microfinance clients quickly returned to work, and, although business slowed down, they were able to rebuild their businesses and continue as clients. Microenterprise owners are by nature resilient and work to maintain their access to funds. In El Salvador, evidence suggests that they used savings and remittances to repay loans before going to their MFI to request a restructured loan.

A diversified client base, strong client loyalty, multiple sources of income, and a substantial increase in remittances helped the institutions avoid major problems of delinquency, loan losses, and loss of income. Fast and ongoing communications between the MFIs and their clients, plus attention to the personal needs of their clients, seem to have contributed to client retention and better-than-expected repayment rates.

FOMIR/DAI assistance was helpful in assessing and determining the extent of risk posed by the crisis, providing information on how other institutions have responded to similar crises, designing and developing appropriate responses and products, facilitating the sharing of information among the institutions and, in the case of Calpiá, arranging access to the DCA loan guaranty.

Techniques for Responding to a Crisis

Based on their own experiences, the four MFIs had a number of suggestions for other MFIs facing similar circumstances, including steps to ensure client loyalty and maintain the safety of their loan portfolios. These include:

- *Maintain client discipline prior to any disaster.* The programs with low delinquency rates before the disaster had fewer problems with delinquencies or loan defaults as a result of the earthquakes than those that were more relaxed in delinquency management prior to the disaster.

- *Ensure the credibility of your client database.* At least one institution found that it had not edited name and address information on a regular basis, and had difficulty locating its clients.

- *Quickly appraise the situation to understand the magnitude of the problem you are facing.* Understanding the nature of the problem you face is essential to overcoming it.

- *React quickly and appropriately to changing circumstances during the course of the crisis.* You must be prepared to take innovative responses to solve the problems that arise.

- *Renew contacts with your clients as soon as possible*. This action is valuable not just to collect outstanding monies, but also to understand the clients' situations and needs and to tailor services that improve their ability to cope with the crisis.

- *Work to mobilize donations of food, blankets, shelter, clothing and other critical survival supplies, and distribute these to affected clients.* Several of the MFIs interviewed reported that their clients considered this to be the best service they offered, and was very important in building their image with their clients. Freeing the clients from having to worry about basic survival needs allows them to start rebuilding their lives quicker. Donations should not be in the form of cash, however, as this might be confused with loan forgiveness or a subsidy.

- *Reschedule loan payments, but only when necessary.* An MFI should not rush into a massive rescheduling program, and should not automatically reschedule loans for everyone, but should be prepared to grant more flexible terms and conditions as individual cases require.

- *Work extra hard to support the integrity of the groups.* "Village banking" and other group-lending programs benefit from the energy and actions of loan officers to help rebuild and support the groups.

- *Do not forgive loans.*

KEY LESSONS LEARNED

Clients

Initial damage estimates tended to overstate the damage and risks. During the first weekend it appeared that a crisis of major proportions existed among MFI clients. By the end of the first week it was obvious that the extent of the damage was much less, and could be managed. Even with the second major earthquake a month later, the massive crisis among clients never materialized.

Even though the earthquakes caused considerable damage over a major area of the country, actual physical damage tended to be local and distinct. Some villages were severely damaged, while neighboring villages suffered hardly any damage at all. One building in a village would be completely destroyed, while the house next door was virtually untouched.

Individual client needs varied considerably. Not everyone needed to rebuild their houses, not everyone had their businesses destroyed, and not everyone needed food and clothing. Rather than a blanket response to the situation, clients needed assistance tailored to their individual needs.

Although there was an increase in defaults and delayed payments, the overwhelming majority of the MFI clients faithfully serviced their outstanding debts. There was an initial "wait-and-see" attitude among the clients to see if there would be a debt forgiveness amnesty, and some clients who learned that their neighbors had received a rescheduling tried to obtain the same even though they had not suffered any damages, but most clients continued to service their debts.

Several trends emerged in the aftermath of the earthquakes. Good clients before the crisis were especially likely to be good clients during the crisis. Clients who received other benefits, such as emergency supplies – especially from the MFI but also from other sources – tended to have better repayment records in the aftermath of the earthquakes than clients who had not received such benefits. Clients tended to exhaust their personal savings and resources before requesting loan rescheduling or other assistance. Some programs did see a modest increase in withdrawal of saving, but it was not significant.

Client businesses did tend to suffer in the aftermath of the earthquakes, due to the general slowdown in economic activity. Sales tended to decline, although the petty trading sector in areas affected by the earthquakes quickly shifted into the sale of emergency supplies – bottled water, gloves, masks, and the like.

Clients became more conservative in their borrowing, and tended to delay borrowing and to request smaller amounts when they resumed borrowing. At least part of the delay in new borrowing resulted from the clients' waiting to see if grant disaster relief funds would be available.

Remittances increased in the months immediately following the earthquakes, and these remittances helped families rebuild, maintain their levels of consumption, and service their loans.

MFIs

Perhaps the most outstanding lesson learned from the earthquakes was that none of the MFIs suffered any of the dire consequences so eloquently documented in other literature on disasters. The anticipated liquidity crisis did not occur: none of the deposit-taking institutions experienced large withdrawals of savings; none of the institutions suffered major delinquency problems; and none of the institutions experienced a significant increase in loan demand. In short, none of the MFIs needed backup financing to cover short-term liquidity needs.

Delinquency problems tended to be short-term, and appearing only after the second month, as clients depleted their own family reserves. With rescheduling and refinancing, however, the crisis was temporary, and loan write-offs were very few. Institutions with poor quality portfolios before the earthquakes tended to have more delinquency problems than institutions that had previously exercised good portfolio discipline.

Institutions that took collateral, especially mortgages, to secure loans generally found that they had overestimated the value of the houses, and had failed to consider the impact of a natural disaster on the subsequent value of the collateral. As a result, they were considerably less protected than they had believed.

Recognizing client needs and assisting with securing non-financial assistance helped build customer loyalty. Institutions that helped their clients find sources of emergency assistance, or that distributed supplies and materials themselves, earned a fierce loyalty from their clients.

Finally, regulated MFIs may have difficulty meeting reserve requirements because of the need to reschedule loans.

Project

FOMIR/DAI shifted to crisis management mode following the earthquakes. During the crisis its role and mission became more one of helping the MFIs understand and cope with the crisis and less one of continuing to build outreach and expand the portfolios. USAID/El Salvador’s flexibility in granting permission to assist the institutions in ways not contemplated in the original project design was essential for carrying out this crisis management function. USAID/El Salvador allowed FOMIR/DAI to establish a new CLIN related specifically to managing the crisis and to engage a series of studies and consultancies to help the MFIs develop appropriate responses to the crisis. USAID/El Salvador also allowed FOMIR/DAI to assist the institutions in all aspects of financial and crisis management, not just those loans or problems that involved rural clients.

Helping the MFIs manage the crisis was important to the institutions. FOMIR/DAI's workshops, the assistance provided directly by FOMIR/DAI technicians, and the materials generated to survey members and assess damages were all considered to be helpful by the affected MFIs. FOMIR/DAI's assistance in identifying and evaluating low-cost housing models for clients, and in developing a model housing loan product, were adopted by several of the institutions.

However, the inability to coordinate with other USAID assistance efforts was a problem. Even though FOMIR/DAI's group of institutions worked in areas badly damaged by the earthquakes, and areas that were included within USAID's priority disaster assistance areas, it was almost impossible to help affected clients gain access to emergency resources provided by USAID through CHF and CARE.

The PAG program generated good will for the institutions and helped MSEs recover.

Donors

USAID and other bilateral and multinational donors are well established to respond to humanitarian relief needs. The donor agencies responded rapidly with assistance for shelter, food and clothing. This relief was essential to meeting basic survival needs.

International donors are not, however, capable of responding to sudden onset disasters with new substantive programs. Internal budget and approval procedures make it almost impossible for donor institutions to initiate new projects to respond quickly to disasters. The Interamerican Development Bank, for example, made a concerted effort to develop a refinancing mechanism for MFIs; it took more than 16 months for the monies to be approved. USAID/El Salvador did not even attempt to launch new projects.[9]

The combination of donor focus on individuals in the aftermath of a disaster and the lack of a suitable mechanism for addressing the immediate needs of institutions is unfortunate. The survival of institutions is important to sustaining benefits to clients, and institutions are just as vulnerable as individuals to the catastrophic consequences of a natural disaster. But donors really have no way to support institutions that they have helped create and nurture, even if these are sound institutions facing a temporary crisis, unless there is an active project on the ground.

International donors are, however, capable of reorienting existing projects to respond to crisis situations. The existence of FOMIR/DAI made it possible for USAID/El Salvador to approve modifications of the workplan to respond to the crisis. Similar actions took place in other on-going projects. USAID/El Salvador's flexibility made it possible to provide meaningful and timely support to the MFIs.

USAID's DCA program, although not designed as a disaster response tool, did provide an innovative response to a particular problem facing one of the institutions – Financiera Calpiá. The DCA's flexibility and rapid response time permitted Calpiá to use the guarantee to overcome its short-term reserving requirements without cannibalizing its portfolio.

[9] Should USAID/El Salvador, or other USAID Mission, encounter a need to mount a disaster response effort in a similar situation, a model plan and scopes of work for such an effort are included in Annex A.

CONCLUSIONS AND RECOMMENDATIONS

"*In a state of chaos, pause to gather and share information, then act with caution and compassion*."
Author unknown.

Conclusions

Natural disasters will occur periodically in a country like El Salvador. However, damage from the natural disasters that are most likely to occur – earthquakes and hurricanes – will have a limited impact on the overall client population of the MFIs, and the amount of damage will vary greatly from location to location. Some areas may experience considerable damage while others will suffer virtually no damage at all. Because the types of disasters that are likely to occur and their timing cannot be predicted, they can not be easily planned for. Because of this there is an impelling need to understand the actual situation in the event of any disaster before acting, and a need to tailor responses to the situation rather than have a pat set of off-the-shelf responses to roll out in any situation.

The responses of the MFIs participating in the FOMIR/DAI project, FOMIR/DAI itself, and USAID/El Salvador to the earthquakes appears to have been appropriate, both in form and content. FOMIR/DAI helped the institutions that were most affected by the earthquakes to prepare realistic and effective responses to the crisis. It provided information on how other institutions had managed similar crises, provided a forum for interchanging ideas, and provided ongoing support to the institutions. USAID/El Salvador responded with sufficient flexibility in reallocating line items in the FOMIR/DAI budget and in relaxing geographic and client criteria to permit the project to respond to the need of the institutions. USAID/El Salvador's approval of the PAG program also served as an important instrument in helping the institutions maintain the loyalty of their clients and help hard-hit clients cope with the situation. The MFIs involved balanced the humanitarian needs of their clients with the business needs of the organizations, and suffered relatively few losses.

One of the most important lessons learned from this experience was that microfinance institutions and their supporters should not react too quickly in attempting to resolve a sudden crisis. While emergency relief and other non-finance responses needed to be quick, financial service responses that would have been adopted in the immediate aftermath of the earthquakes would have been counterproductive. What initially appeared to pose an immediate financial crisis for several of the institutions turned out to be very manageable. The responses that were crafted after a more careful analysis of the situation were more appropriate in meeting the needs of both the institutions and their clients.

Another key lesson that was learned was that loans secured by fixed assets, especially mortgages on buildings, tended to be overvalued. When those assets were destroyed by the earthquakes, the collateral itself disappeared.

The MFIs learned that good clients in the non-crisis environment will tend to also be good clients in a period of crisis. Those institutions that had carefully cultivated a culture of faithful repayment had very few delinquency problems while those that had been lax in enforcing a repayment discipline had more problems with delinquency during the crisis.

The DCA guaranty for Calpia was particularly effective in helping this one institution meet its temporary reserve crisis. DCA responded quickly and helped Calpiá avoid the problem of having to cannibalize its loan portfolio to meet reserve requirements on rescheduled loans.

Coordination between the FOMIR/DAI project and relief activities was not particularly successful or effective. Numerous attempts by FOMIR/DAI to coordinate the needs of its microfinance clients with sources of emergency assistance – either through USAID/El Salvador officials or directly with the NGO emergency response managers – were met by a decided lack of support. USAID/El Salvador-sponsored relief activities involved in emergency housing, though operating in areas in which the FOMIR/DAI participants had active clients who had been affected, were unable or unwilling to include these clients in their assistance programs.

The large official donor organizations find it difficult to initiate or develop a program response to crisis situations. For the donors, program activities require lengthy project identification and budget approval processes. The IDB, for example, took more than 18 months developing a back-up loan facility for MFIs. USAID/El Salvador did not even attempt to develop a new program or development project to assist microenterprises, cooperatives, farmers, or other recover from the earthquakes – the amount of time and effort required to put a new project into operation were simply too great to even consider. Assistance to affected people was accomplished through slight modifications in existing programs rather than major new initiatives or redirection of existing programs.

Similarly, the GOES found it difficult to develop a new loan program rapidly to support microenterprises through NGOs, even though the Ministry of Finance and BMI were willing to do so. Tradition and the lack of flexibility in operating policies and procedures – to say nothing of the fact that funds for the program never materialized – prohibited an innovative response that could have both benefitted the MFIs and greatly increased the government's outreach to poor microentrepreneurs.

In conclusion, success in managing a crisis stemming from a natural disaster depends primarily on understanding the nature and extent of the damage, on managing information expectations, and on tailoring responses to the specific needs of the affected populations.

Recommendations

MFIs

The MFIs that participated in the FOMIR/DAI project were lucky. None of the institutions suffered a loss of staff or serious institutional damage. None of the institutions lost their computer systems or institutional data. At the time of the earthquakes most of the institutions were exposed to the disruptive and damaging impact the earthquakes could have produced, yet none of them had disaster plans or procedures for handling disasters.

As we look back at the earthquakes in El Salvador, it becomes apparent that:

- All MFIs should have a basic risk management plan to cover common risks;
- All MFIs should follow prudent practices of maintaining off-site backup of data and systems;
- All MFIs should work to maintain strong portfolios during normal periods, and need to focus immediately on the portfolio implications of a disaster situation; and
- All MFIs should have standard policies on client relations during a period of crisis.

Projects

The main role of a project – such as the FOMIR/DAI project in El Salvador – is to help its institutions manage the crisis. On-the-ground projects should be prepared to bring in outside experience to demonstrate that other institutions have successfully managed crisis situations and to introduce some of the tools and techniques that have been successful. These projects should be prepared to provide assistance in helping their partner institutions assess and understand the situation, and plan appropriate responses. It is extremely important that on-the-ground projects not panic and not over-react.

Projects are in a key position to help MFIS produce and understand the data needed to manage the crisis, through monitoring their portfolios and plan actions to minimize portfolio and income losses, liquidity problems, and the risks of insolvency. Project advisors should work with the MFIs on a daily basis to make sure that they are assessing the situation correctly, and taking appropriate actions to respond to any situations that threatens the safety and soundness of the institution. In particular, a project should be prepared to develop and work with the institution to understand and apply several key measuring instruments, including:

- Client survey tools;
- A comparison of planned and actual collections (recuperaciones);
- A daily delinquency profile for the first 30 days;
- A daily or weekly projection of income and expenses, comparing actuals and projections;
- A monitor of changes in savings withdrawals and loan requests (especially for borrowers with current loans);
- An indication of changes in cash flow;
- Projections of potential write-offs and reserving requirements;
- Possible loan restructurings, and their impact on income, liquidity and reserves; and
- Liquidity requirements.

These instruments – charts, graphs and projections – can quickly identify problems while they are still manageable.

Projects can also help institutions access other resources – either for the institutions themselves or for their clients. It is unlikely that either the MFIs or the project will have resources to respond to the humanitarian crisis that accompanies a disaster, but a donor-financed project should be in a good position to help the institutions link their clients to disaster relief efforts. To the extent that clients are able to resolve some of their cash needs and reconstruction requirements through grant programs, they will have less of a need to withdraw savings or request "exceptional" loans, and will be more likely to service their existing loans. A project should make contacts with sources of disaster assistance and direct client institutions to sources that are capable of providing needed assistance. In many cases it will need to broker the contact between suppliers of disaster relief and the MFIs.

A third important role that a donor-financed project can play in a crisis situation is to take an active role in identifying, evaluating and developing appropriate guidelines for access to short-term liquidity sources. If an MFI appears to be facing a liquidity problem, the donor-financed project should be taking an active role in helping it assess its options, assess the impact of funding on its financial stability and growth, and apply for needed funding if a solid justification exists.

In a more general sense, any donor-assisted project working with MFIs need to include risk management (including disaster management) in its services to the MFIs, which would include:

- Developing tools and offering training to help the MFIs make a more thorough assessment of their risk profiles and develop a risk management plan;
- Formalizing a set of recommended steps and procedures for understanding and mitigating risk in a variety of settings;
- Developing a disaster preparedness plan to cover small as well as widespread disasters.

The risk analysis tools and training, and the model disaster preparedness plan, should cover the full spectrum of risk for financial institutions, not just those associated with a widespread disaster such as a hurricane or earthquake. Risk management preparations should include:

- Physical structures, including security and fire danger;
- Operating procedures;
- Data processing, reporting and information storage;
- Computer security;
- Cash handling;
- Auditing and accounting standards;
- Bonding and insurance; and
- Procedures to follow in emergency or disaster situations.

Donors

The primary donor response to a crisis situation is to provide humanitarian assistance – emergency food, shelter and clothing. Donors are well positioned and well prepared to do this. Donors such as USAID should certainly take a leadership role in pulling together all of the institutional contractors and programs they are financing to ensure communications among the contractors and to provide a basis for appropriate responses and coordinated actions. Donors such as USAID should be especially concerned with supporting affected beneficiaries of the projects they are funding, and should ensure that these affected beneficiaries have access to the humanitarian and reconstruction assistance that is being provided.

Although donors are not particularly well prepared for initiating a program response to a crisis, or making major changes in the purpose or mandate of existing projects to focus on a crisis response, they should be prepared to grant projects the flexibility to address the crisis, and to tailor innovative responses to the situation.

The El Salvador experience aptly demonstrates that donors should not attempt to set up permanent structures or responses when there is no regular or chronic disaster threat. Although a disaster recovery loan fund may have been useful, it was not essential in this case, and would have caused funds to sit idle long before ever being used.

Donors especially need to assess the situation in any crisis before rushing in with assistance, as many, if not most, of the original concepts for relief responses to the earthquakes would have inappropriate

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Brief 1. Loan Rescheduling After a Natural Disaster
Brief 2. New Loans After a Natural Disaster
Brief 3. Using Compulsory Savings for Natural Disaster Response
Brief 4. Non-Financial Emergency Services to MFI Clients
Brief 5. MFI Liquidity Problems After a Natural Disaster
Brief 6. Pre-Disaster Planning to Protect Microfinance Institutions
Brief 7. Pre-Disaster Planning to Protect Microfinance Clients
Brief 8. Microfinance Donors: Preparing for Natural Disaster

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ANNEX A

MODEL ACTION PLAN FOR RESPONDING TO DISASTERS

FOMIR was able to respond to the needs of its partner MFIs with information and direct assistance from both long term and short term consultants. Seven majors terms of reference were developed and implemented. To assist USAID in responding to future disasters, FOMIR has provided the scopes of work for consideration and implementation in the event of a future disaster. These include:

1. Developing and Implementing Action Plans for MFI Response to Natural Disasters
2. Identifying the Need for Financial Resources to Respond to the Earthquake
3. Designing Productive Asset Replacement Program
4. Designing Loan Products for Housing
5. Assessing Damage to Local Commercial Markets
6. Defining Opportunities for Small and Micro Enterprises in the Housing Construction Market
7. Position Description for Long Term Technical Advisor To Assist MFIs Affected by Earthquakes

Scope of Work #1

Developing and Implementing Action Plans for MFI Response to Natural Disasters

Summary

After a disaster, microfinance clients and the poor in general need capital infusions to meet emergency cash requirements, replace productive assets, or rebuild their houses. Access to capital speeds up the pace of re-establishing livelihoods and income-earning activities, enabling clients to recover from the disaster as well as meet their obligations of repaying new loans and rescheduled old loans. From a long-term perspective, new loans help MFIs retain good clients and protect their future portfolio through regular repayments. Three types of loans have typically been extended to clients in good standing: (I) emergency loans, (ii) housing loans, and (iii) asset replacement loans.

Emergency loans are for small amounts sufficient to buy food, clean water, and medicine. They should be provided immediately after a disaster. Not only are they most effective at that time, but they also enhance the microfinance institution relationship with its members

Housing loans and Asset replacement are medium-term loans made for the purpose of replacing or repairing physical assets of the household and business. Intended uses include replacing lost equipment needed for income-generation activities, ranging from cooking utensils to sewing machines, and rebuilding damaged homes and business premises. The objective of the loan is to help the household to reconstruct livelihoods and businesses to their pre-disaster state loans to generate enough income to completely service these asset replacement and housing loans.

Two additional issues are important for consideration: (1) Timing is critical. Microfinance institutions must first develop a clear strategy and action plan for assessing and protecting their existing portfolio while developing new products. (2) Given that terms and conditions of these loans differ significantly from typical microfinance products, microfinance institutions specializing in short-term group loans must update their financial technology and skills to provide these products.

Details of Work

FOMIR/DAI will provide each of it's 11 client institution with immediate technical assistance to assist them to develop and implement an action plan that allows them to define and respond to clients needs rapidly in ways that mitigate the risk to the financial institution and microfinance industry in general.

Past experience has demonstrated that poorly planned disaster response loan programs lead to poor repayments and most importantly distortion in the microfinance market. Each consultant will be required to:

1. Assist FOMIR/DAI grantee institutions to prepare and implement emergency portfolio management plans.
2. Using FOMIR-provided survey tools, provide technical assistance required to assist MFI in gathering and analyzing information on number of clients affected by the earthquake, preparing restructuring plans, and in defining portfolio financing strategies.

In preparing emergency portfolio management plans two additional issues are important for consideration:

- Timing is critical. Microfinance institutions must firs develop a clear strategy and action plan for assessing and protecting their existing portfolio while developing new products.
- Given that terms and conditions of these loans differ significantly from typical microfinance products, microfinance institutions specializing in short-term group loans must update their financial technology and skills to provide these products.

Resources Requirements

Short term technical advisors skilled in working with MFI management and previous experience planning responses to natural disasters. FOMIR will provide between 5 to 10 days for direct technical assistance based on level of need of the MFI. Follow-on technical assistance in implementing action plans will be considered.

Scope of Work #2

Identifying the Need for Financial Resources to Respond to the Earthquake

Summary

Prior to January 13, 2001, El Salvador had a sound microfinance system that was, with USAID/El Salvador assistance, rapidly expanding into rural areas of the country. Through technical assistance, training and limited financial support, the eleven MFIs participating in the FOMIR/DAI program had an expanding client base, a growing portfolio of loans in rural areas, a relatively low and decreasing rate of delinquency and continued improvements in institutional sustainability.

The earthquake that struck El Salvador on January 13, 20001, caused widespread damage throughout the southern part of the country. Some 800 people died, another 4,500 were injured, and nearly 200,000 homes were damaged or destroyed. Due to the effect of the earthquake on microentrepreneurs and their families, the initial damage to the MFIs participating in the USAID/El Salvador-sponsored FOMIR/DAI project was considerable. However, it created a need for caution to implement a process to assess the current and future damage, evaluate and implement options to safeguard their growth and sustainability.

A second major earthquake struck the country on February 13, killing more than 400 people and extending the damage to homes, public services and productive assets in three additional departments of the country. Significant aftershocks, notably on February 17, continue.

This rapid succession of earthquakes in February exacerbated the problems facing the MFIs participating in the FOMIR/DAI project – particularly Calpiá, CAM, ASEI, ACCOVI and ACACSAMERSA, and to a lesser degree institutions like Fundación Duarte. A substantial percentage of the clients of these institutions have been severely impacted by the earthquakes, and they are now experiencing higher rates of delinquency, lower rates of repayment, and lower income. What originally appeared to be a manageable situation has now become more tenuous, and additional actions may be required to stabilize the institutions, protect the loan portfolios and maintain the solvency of the institutions involved.

Client Situation

The microentrepreneurs who comprise the clients of the eleven MFIs were affected in several ways: injury or loss of life to themselves and family members;

- loss of personal property, in particular houses and furnishings;
- loss of business assets – locales, equipment and inventories – especially for those businesses that were located in the clients' homes; and
- loss of ongoing sales because of damage to their own clients.

MFIs have reported 8 to 40 percent of their clients throughout the country (with up to 50% in the hardest hit departments) suffered a severe direct loss of assets. Moreover, all clients are experiencing reduced sales from the earthquakes' dampening affects on the economy.

As a result, many of the microentrepreneurs are faced with the need to make major expenditures to reestablish homes and businesses, and have a diminished income in the short-run. Their ability to service outstanding loans has decreased and they are faced with the need to increase spending to reestablish homes and businesses. Lacking large amounts of cash and savings, they require access to relief grants and ongoing financing for business activities. Because of the widespread damage to houses and productive assets, many clients need larger and longer-term loans to cover reconstruction.

Institutional Situation

Given the situation of MSE clients, the MFIs participating in the project experienced an immediate and precipitous decline in collections in the period immediately following the first earthquake. Several of the institutions noted that collections fell to as little as 30 to 40 percent of normal collections in the week following the earthquake. Collections began to improve in subsequent weeks, however delinquency has continued to rise. None of institutions that accepted deposits witnessed a major increase in withdrawals of savings following the first earthquake, and requests for loans did not increase significantly.

The situation has deteriorated in the wake of the subsequent earthquakes. Collections have again declined, this time on a much broader scale. Delinquency has increased. And, the demand for cash has increased, resulting in increased withdrawals of savings and increased requests for financing. This has resulted in:

- increasing problems with liquidity and solvency;
- declining income;
- increasing need to reschedule loans and possibly to write off significant amounts of loans.

Financing Needs

FOMIR/DAI has the resources available to assist the institutions to work through the technical, policy and operational effects of the earthquake. However, it does not have sufficient resources to meet the increased financing needs of the MFIs, which fall into the following categories:

- backup financing for loan rescheduling and reserving for loan losses due to deteriorating outstanding portfolios; and
- portfolio financing for short-term emergency loans and working capital and longer-term financing for reconstruction of housing and productive-asset for microentrepreneurs.

In the absence of such financing, several of the non-bank institutions participating in the project could encounter severe problems due to clients' inability to service outstanding loans and diverting funds from their businesses working capital needs to replace their lost assets.

Deposit-taking institutions such as Calpiá, ACCOVI and ACACSAMERSA could face problems of insolvency if their delinquent portfolios cannot be restructured in such a way as to protect their capital. They could also face a serious crisis of confidence if they lack the liquidity needed to meet demands for withdrawals and new financing. The non-depository NGOs will simply contract as they write-off bad loans. In such a contraction, it would be prudent for them to eliminate their less profitable services, particularly their new efforts in rural areas and the more risky areas affected by the earthquake. This would undermine the key objective of USAID/El Salvador's strategy for increasing the availability of financial services in rural areas and reduce the ability of microentrepreneurs to rebuild their businesses and reestablish their families' source of livelihood.

Financing Options

Numerous alternatives have been proposed to meet institutions' solvency and liquidity requirements so they can continue to service rural microentrepreneurs' needs for short-term working capital and longer-term financing for reconstruction of housing and productive assets. The options presented here offer the greatest promise to leverage local resources and maintain the MFIs' financial discipline by meeting the institutions' financing requirements in a commercial relationship. Hence they support USAID's microfinance objectives and FOMIR/DAI's operating principles by fostering institutional development while enabling MFIs to reach more rural microentrepreneurs on a sustainable basis. Following are short, initial descriptions of financing mechanisms that could meet these dual needs and objectives. The first two options are designed primarily to meet the institutions' needs for back-up financing while the latter option is for portfolio financing. Each mechanism requires further examination and development.

Trust Fund to Buy Bad Debt

USAID could establish a trust fund (fidecomiso) in one or more commercial banks to buy the bad debt off of the balance sheet of the affected MFIs. This would reduce their need to set reserves and become insolvent. The sale could be in the form of a repurchase agreement, in which the MFIs would continue to service the doubtful loans. As the debt is collected, it reverts back to the financial institution. Any bad debt is absorbed by the trust fund.

When the process is complete (all loans either collected or all hope is given up), the trust fund becomes free to do other things (e.g., return funds to the US government or other donors, establish a permanent backup financing facility for the MFIs, etc.)

The advantage for the MFIs is that it takes bad debt and rescheduled loans off of the balance sheet, thus avoiding risks of insolvency and allowing them to continue to finance their portfolios. If they sold the portfolio to another institution, they would have to sell at a discount, which would limit the ongoing lending activities they could finance and reduce their sustainability.

The advantage for USAID/El Salvador and FOMIR/DAI is that it keeps the institutions solvent and provides liquidity so that they can generate a new performing portfolio. It allows FOMIR/DAI to assist the institutions in a way that encourages them to operate in a more commercial, sustainable manner. If collections take longer than the time remaining in the project, the mechanism can continue independently.

The main disadvantage is that it requires the commitment of sufficient funds to purchase the initial bad debt of the institutions, which could be in the neighborhood of $10 million.

Guarantee a Local Bank Repurchase Facility

A similar mechanism could be established using a guarantee instead of direct funding. This would require a local (or international) bank(s) to fund the repurchase facility with a guarantee from the A.I.D. Development Credit Authority (DCA). The bank would purchase portfolios of debt from affected MFIs at a discount, under a repurchase agreement. The MFIs would continue to service the loans. As the loans are paid off, the MFI repurchases the loan from the bank. The guarantee and the participating bank cover any losses according to a predetermined schedule.

The major advantage of this approach is that it does not require a large cash outlay from the U.S. Treasury, and can be implemented quickly. The participating bank(s) would be able to use its own liquidity in a more productive manner, with a substantial guarantee from the U.S. treasury.

The major disadvantage is that the MFI would not receive a full re-flow of its funds, and would be forced to reduce its portfolio and operate at a lower level of sustainability.

Guarantee a Loan Facility

A similar type of institutional arrangement could be used to finance loans from a commercial bank to the MFIs. This would not resolve the problems of refunding the doubtful loans in the portfolio, but it would give the MFIs access to cash for short-term liquidity purposes. This mechanism could, furthermore, facilitate client access to longer-term funding to reconstruct houses and productive assets.

Although programs to provide subsidized loans for housing reconstruction have been announced in the country, very few microentrepreneurs will be able to access these funds. Housing reconstruction is clearly one of the immediate needs of a large number of the clients of the FOMIR/DAI-assisted institutions and, unless the housing issue is resolved, these clients will have difficulty servicing their existing enterprise loans and may not be eligible for future loans from the institutions.

Small financial institutions face severe challenges in making housing loans. The larger size of the loans and the longer payback period limits the number of houses a small institution can afford to finance. Credit unions in the United States were unable to engage in significant housing lending until they established their own mortgage company to pool and sell housing loans through the secondary markets. The non-bank MFIs in El Salvador face a similar constraint.

A guaranteed loan facility could foster a secondary mortgage fund for microentrepreneurs by leveraging funds from a commercial bank to purchase portfolios of housing loans generated by participating MFIs. The MFI would originate a number of loans and package those for sale to the fund. The MFI would continue to service the loans, earning a service fee. Losses would be covered under a predetermined schedule by the bank and the DCA.

Next Steps

The most important step to take in the near term is to assemble the various interested parties – USAID/Washington, USAID/El Salvador, FOMIR/DAI, the InterAmerican Development Bank and one or more commercial banks – to determine whether or not there is a need for action. If action is required, these representatives need to assess the various alternatives and determine an appropriate course of action for assisting the MFIs through this period of crisis.

FOMIR/DAI would like to request USAID/El Salvador to invite the appropriate staff members of the USAID/Washington Office of Microenterprise Development and DCA to visit El Salvador during the week of March 12th. The objective of the week would be to assess the situation and design an appropriate response to the financing needs of the MFIs in the wake of the recent earthquakes. The week would require an intensive working collaboration among USAID/Washington, USAID/El Salvador and FOMIR/DAI. Following is an outline of key activities that should form the basis of the weeklong working visit:

- Meeting between USAID/Washington and USAID/El Salvador to determine most appropriate mechanisms to address the MFIs' needs.
- Meeting of USAID/Washington and USAID/El Salvador with FOMIR/DAI to present situation of microfinance sector in general and MFIs participating in FOMIR/DAI project in particular.
- Stakeholder interviews with select MFIs, donors, bankers and other relevant parties.
- Draft plan and application process.
- Joint presentation by USAID and FOMIR/DAI to MFIs to solicit reaction and present application process.
- Finalize financing plan and process including application format and timeline for implementation.

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Details of Work:
Following is an outline of key activities that should form the basis of the weeklong working visit.

- Meeting between USAID/Washington and USAID/El Salvador to determine most appropriate mechanisms to address the MFIs' needs.
- Meeting of USAID/Washington and USAID/El Salvador with FOMIR/DAI to present situation of microfinance sector in general and MFIs participating in FOMIR/DAI project in particular.
- Stakeholder interviews with select MFIs, donors, bankers and other relevant parties.
- Draft plan and application process.
- Joint presentation by USAID and FOMIR/DAI to MFIs to solicit reaction and present application process.
- Finalize financing plan and process including application format and timeline for implementation.

Resource Requirements:

Consultant with experience in liquidity planning for MFI, knowledge of local regional and international funding sources. Required level of efforts is estimated at 15 work days.

Scope of Work #3

Designing Productive Asset Replacement Program

Summary

Rebuilding personal assets, specifically a home damaged or destroyed in the earthquakes, is the first critical step in the rehabilitation process. A new area of work for FOMIR/DAI will be to work closely and rapidly with local partner organizations to identify those clients severely or totally affected by recent earthquakes. The objective of the Productive Asset Grant program will be provide grants to small and micro entrepreneurs in need of assistance to re-establish their homes and their livelihoods. To ensure leverage, Productive Asset Grants will only be provided in cases where the MFI commits to restructuring or issuing new loans to the Productive Asset grantee.

FOMIR/DAI has ear marked $400,000 from its existing grant fund and USAID intends to add an additional amount of $600,000 to create a $1,000,000 fund. Operational cost for the funds are estimated at $97,000.

FOMIR/DAI has established a preliminary list of how grants might be used. Productive Asset Grants will be used to:

- Repair damage to business locations;
- Partially or completely replace productive assets, for example sewing machines, ovens, production machinery, business furniture, and other equipment;
- Buy material to repair space in the home used to operate the business;
- Pay for the costs associated with new or restructured loan, for example for registering housing title or mortgages; and
- Pay for construction inspection services.

The program will be open to all clients and will give preference to those clients living mainly in the municipalities of Usulutan, San Vicente, and La Paz.

Activity to Date

In May, FOMIR completed a study of the current and planned housing reconstruction project including development of geographic maps highlighting location of intended reconstruction project. The information gathered from this survey will be disseminated to MFI organization as part the PAD program.

FOMIR has developed preliminary client selection criteria. Upon receipt of contract amendment, FOMIR will submit selection criteria to USAID for final approval. MFI clients served under the program will meet the following criteria:

- Client will commit to continue or re-establish their small and micro activity;
- Client will have had a performing loan with a FOMIR/DAI MFI prior to the earthquake of February 13, 2001;
- Client will commit to terms of new or restructured loan from a FOMIR/DAI assisted MFI; and,
- Client will be deemed by FOMIR/DAI, in coordination with the MFI, to have limited capacity to repay the new or restructured loan and been severely affected by the earthquakes in terms of personal assets.

FOMIR/DAI has already begun work with its partner MFI's, to analyze and segment the portfolio affected by the earthquakes, to identify those clients in need of grant assistance to re-establish their income generating activity. In June, ACCOVI conducted of survey of clients severely affected by the earthquake and identified 422 clients in need of productive asset grants. Both Calpia and CAM are completing their assessment.

To continue this process and prepare for program launch, FOMIR intends to contract the services of a consultant to work together with CAM, Calpia and Accovi to define current status of portfolio affected, activity to date in respect to restructured loans and current needs of clients affected by the earthquake.

Details of Work:

For each the three above referenced organization:

- Review and provide update financial information on the segment of the loan portfolio affected by the recent earthquake,
- Determine the number and percentage of the portfolio at risk that has been restructured and the number of and percentage to portfolio still to be restructured,
- Review and comment on each the process used to restructure loans of clients affected by the earthquake,
- Determine the number of at risk (clients with or awaiting loan restructuring) requiring productive asset grants.
- Review current PAD general client criteria and recommend specific method for qualifying clients on a case by case basis.
- Review current PAD guidelines and provide comments on ways to increase project impact and objective to assist those microenterprise owners in need to reestablish productive activity.
- Document information generated in a written report not to exceed 10 pages.

Resource Required:

Consultant with Microfinance/Banking Experience and previous experience in designing relief programs targeted to microenterprise owners. Level of effort is anticipated at 15 work days

Scope of Work #4

Designing Loan Products for Housing

Summary

FOMIR/DAI has worked closely with our partner organizations to assess the impact of the earthquakes, and more importantly to implement a process that provides the information required to make sound program decision in response to disaster and the resources required to respond to the needs of the institutions and their clients.

During the last three weeks, FOMIR has participated in various meetings with the Minister of Economy, Conamype and BMI discussing ways to ensure that well designed credit products are available to the microfinance segment of the economy. As a result of these meetings, the government of El Salvador and BMI has requested that FOMIR design and implement a pilot project to develop and test new microfinance/housing products.

Based on the recommendation of FOMIR/DAI, six FOMIR grantee institutions have been selected to participate in the pilot program. The purpose of this program is to develop and launch a new microfinance/housing loan product designed to address the needs of microenterprises affected by recent earthquakes. To address the substantial need for loans to rebuild their homes and businesses, new finance products must be developed and available within 45 days. The six organization selected to participate are CALPIA, CAM, FUSAI, ACCOVI, Banco Agricola and Banco Salvadoreño

Over the next month, FOMIR working together with the pre-selected group of organizations, will develop and launch new finance products. The process will be managed by BMI, with key technical assistance and training inputs provided by Fundamicro and USAID through the FOMIR/DAI project. Government will play an important role in providing the resources required to develop and disburse the new credit products but the participation of the FOMIR organizations is critical to financial success of the program.

The program will be implemented in three phases:

Phase 1: Rapid Design of credit products, policies and procedures and design of pilot testing process.

Phase 2: Pilot test of new products in areas affected by the earthquake for 60 days.

Phase 3: Full new product rollout.

To participate, the pre-selected organizations must be willing to assign an experienced credit product development manager and three credit officers to the program. The product development manager will serve as part of a design team assigned responsibility to develop product terms and policies. The product development team will begin work on April 17th and will work full time for three months. Credit Officers will begin training on April 30th and be expected to begin identifying and appraising loan candidates during second half of May. To compensate the FOMIR organizations, the Ministry of Economy will cover the cost of the salaries and training of staff assigned to program for a period of 90 days. Should the FOMIR institutions require funds for lending, BMI will provide your organization with access to capital at a rate equal to the passive rate of interest.

Details of Work:

1. Design Team Formation and Orientation Program
2. Design and Implement a New Product Development Process including:
    - Client Profile & Need
    - Terms
    - Policies and Procedures
3. Design and implement the steps to customized the generic product each MFI Requirements
4. Design Pilot Test with six MFI's x 3 Credit Exec's Implementing pilot in 21 locations
5. Coordinate with Fundamicro on training provided to FOMIR Institution Credit Officers
6. Advise BMI on its MFI Selection and Contract Process
7. Test New Products in respect to:
    - Market Response
    - Terms
    - Appraisal Process for Efficiency
    - MFI Institutional Development Requirements
    - Defining most appropriate Credit Exec. Profile
8. Plan National Roll-Out

Resources Required:

Consultant with experience in designing and launching housing loan products targeted to micro enterprise owners. Consultant should understand and appreciate common constraints associated with introducing new products to developing MFIs. Estimated level of effort is 60 days over a four month period.

Scope of Work # 5

Assessing damage to Local Commercial Markets

Background

The January 13th earthquake caused a disruption to the income generating capacity of the micro and small enterprise sector in El Salvador. Preliminary estimates indicate approximately 57,000 of the 473,163 micro and small entrepreneurs nationally suffered severe damage to their homes and/or businesses.

The earthquake has damaged and disrupted micro and small entrepreneurs' business locales in their homes, central markets, stores and workshops. It has changed their immediate and medium term financing needs. The effects of the earthquake have modified demand in the sectors in which MSEs operate. These dimensions of the effects of the earthquake on MSEs can be seen in the following manner:

Forty nine percent of MSEs operate their businesses out of their homes, and more than half of them are women and single headed households. These homes are often poorly constructed and suffered severe damage or outright destruction from the earthquake. Hence these families have felt a direct impacts upon their current and future livelihoods.

Structural damage to central markets has interrupted normal distribution and sales in the commerce and service sectors, which represent 59% of the MSEs in El Salvador. Moreover, MSEs operating out of small storefronts and workshops also have suffered severe damage to their locales.

With MSEs providing the main source of income for almost half of all Salvadorans, it is imperative this productive sector get back on its feet quickly to enable poor, working families to earn their livelihoods.

Information on actual damage to physical markets is difficult to obtain. Is it estimated by FOMIR DAI that 20-25 central markets were damaged as a result of the earthquakes on January 13th and February 13th, 2001. As the commerce sector is critical to income generation capacity of rural poor and an important segment of the microfinance portfolios services by FOMIR grantees, the project must determine the qualitative and quantitative impact of the earthquake on physical markets located in the departments most affected. From the information generated, FOMIR/UDSAID will develop appropriate market/municipality development projects.

To determine the qualitative and quantitative impact of the earthquake on retail markets, FOMIR will conduct three related assessments.

Using information provided through COEN, FISDL and USAID, the project will develop a list of those municipalities reporting damage to the physical markets. This information will be cross-referenced with information from Fomir institution on the municipalities that have a high number of MFI clients affected by the Earthquake. The results of this analysis should provide FOMIR with a specific list of physical markets reporting damage.

From the total list of market sites damaged by the earthquake, FOMIR will develop a short list of markets to be visited for on-sight inspection and interviews. In each site FOMIR/USAID will:

- Conduct interviews with the Alcadia to solicit information on damages to local markets, emergency response programs and plans for reconstruction.
- Conduct interview with the market association to determine affects of the earthquake and needs of micro entrepreneurs that operated from the market.

- Conduct interview with 10 microfinance clients to gather information on problems resulting from the earthquake and to identify potential solutions.

In the markets visited, FOMIR/USAID will conduct a physical inspection of the markets to identify the level of damage and options for repair, demolition and or relocation. These structural damage reports will provide basis for in-depth evaluation to be conducted at a later date.

Personnel Requirements:

Survey Coordinator to design and mange the three assessments, coordinate activities, manage interview coordinator and engineer and produce final report. FOMIR intends to contract the services of Mr. Carlos Cardona for a period of 30 days beginning March 22, 2001.

Interview Coordinator to design market association and entrepreneur interview format, conduct interviews and document finding of interviews. FOMIR DAI has arranged to access the service Peace Corps Volunteer, Riley B. Folds for five week period beginning March 22, 2001 ending April 24, 2001.

Engineer to conduct diagnostic of Physical Market to identify the level and estimated cost of repairing market included in the site visit. FOMIR will contract the services of a local engineer (To be determined) for up to 15 day days.

Products:

- General Report on the Status of Physical Market in areas affected by the Earthquake.
- Report on Interviews with market women
- Summary on problems and constraints identified in the assessment and recommended program actions to respond to need.

Work Plan:

Week #1: Develop list of Physical Markets Damaged, Select Municipalities for On-sight visit, design survey tools/questionnaires. Establish and confirm visits to municipalities.

Week #2 and #3: Conduct On-sight visits and interviews, document interview findings. Prepare preliminary finding reports and conduct meeting with USAID on April 5th.

Week #4 and #5Conduct required follow-up meeting and complete report for submission to FOMIR and USAID.

Resources

FOMIR/DAI will provide office facilities, administrative/secretarial and logistical support to the consultants. The Peace Corps Volunteer will be provided with per diem and housing while on assignment to FOMIR.

Scope of Work #6

Defining Opportunities for Small and Micro Enterprises in the Housing Construction Market

Summary

As a result of recent earthquakes, FOMIR grantee institutions are planning to launch new products designed to help microentreprenuers rebuild their houses and reestablish productive assets. The target market for loans currently being developed by the FOMIR MFI's is to microenterprise owners who make between 2-6 minimum monthly salaries.

This market in some cases overlaps and other is just above the market to be served by government, USAID and other donors with free housing. FOMIR MFI's would benefit from real time information on the proposed housing development and reconstruction project to be implemented over the next six months. Review select survey documents and conduct a sample survey of construction related industries in the target area to estimate the number of micro and small enterprises involved in the housing construction sector. Conduct stakeholder interviews to determine capacity to provide products and services.

Consultants will be hired to develop a sector map of the enterprises involved in the housing construction sector with specific emphasis on defining products and services that can be provided by the microenterprise sector.

The consultants will meet with governmental and non-governmental organization (NGO's) involved in the implementation of housing programs to gain a clear understanding of the program criteria, implementation process and existing level of utilization to small and microenterprises in the construction process. To gather up to date information on the various housing and reconstruction programs planned for implementation, FOMIR will hire a short-term consultant for 18 days to complete the following tasks:

Details of Work:

Conduct interviews with CHF/CRS/CARE and other local NGO's who are planning to launch housing programs. The purpose of these interviews will be to identify:

- Intended target group for the proposed program
- Geographic location of the programs to be implemented to be cross referenced with FOMIR MFI new product pilot programs
- Obtain housing designs and cost estimate to determine similarities and difference between credit financed and grant financed housing market,
- Define each organization's approach to construction and house inspection to assess level of compliance with building standards and local codes, and
- Identify the criteria and process for collection and analysis of date used to determine which clients are eligible for grants subsidized houses.

From review of USAID documentation and interviews with GOS agencies, determine the process and key constraints in applying for and obtaining land title specifically for individual families and single plot construction. Identify ways to streamline the process.

Using data obtained in above referenced meetings and through GOS, and USAID develop a map and listing of municipalities most affected by earthquake in need for housing.

Using data obtained in above referenced meetings and through GOS, and USAID develop a map and listing by municipality of known suppliers of housing programs.

Products:

- Report highlighting finding from interviews conducted and process/constraints involved in obtaining or transferring land titles.
- Demand/need map for housing.
- Supply map.

Scope of Work #7

Position Description for Long Term Technical Advisor
To Assist MFI Affected by Earthquakes

Summary

Prior to January 13, 2001, El Salvador had a sound microfinance system that was, with USAID/El Salvador assistance, rapidly expanding into rural areas of the country. Through technical assistance, training, and limited financial support, the eleven MFIs participating in the FOMIR/DAI program had an expanding client base, a growing portfolio of loans in rural areas, and a relatively low rate of delinquency. MFI assisted under the project were ahead of schedule in achieving project targets in terms of outreach and sustainability. As a result of the recent earthquakes, project conditions changed.

The earthquake that struck El Salvador on January 13, 2001 caused widespread damage throughout the southern part of the country. Some 800 people died, another 4,500 were injured, and nearly 200,000 homes were damaged or destroyed. The initial damage to the MFIs participating in the FOMIR/DAI project, while considerable, appeared to be manageable.

However, a second major earthquake struck the country on February 13, killing another than 315 people and extending the damage to homes, public services and productive assets. A third substantial earthquake occurred on February 17 and three additional moderate earthquakes on February 23.

Nationally, at least 42,000 MYPE's experienced substantial or complete damage to homes and more importantly productive assets, with FOMIR institutions reporting 11,000 clients affected.

This rapid succession of earthquakes in the February 13 to 23 period exacerbated the problems facing the MFIs participating in the FOMIR/DAI project – particularly Financiera Calpiá, CAM, ASEI, ACCOVI and ACACSEMERSA. A substantial percentage of the clients of these institutions were severely impacted by the earthquakes, and the institutions are now experiencing higher rates of delinquency, lower rates of repayment, and lower income. In respect to project targets, the earthquake has dramatically slowed progress related to increased outreach and sustainability.

The institutional development process required for transformation of FOMIR/DAI grantees became more complex as a result of the earthquakes. The 11 microfinance institutions supported by the program were all faced in with the tasks of measuring and responding to the impact of the earthquake while continuing to grow their portfolios, re-engineer internal systems, hire and train new staff and plan for transformation under new banking laws. In addition, new activities related to gathering and disseminating market information and increased coordination among earthquake response institutions augments the technical and managerial content of FOMIR/DAI.

Increased Technical Assistance

To effectively manage and implement this new work, DAI received USAID approval to upgrade the position of Microfinance Technical Specialist to **Senior Microfinance Specialist**. The SMS was recruited and hired in August 2001 with the primary objective to strengthen the full time technical support provided to local MFI, specifically those affected by the earthquake. The SMS is responsible for managing the institutional development programs for the Banco Salvadoreño, ASEI, CAM, ACCOVI, ACACU and ACACSEMERSA. Three of these institutions; Calpia, Cam and Accovi had significant numbers of clients affected by the earthquake.

Position Description
Senior Microfinance Specialist

The SMS will be responsible for management and coordination of the specific institutional development programs for the to be assigned grantee institutions. Given the various legal structures among the institutions, the SMS must have skills needed to coordinate a complex institutional development process for among a diverse group of institutions.

The SMS is expected to plan and implement an effective transformation plan for the MFIs he or she is assigned. Specifically this will require development and implementation of two-year plans for the five institutions that will define the legal, governance and capital structure to be in place when the project is completed at the end of FY 2003.

The SMS will be expected to manage the final re-engineering MFI systems, policies and procedures their assigned institutions.

The SMS will also be expected to manage these medium term objectives while providing ongoing assistance designed to address current institutional problems, including the growing delinquency, faced by the project assisted MFIs. Seven of the eleven MFIs have portfolio at risk rates (more than30 days) greater than 12 percent at the end of May.

The SMS will be responsible for producing monthly, quarterly and annual report on activities and achievements of each grantee institution assigned.

Other activities assigned by the Chief of Party.

Candidate must possess:

- Change management skills needed to coordinate a complex institutional development process for many institutions;
- Operational skills required to identify and re-engineer MFI systems;
- Experience in analyzing and interpreting local banking regulations and norms; and
- Vision to plan and implement an effective transformation process, and
- Fluency in English and Spanish.

Resources Required

Funding for LTTA for a period of 18 months including standard benefit