DISASTER-RESILIENT MICROFINANCE

LEARNING FROM COMMUNITIES AFFECTED BY TYPHOON HAIYAN

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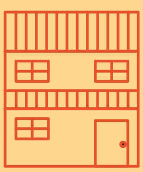
DISASTER-RESILIENT MICROFINANCE OVERVIEW

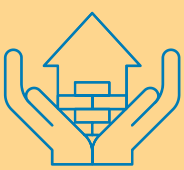
Microfinance is now an embedded feature of almost all low and middle income countries inextricably linked to the development of local markets and economies. These countries are often the most exposed to extreme climate events and so one must ask: "Can microfinance improve its role before and after such disasters hit?"

Typical postdisaster context today:

There is enormous demand for microfinance from the poor as affected populations look to rapidly begin recovery.



Microfinance Institutions (MFIs) affected by the disaster, face liquidity and potentially solvency issues, hindering their ability to provide these services.



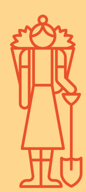
Donors and humanitarian relief programs do not commonly work with or fund MFIs for recovery lending, despite extensive locally based capacity.

Possible sustainable solutions:

MFIs delivering "Recovery lending" soon after a disaster to support rapid recovery of client's livelihoods using capable, local loan officers, thereby minimizing risk.

Insurance-like Financial Disaster Risk Management (FDRM) schemes to protect MFI portfolios enabling them to support poor communities postdisaster with scaled, reliable and efficient financial services.

Donors supporting the adoption of FDRM schemes to increase resilience of the poor while fostering financial inclusion as well as enhancing disaster response and recovery.



Humanitarian relief programs use the capacity of MFIs to enhance the recovery of livelihoods affected.

INTRODUCTION

The following report sets out the experience, analysis and conclusions of VisionFund International and their Philippine microfinance operation Community Economic Ventures Incorporated (CEVI). This analysis follows the economic recovery of over 4,000 client households badly affected by typhoon Haiyan over the 18 months following the calamity and seeks to derive recommendations for future financial disaster risk management solutions. The work was funded by the Integrated Disaster Risk Management Fund of the Asian Development Bank (ADB) with financial support from the Government of Canada.

Disasters triggered by natural hazards pose an increasing risk to Asia's poorest people; including the large archipelago nation of the Philippines. Despite the preparations of households, families and communities the effects of the most extreme of these events often bring debilitating economic impact that can set back economic progress for years. At VisionFund, we are a microfinance network that targets largely poor rural clients and recognises these risks. We are seeking sustainable disaster risk management solutions to support client resilience in the Philippines, in Asia and across the developing world.

On 8 November 2013 Super Typhoon Haiyan (locally named "Yolanda") drew a path of destruction across the Central Philippines that left millions of Filipinos homeless, injured, and without a viable livelihood. This unprecedented event severely stressed all aspects of individual, family and community resilience. In 2014, VisionFund with financial support from the ADB's Integrated Disaster Risk Management Fund, financed by the Government of Canada began to evaluate the impact of Typhoon Haiyan on the livelihoods of the communities most affected; and thereby to recommend improvements to the role of microfinance in enhancing the financial resilience of such communities. Further, this collaboration looked specifically at how best to deal with disasters by looking at the viability and benefits of an Asian Region Disaster Insurance Scheme (ARDIS). This scheme is envisaged as a regional index-based or "parametric" insurance scheme that will provide financial support to VisionFund's MFIs across Asia so that they might have the financial resources to assist their clients in such calamities. The purpose of the scheme is to ensure that MFIs have reliable access to liquidity and capital after a disaster in order to rapidly restructure existing loans and deploy fresh loans into affected communities in a way that supports the rebuilding of economic activity. We term our approach to this rebuilding of livelihoods: "recovery lending."

Typically, credit providers such as MFIs reduce lending postdisaster in response to perceived increased credit risk and their impaired balance sheets; unfortunately, should repayments exceed new loans this can lead to net outflows of cash from impacted communities at a time when they need help most. Following Haiyan, VisionFund and its Philippine MFI, CEVI, chose instead to deploy a "recovery lending" approach. This approach increased lending allowing clients to access fresh loan capital to jump start their livelihood recovery efforts, requiring only that they articulate a plan for a viable business use for the funds. VisionFund's work under this project drew heavily on lessons learned from this recovery lending to evaluate the impact on both client and institutional resilience in such an extreme event. The project further built a better understanding of the spectrum of community and household vulnerabilities, the recovery strategies employed against such shocks and the roles microfinance might play in such situations. Our conclusion is that microfinance has a growing role to play alongside household and community resilience and that is complementary to the great work of government and relief organisations in such calamities.

We have applied therefore a layered approach to understanding risk and the role microfinance can take in mitigating these layers of risk. This approach positions all of the services of an MFI and points to the need for our proposed ARDIS scheme for the most extreme and rare events.

OVERVIEW: A LAYERED VIEW OF RISKS AND FINANCIAL SAFETY NETS

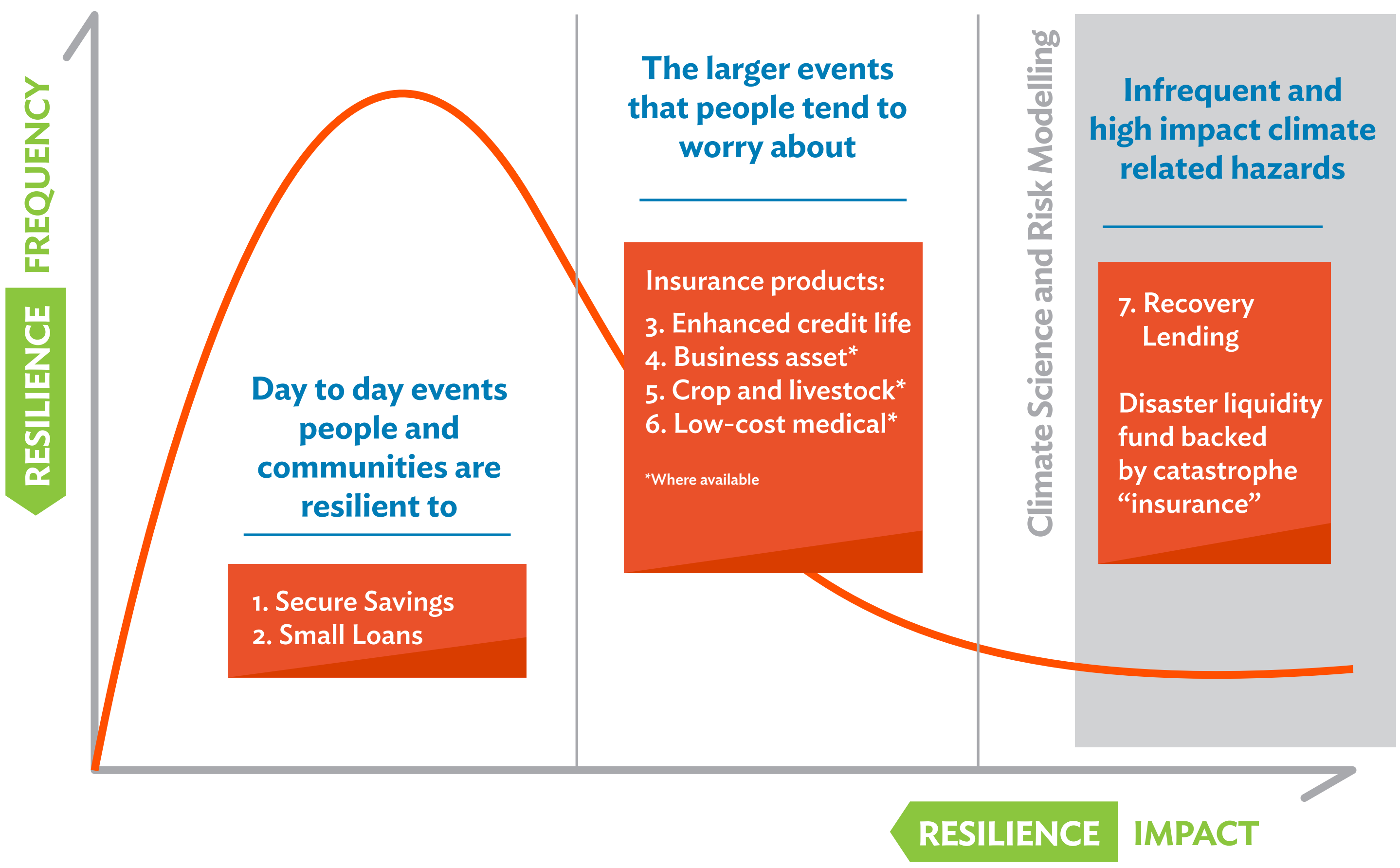
The Philippines is prone to frequent and extreme weather shocks and climate-related disasters. Poor households engaged in agricultural and fisheries sectors particularly feel the effects of these shocks given the direct impact of weather on their livelihoods. The poor are remarkably resilient and this resilience is enhanced further by their families, their communities and by government and nongovernment organizations, such as our parent World Vision, providing targeted support.

MICROFINANCE CAN HELP THIS RESILIENCE IN SEVEN KEY AREAS:

1. **Savings:** Encouraging secure cash savings to handle unexpected events

2. **Loans:** Providing small loans to deal with the negative financial effects of short term unexpected financial shocks with the discipline to avoid generating over indebtedness

RISK LAYERS AND FINANCIAL SAFETY NETS



3. **Enhanced credit life insurance:** Providing insurance to pay off loans on death or disablement of key family members, to contribute to end of life costs and to cover loan payments during their hospitalisation

4. **Business asset insurance:** While general property insurance is challenging for the poor certain specific and identifiable business assets are increasingly able to be insured at reasonable cost in relation to their value and cash contribution e.g., motorcycles, farming/fishing equipment

5. **Crop and livestock insurance:** Where agricultural practice reaches a good level of discipline and looks to reach a more sustainable economic scale/value then crop and livestock insurance is increasingly feasible

6. **Low-cost medical insurance:** Where appropriate working along side government provision to provide the targeted high value low-cost health care access that the poor most need

7. **Recovery lending:** The above still leaves the majority of loans exposed to losses through floods, droughts and storms. To address this, MFIs can help their clients with grace periods, loan restructuring and recovery loans that support their recovery from such shocks.

A CASE STUDY: TYPHOON HAIYAN

During the 2 years following Typhoon Haiyan. VisionFund studied the resilience of over 4,000 CEVI clients affected by the typhoon. This study evidenced that in their reaction to Haiyan these communities had been practically, emotionally and spiritually resilient to a very significant extent. These clients and their communities also received humanitarian aid from government and NGOs and remittances from relatives to further support their recovery following the typhoon; CEVI added to this support with grace periods on loans and early assessments of other client needs.

However, soon after the super typhoon, clients highlighted that, while relief aid was welcome and helpful, it would not support their family in the long-term and so they were eager to urgently restore their livelihoods and income before the aid came to an end. Approximately a third of our clients needed additional capital to fully restore their economic activity. Some, were also forced to find alternative sources of income, which were difficult to maintain without sufficient financial resources. We also found many others in these communities with similar needs. CEVI's Bangon Kabuhayan, or "recover your livelihood" loan, sought to address this need by providing loans of sufficient size to restore livelihoods, repayment periods to ensure repayments were affordable and, when needed, refinancing of old loans. All households that developed a viable business plan needing loan financing could apply. Loans were typically disbursed within one to two weeks after the application with repayment schedule set to match the cash flow of each individual borrower.

Through the recovery lending process, CEVI and VisionFund continued to monitor the progress of these clients and came away with four key areas of learning:

1. **Recovery lending enabled rapid client recovery:** The Bangon Kabuhayan recovery loan allowed clients to make significant investments into their livelihood. Within 20 months of the disaster, 96% of clients reported the Bangon Kabuhayan loan had supported their recovery, with approximately half of those reporting recovery as "full" or "better than before the typhoon."

2. **Recovery lending was affordable and did not lead to over indebtedness:** CEVI distributed the recovery loans in a disciplined way following its full credit processes. It was found that both on-time repayment rates and write off ratios were better than CEVI's averages for regular loans. Furthermore, in the postproject survey, only 3% of clients indicated that repayments had been significantly challenging, while 6% of clients indicated that they would not necessarily recommend a recovery loan to someone in a similar situation in the future. Aligned to the focus group discussions and surveys taken throughout the project, the evidence indicates that very few, 3% to 6%, of clients faced some difficulty or hardship in paying loans.

3. **Recovery lending is good business for MFIs which covers its costs and does not have an abnormal credit risk:** Typically the supply of credit reduces after a disaster while the demand increases. This reduction in supply is primarily due to impairment of the balance sheets of lenders but may also be because of the belief that lending post disaster brings high risk. CEVI's recovery lending project charged interest rates that fully covered the costs of making the loans and contributed to the recovery of CEVI's losses incurred from the typhoon, while maintaining on-time repayment rates that exceeded CEVI's average before the Typhoon. The write-off ratio was approximately half of the average, demonstrating that even after a major disaster, recovery lending can be low risk and sustainable.

4. **Preparation 'before the event' is needed to optimise the speed and effectiveness of recovery lending:** Funding the recovery lending response was challenging. Relief funding in disasters is generally not available to fund lending. Further, traditional funding sources were scarce due to CEVI's impaired balance sheet and the funders perception of risk. Our research indicates that this is a typical situation after many disasters and leads to reductions in credit supply. In this case CEVI's parent VisionFund and others found the resources to fund the response. However, this took time and would not be a reliable approach for future disasters. Our thoughts therefore turned to how best to fund such a response and to have the capacity in place to mount recovery lending responses when ever major disasters hit our clients. This has led to the development of our ARDIS.

THE PHILIPPINES TYPHOON HAIYAN RECOVERY

BANGON RECOVERY LOAN

4,889 LOANS DISBURSED

$430 AVERAGE LOAN SIZE

A TOTAL OF **$2,100,000** LENT TO HELP REBUILD BUSINESSES

FISHING · TRADE · ANIMAL HUSBANDRY · SERVICES · AGRICULTURE · PRODUCTION

10,500 CHILDREN ARE HEALTHIER, SAFER AND CARED FOR

THOUSANDS OF OTHERS ARE BACK TO WORK

Numbers as of 31 January 2016. All currency is in US$.

VIDEOS

RECOVERING HOPE

Watch how microfinance recovery loans bring hope to those that have lost their livelihoods to disasters: vflink.it/RecoveringHope

BANGON RECOVERY

Following Typhoon Haiyan, VisionFund designed a one-time recovery loan to help clients and other community members recover their businesses as quickly as possible. Watch how this was done: vflink.it/BangonLoan

THE BENEFITS OF 'BEFORE THE EVENT' FUNDING

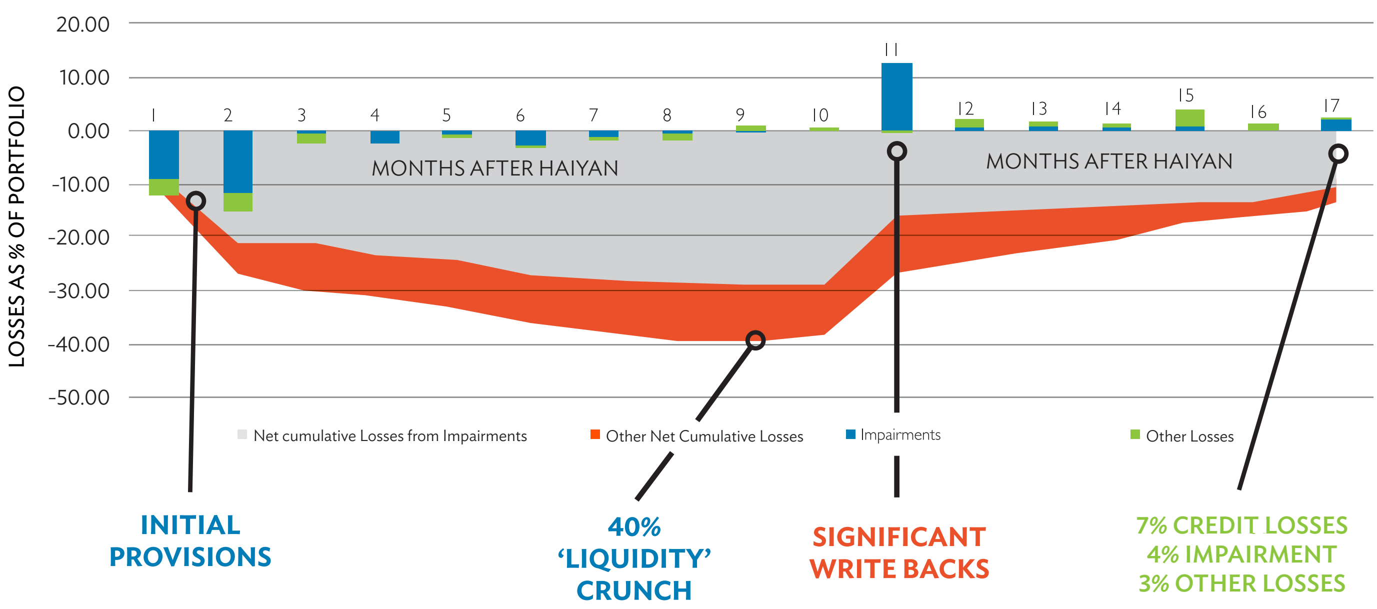
A recovery lending response requires "liquidity" by way of rapid debt funding that can be repaid after the response is complete. In addition there is a need for capital to restore the balance sheet for losses and to fund client support such as grace periods. The evidence from Haiyan clearly demonstrated that liquidity played a bigger part and so was more important than capital to such a response. Further, at VisionFund, our evidence showed that the recovery lending response reduced the credit losses to an extent that capital losses were fairly modest.

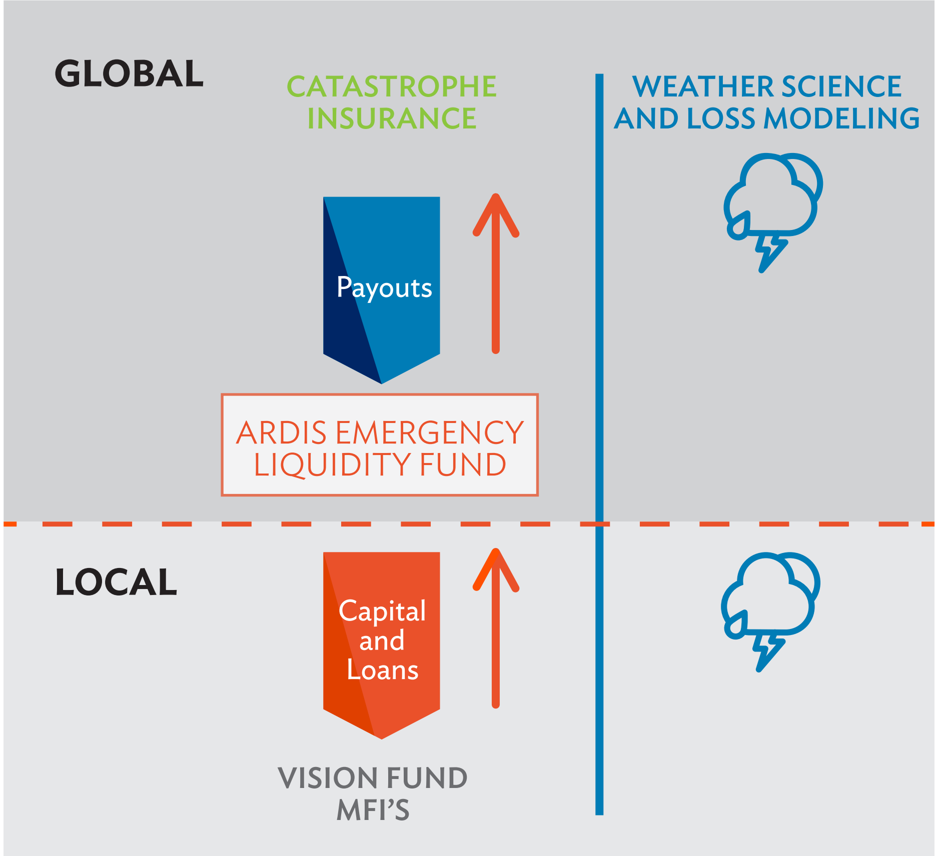
VisionFund has modelled our global requirements for such funding based on weather data going back to 1980 to develop a statistical model of weather trends thereby giving a view of climate risks now and in the near future. This modelling has shown that a liquidity fund of approximately $6 million, backed by a sophisticated weather index cover, and focused on key disaster risks could allow a recovery lending approach to be mounted for major disasters across our portfolio. This FDRM scheme combines climate science, financial modelling, recovery lending methods, weather index derivatives/insurance and liquidity funds to create a response mechanism tuned to meet our MFI and client needs with an annual cost of under 2% of our global portfolio.

FINANCIAL IMPACT: REDUCED CREDIT LOSSES

FINANCIAL PROGRESS OF MFI BRANCHES SEVERELY AFFECTED BY HAIYAN

(Actual financials over the period of the recovery lending program)





- MFIs need both capital and liquidity to respond to a disaster.
- An Asian region liquidity fund will be established to hold funds and access further liquidity.
- Catastrophe insurance will be purchased to top up the fund and restore capital losses.
- MFIs will pay a premium for this with a global average under 2% of portfolio value. High risk countries will pay a little more; others much less.
- Weather and loss modeling adds significant value day to day beyond the financing to manage risk and drive inclusion.

The scheme is currently in development with our partners GlobalAgRisk with funding from ADB, Rockefeller foundation, Nederlandse Financierings-Maatschappij voor Ontwikkelingslanden N.V./ Netherlands Development Finance Company (FMO), and Department for International Development (DFID). The application of this approach in our Asian region has been termed ARDIS and is due for detailed design to be complete by September 2016 and rolled out to four countries representing 446,000 of our Asian clients: Cambodia, Myanmar, Sri Lanka, and the Philippines during the following year.

LINEL: A CLIENT'S STORY

Filipino client Linel used to farm and sell dried fish. This all disappeared after typhoon Haiyan destroyed both her farm and the dried fish that she would sell.

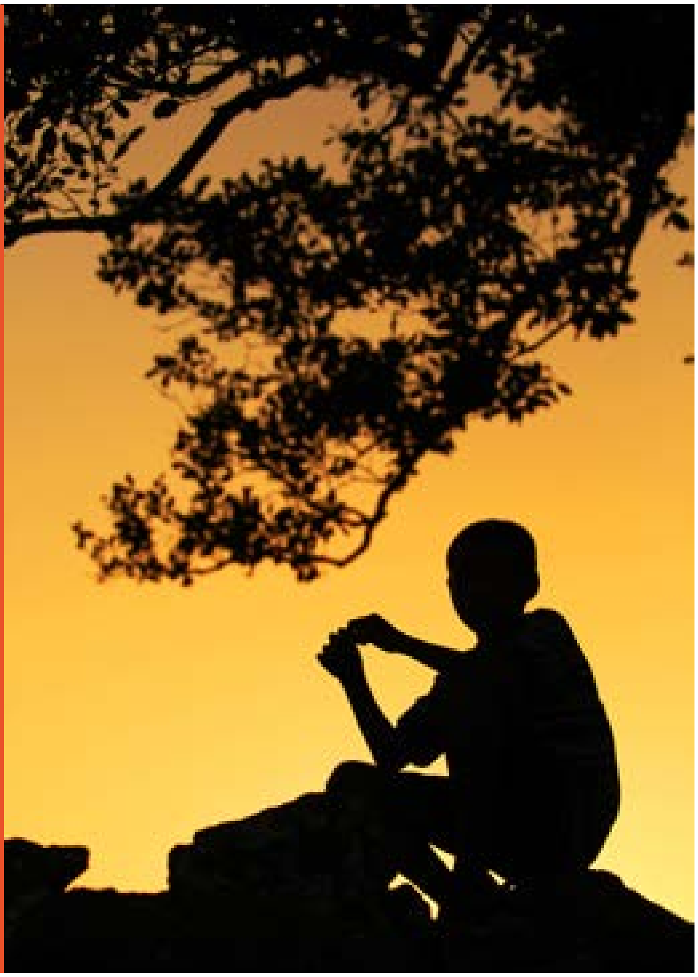
Linel's house was also damaged significantly. As she worked to rebuild her house, Linel bought a chainsaw to cut and remove the fallen trees. She used the same tool to also cut down and remove destroyed trees throughout her community. Through this initiative, Linel was able to earn extra income.

Through a series of micro loans, Linel has been able to purchase three chainsaws. Now, even after the typhoon, Linel employs other members of her community and earns more income than before. The extra income allows Linel to care for her four children, including ensuring they are being well fed.

IMPLICATIONS AND A WAY FORWARD

Microfinance Institutions (MFIs) are aware of the risks of an individual borrower and, collectively, at the portfolio level. MFIs address certain individual borrower risks with credit life insurance. While these compulsory products address some of the individual client's needs for risk protection, there remains a shortfall in products appropriate for clients' diverse needs. Therefore, there is a gap to be filled.

Furthermore, MFIs are not themselves adequately protected and so the supply of credit will typically contract far below demand after disasters, just as credit demand experiences a surge prompted by the needs of rebuilding livelihoods. Thus, there are two areas of current market failure: (a) inadequate microinsurance coverage, and (b) a mismatch of demand and supply of credit following a disaster. It would also appear that addressing these issues could increase financial inclusion particularly of agriculture and fisheries activities by ensuring that risk is properly assessed and mitigated in communities currently regarded as too high risk to be serviced by the market.



Borrowers in the Philippines are familiar with insurance. They are receptive to it, appreciate its value and have experienced it via compulsory term insurance. The government is actively engaged in activities in support of microinsurance, including the promotion of financial literacy and a changing regulatory environment that is more supportive of microinsurance and disaster risk insurance. Therefore, we have reasonable expectation of a receptive market to insurance solutions to increase resilience.

Positive developments in microinsurance are underway in the Philippine market. There are already insurance companies servicing the microfinance sector and their products are being improved and updated following Typhoon Haiyan. They have indicated that they are willing to increase exposure to the MFI sector with well-designed products with a range of features to meet many of our clients' reasonable expectations. We have compared our clients' needs with the services offered by a number of microinsurance suppliers and will now implement an upgraded credit life product to better meet our enhanced understanding of our clients' needs. However, we do not expect these products to cover the effects of extreme weather events in a satisfactory way.

We believe that microinsurance products can and should be complemented by a new innovative "insurance-backed" portfolio level scheme to fund recovery lending activities following a disaster. These recovery lending activities are designed to restore livelihoods by giving short grace periods, restructured loans, and new loans to restore business assets and activities. At VisionFund, we believe that the combination of good microinsurance products and our recovery lending scheme will provide a package to improve the financial resilience of our clients and their communities to the broad range of shocks they face.

VisionFund seeks to keep microfinance clients' loan payments as affordable as possible and have appraised willingness and capacity to pay for additional risk transfer based on interest rate spreads for current packages. Almost all clients consulted were positive about the prospect of paying additional fees in order to access disaster recovery lending in case of a similar event as Typhoon Haiyan. At a 1.5% to 3% price point for the fees for the disaster recovery scheme, potential costs to the CEVI borrower would be within affordable limits for total insurance spend in the Philippine market.

This solution to support recovery lending is ideally regional, if not global, because we need to avoid the fragility brought by single country covariant risks. We are proposing the ARDIS as a feasible and scalable solution via the VisionFund network. Scaling up will spread the risk and improve feasibility. We continue to build our ARDIS and wider FDRM initiatives and expect to implement an ARDIS to support recovery lending within the next 12 to 18 months. We are proposing a pilot implementation in our MFI's in four of our seven Asian countries: Cambodia, Myanmar, Sri Lanka, and the Philippines. These MFIs have over 446,000 clients and a combined portfolio of $163m (representing over 90% of our Asian portfolio and 33% of our global portfolio).

PARTNERS INVOLVED IN THIS INITIATIVE

WORLD VISION

World Vision is one of the world's largest Christian relief, development and advocacy organisations dedicated to working with children, families and communities to overcome poverty and injustice. Its 45,000 staff and volunteers in nearly 100 countries are committed to working with the world's most vulnerable people, regardless of religion, race, ethnicity, or gender.

For over sixty years, World Vision has been working to improve the lives of children. By bettering health, nutrition, education and access to water in the communities where it works, World Vision is tackling the root causes of poverty. It also helps to equip the poor with financial empowerment through its microfinance services operated by VisionFund.

VISION FUND

For over a decade VisionFund has been improving the lives of children in the developing world by offering small loans and other financial services to families living in poverty. Its clients are able to develop successful businesses, which enable them to ensure their children grow up healthy and educated.

Working on behalf of World Vision in around 35 countries, VisionFund microfinance institutions are found across the globe in Africa, Asia, Latin America, and Eastern Europe.

AON

Aon plc (NYSE:AON) is a leading global provider of risk management, insurance brokerage and reinsurance brokerage, and human resources solutions and outsourcing services.Through its more than 72,000 colleagues worldwide, Aon unites to empower results for clients in over 120 countries via innovative risk and people solutions.

Aon has worked with VisionFund on the principles of disaster-resilient microfinance solutions and is fully supportive of the aims and objectives of VisionFund's approach.

GLOBALAGRISK

GlobalAgRisk is a research and development firm that is a leader in introducing sustainable and pro-poor financial disaster risk management (FDRM) solutions to the world. Alongside DFID, GlobalAgRisk is launching Global Parametrics (GP), a new social venture designed to catalyze more affordable and scalable market-based FDRM solutions in low and middle income countries.

THE ASIAN DEVELOPMENT BANK

The Asian Development Bank (ADB) was conceived in the early 1960s as a financial institution that would be Asian in character and foster economic growth and cooperation in one of the poorest regions in the world.

ADB assists its members, and partners, by providing loans, technical assistance, grants, and equity investments to promote social and economic development.

ADB is composed of 67 members, 48 of which are from the Asia and Pacific region.

GOVERNMENT OF CANADA

This initiative is undertaken with funding from the Government of Canada, through Global Affairs Canada, to the ADB-managed Integrated Disaster Risk Management Fund. The Fund contributes to Canada's regional efforts to address transboundary issues across the Association of Southeast Asian Nations (ASEAN), including in the disaster risk and hazards that can have a significant impact of the poor and most vulnerable, and compromise hard-won development gains. Reducing economic and human vulnerability to disasters is one way to increase resilience and stimulate sustainable economic growth in ASEAN.

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