5. Lending procedures

APPLICATION FORM AND DOCUMENTATION

The application form and accompanying documentation provide the lending institution with the information necessary to decide whether to grant a loan. The information should be sufficient for the bank to determine whether the applicant's loan request is technically and financially sound and whether the borrower can repay the loan within acceptable levels of risk. There are advantages to using a single application form for all types of loans; the same information is obtained from all prospective borrowers. While the application form should contain all necessary information about the borrower, special activity forms can be used to collect the information necessary to evaluate the particular activity financially and technically.

The application must identify the applicant clearly enough for all officers and extension staff to locate the person without delay or confusion with other people with similar names. In countries where identity cards are used, the applicant's identification number should be used on the loan application. Where no identity document is issued, all applicants should also thumb-print the document next to the signature. If applicants are known in their communities by a nickname rather than the name appearing on the application, the nickname should be on the application and a space provided for it.

Fisherfolk will have an address which should be listed in the way it is normally known in the community. If a time and place at which the applicant can readily be found (such as a landing place at dawn) is known, this place should be noted on the application form in addition to the applicant's home address.

Migratory fishing communities present special problems, which need to be dealt with in a way that allows staff to have a clear idea of where the applicant can be found at times when repayment is due.

In addition to the name and address of the applicant, the general application form should contain details of the identity document, proposed guarantees and equity contributions, the amount and purpose of the loan, and terms and conditions of repayment. Annex 3.1 shows a sample loan application form.

The activity to be carried out with loan support needs to be clearly identified and thoroughly described in a separate activity form. All information needed for analysing its effect on the applicant's assets and liabilities, the working capital and labour required, the purpose of acquisition of equipment and secondary occupations must be included. Assets to be identified on the application are those which have some bearing on the production process or which would normally be used by the bank as security for the loan. For example, it would be relevant to include nets on the application form if they are crucial to the successful employment of a productive asset (such as a boat) financed by the loan. It will also enable bank officers to assess whether the level of assets listed on the loan application are still available at various points during the period of the loan. It would be irrelevant to list a house and land as assets if the bank has no intention of taking out a mortgage on them and foreclosing in the event of default on the loan. Activities which require additional working capital call for information on the amount required and its source. Activities which result in changes in labour requirements must show how the additional labour will be paid for or how the share of the catch will be affected.

Since a financial analysis is already available for each activity to be financed (see Annex 1.2), there is no need to include information on expected revenues or production figures. An example of an activity form is shown in Annex 3.2 together with the guidelines on how it should be used.

For further information about the economic environment of potential borrowers, a village profile can be used to collect village-level information. An example is shown in Annex 3.3.

APPRAISAL: CHARACTER APPRAISAL, CREDIT HISTORY AND REPAYMENT CAPACITY

The appraisal of individual loan applications is carried out using the loan application and loan activity forms, and with reference to the lending programmes, which include the financial analysis of all activities to be financed under the particular credit programme.

The purpose of loan appraisal is to assess whether the loan applicant's character, capacity and collaterals will guarantee the proper utilization and repayment of the loan. The following points must be considered.

Credit history check

Provided a prospective borrower has adequate resources, the main guarantee that the loan will be repaid is his/her character. A thorough knowledge of the economic situation and character of members of the communities in which they operate is one factor responsible for the success of money-lenders, traders and fish-merchants throughout the world. Successful operation of institutional lending programmes requires that officers in charge of loan appraisal know more about prospective borrowers than the information included on the loan application.

Often fisheries department officers, village headmen and leaders of fisherfolk cooperatives can provide information on whether prospective borrowers will fulfill their obligations based on their reputation in the community. Where credit schemes have operated in an area in the past, records should be examined and, if possible, programme administrators contacted to determine which members of the community remain in arrears and which applications seem to have involved willful default. Where large numbers of fisherfolk have unpaid loans from past programmes, judgements will have to be made as to whether the principal responsibility lies with the programme or with the borrowers. Many failed credit schemes never made it clear to borrowers that the money or equipment provided were not grants and that repayment was in fact expected. That a prospective borrower has an unpaid balance on a previous loan, should not be an automatic justification for excluding that person from participation in a new loan programme.

Even where formal lending programmes exist, fisherfolk make extensive use of informal credit. Studies show that formal credit is often a complement to, rather than a substitute for, informal credit. Under certain circumstances, it might be possible to obtain information on liabilities for informal credit from local lenders. In all cases, the credit officer should determine as accurately as possible the extent of a prospective borrower's liabilities for informal credit when appraising a loan application.

Repayment capacity: activity, outside income, collateral and other loan guarantees

Equity. The lower the proportion of the cost of an investment financed by borrowing, the lower the risk to the lending institution. Borrowers should always be encouraged to contribute as high a proportion of the cost of the proposed loan as possible from their own resources rather than a fixed minimum percentage.

Non-fishing income. Many fisherfolk or members of their immediate family have other sources of income besides fishing. Weather and seasonal fluctuation makes it impossible or uneconomical to fish during certain periods of the year. Many fisherfolk in developing countries supplement their incomes by farming or wage labour in agriculture. It is also common for one or more members of fishing households to be engaged in other occupations. The diversification of income sources regulates family income over the year. It also increases the likelihood that loans made to families with other sources of income will be repaid. Non-project income available for loan repayment should be considered in loan appraisal. Knowledge of local customs will allow appraisal officers to determine what proportion of incomes of individual family members is contributed to common family expenses and is thus available for loan repayment.

Collateral. In the informal credit market, collateral is rarely used; the borrower's reputation within the community constitutes the principal guarantee of repayment. Loans from formal credit institutions tend to be larger and normally require collateral. The collateral for larger loans is usually the asset purchased with the loan. From the point of view of the lending institution, it is important to ensure that the asset remains in the hands of the borrower over the life of the loan and that its value during the period of the loan never falls below the amount outstanding on it. The first condition should be guaranteed by a charge on the asset; particularly in the case of a boat, a mechanism needs to be developed to make it impossible to sell the asset until the loan is paid off. In some countries it is possible to make boat registration contingent on proof that loan obligations to participating financial institutions are being met. In most developed countries, borrowers are required to insure against the risks of loss or destruction of the asset. The insurance of major assets such as boats should be required where such coverage is available; where it is not, local insurance companies should be encouraged to provide it.

As the resale value of assets financed by loans will fall during the loan period, additional guarantees are often required, particularly property. In the case of small artisanal fisherfolk the desirability of pledging the family dwelling in addition to loan finance assets must be considered. Foreclosure, even in the case of willful default, is extremely unpopular in the community; many financial institutions, particularly development banks with ties to the national government, may find foreclosure politically unfeasible. If so, such assets do not provide acceptable guarantee. On larger loans, particularly those made to non-fishing boat owners, it is desirable to require the pledging of as many assets as necessary to ensure loan repayment. In addition to charges on property, it may be desirable to require a "floating charge" which gives the bank access to all assets owned by the borrower without requiring their specification. Local legal counsel must be sought so that charges can be legally certified and registered; if not, the financial institution may not be able to take legal action in case of default.

Co-signers. Financial institutions like to obtain as many co-signers as possible when they doubt the repayment capacity of borrowers. Co-signers individually or as a group can be held responsible for payment of any part of a loan the principal borrower does not pay. Since fisherfolk are viewed by many lenders as high risk borrowers, banks like to have as many co-signers as possible. Particularly for people in low-income and low-status positions, as is the case with many fisherfolk, co-signers can only be obtained at a price. In some cases, a percentage of the first disbursement is paid to the co-signer, which could make an otherwise viable project fail. Other forms of payment put a claim on part of the family resources which might otherwise be directed toward repaying the loan. In many cases, fisherfolk may simply be unable to find co-signers with steady jobs or other sources of income who would be acceptable to the bank as guarantors of repayment of the loan.

Where loans are made to limited liability enterprises (stock companies, cooperatives, etc.), owners or members should be co-signers and so personally liable in case of bankruptcy or dissolution of the limited liability enterprise. Annex 3.1, section C, shows how personal guarantees can be incorporated into a loan application form.

Group responsibility. It may be feasible to make all members of a group of borrowers jointly responsible for the debts they individually contract with the bank. Until all debts incurred by members are paid off, no new loans will be made to any member. Group responsibility works best when groups are small (maximum of ten members), when there are kinship ties among members, and when groups existed before the lending programme and have not been formed expressly to acquire loans. In the case of group responsibility for loans, individual loan accounts should be kept and repayments credited to the individual responsible. In most cases, it is highly desirable for repayment to be made directly by the borrower to an employee of the bank or a collection agent hired by the bank rather than to leaders of the groups; in any case, a receipt should be given for any funds repaid naming the person making the payment and specifying the account to which it should be credited.

Credit guarantee arrangements. To safeguard national financial institutions using their own funds in revolving loan funds or credit programmes for fisherfolk, a credit guarantee fund can be established by the project with the participating bank. Monies from the fund can be used by the financial institution to cover itself against bad debts. Annex 3.6 shows a format for a guarantee fund agreement.

SANCTION

One of the major failings of formal credit programmes is the time it takes to get approval for the smallest and simplest loan. Loans from informal sources are either granted immediately or within a few days; the average size of informal loans is much smaller than of loans obtained from the bank or revolving fund. Nonetheless, the lower the level at which a decision can be made on a loan application, the faster approved loans can be disbursed and the more useful they will be to the fishing community.

Credit limits for branch managers are based on the size of the branch and the qualifications and experience of the branch manager. Some complicated or larger loans will be determined at the regional or headquarters level. In the interest of efficient operation, branch managers should have sufficient authority to approve or refuse most loans. When their decision on a loan application goes against the recommendation of the officer who carried out the loan appraisal, a reason should be given, particularly if this involves turning down a loan recommended by the officer. The reasons for rejection of the loan application should also be explained to the unsuccessful applicant.

Managers should have the authority to grant all loans within their limit, although for their own protection they may want to refer loans to a regional or headquarters credit committee, particularly where the officer in charge of appraisal makes a recommendation that appears to contradict standard loan criteria. Presumably, credit committees at appropriate levels will meet on a monthly basis and will be able to handle all loans of the size of those referred to them from revolving fund target group applicants.

ADVICE

Loan applicants should be informed as soon as possible of the decision on the application. If the postal system works well, a registered letter will suffice. In most countries, a visit from the loan officer or the fisheries department extension agent will be necessary. They should inform the applicant of the decision on the loan application and, if accepted, when they should come to the bank and what documents they should bring with them. If the loan system allows appeals against unfavourable decisions, as it should, the applicant who has been turned down for a loan should be informed of his right of appeal.

Annex 3.4 shows the loan appraisal procedure used by a bank in Tanzania for operating a fisheries revolving fund.

CONCLUSION OF LOAN AGREEMENT

The conclusion of loan agreement is extremely important since it marks the change in the status of the fisherfolk involved, from applicants with no responsibilities to the bank to borrowers with fixed and clearly established responsibilities. It is at this stage that the borrower is informed of what she/he is to receive from the bank and how much, on what dates and where she/he must make the repayments. The borrower must also be informed at this time as to what action will be taken if repayment is not made as agreed. If borrowers cannot read, they should bring a relative or friend with them to read the loan document to them. It is best if the conclusion is done at the bank offices. If done in the community, a large group of borrowers should be assembled for the conclusion of their loans. The branch manager or another senior officer should attend and sign the loan agreements. Annex 3.5 shows a sample loan agreement. The loan officer who has handled the application and the officer in charge of supervision should also attend. The proceedings should be carried out with as much formality as possible.

The points that have to be explained to the borrowers are:

(1) what is being given is a loan to be repaid and not a grant;
(2) the dates when disbursements will be made and what conditions must be fulfilled before they are made;
(3) the date when the first repayment is due and where it is to be made;
(4) the frequency of repayment and the amounts due at various times in the fishing year, and
(5) the importance of bringing any problems affecting loan repayment to the attention of the supervisory officer as soon as they occur.

In the past, it was common practice to give various types of subsidies and grants to fisherfolk. It is absolutely essential that they understand that the cash, gear or supplies they receive constitute a loan which has to be repaid.

Failure to make this point has led to the downfall of many credit programmes.

The borrower should be informed of the exact dates on which the first and subsequent loan payments are due upon completion of loan documentation and should be given the repayment schedule. One way to do this is to give the fisherfolk calendars or lunar calendars, if that is the way they normally calculate the passage of time, with the due dates and amounts marked on the calendar. Lending programmes in developed countries often provide the borrower with a booklet containing payment vouchers with the amounts payable on the due date marked on each voucher as well as the amounts payable in case of late payment; when stamped by the cashier at the bank or collection agent, the stub in the booklet is the borrower's receipt. A similar system could be instituted for fisheries loans. Such a system makes it clear to the borrower what is due and the cost of paying late; it can also be computerized and reduces clerical errors in calculating late payment fees. Where the payment is to be made should be shown on the stub using the logo of the bank.

If the officer in charge of supervision did not deal with the loan application, that officer should be introduced to the borrower. Since the main method of preventing delays in loan repayment from becoming outright default is to maintain contact between the borrower and lender, it is important that the borrower understands her/his responsibility to discuss problems of loan repayment as soon as they occur.

DISBURSEMENT OF LOAN

Both the disbursement and the repayment schedule should be tailored to the cash-flow established for the activity being financed. The number of disbursements and their size will vary according to the activity being financed. Disbursements should correspond to measurable steps in a specific activity and should relate to the progress of the asset or activity being financed. If two separate payments to a contractor are required upon completion of two separate stages of a project (for example, laying the keel and completing the ribbing of a boat), two separate disbursements should be made upon certification by the supervisory officer that the work has actually been finished satisfactorily. Prepayment for work not yet done should be avoided as far as possible; materials should be paid for against pro-forma invoices. Supervision is required to make sure that the materials are delivered. Since the borrower is responsible for loan repayment, his signature (and in most countries, thumb-print) should appear on all receipts, even when they are paid directly by the bank to local suppliers.

In kind and cash disbursements

Loans can be provided in kind (delivery of the actual physical asset to be used to carry out the activity supported by the loan), as a supplier credit (where the bank pays the supplier directly against a pro-forma invoice) or in cash as a cash payment to the borrower. In some cases, in kind supply is the only possible method to use, as in the case of imported equipment; in kind supply also ensures that technical standards established by project staff are met, and that a supply of spare parts and technicians capable of performing necessary maintenance are available, both of which may be impossible if fisherfolk are allowed to select equipment for which spares and service may be unavailable.

In kind supply is often advocated for equipment produced locally. Because of the size of their purchases, projects can often secure substantial discounts. Project staff can set higher standards for equipment and technological innovations can be introduced. If selection of the businesses to be given contracts for the provision of the required goods or services is done by anyone other than the borrowers, questions of favouritism and improper payments to purchasing agents can arise; rumours, even if unfounded, or dissatisfaction with the goods provided can affect other programme activities, particularly repayment.

Supplying the items to be used in the loan-financed activity reduces the possibility of diversion of loans to other uses (such as ceremonial expenses, family consumption or medical expenses). Even when the items themselves are supplied, there is a possibility that funds will be diverted. Any asset is "fungible" and can be turned into cash, usually at a discount. In kind supply adds an additional step to transforming loan proceeds into cash and therefore will reduce diversion of loan proceeds to other uses.

Import and domestic supply

Imported equipment is often highly attractive compared with locally purchased goods. Even if motors and other complex gear can be obtained on the local market, the waiving of import duties, fees and taxes (a normal condition of many internationally supported projects) makes import a very attractive option. What can be imported is often of better quality. In many projects, equipment is unavailable locally and once the decision has been made to use a certain type in the project, import is the only option.

Before choosing imported over domestically supplied equipment, a number of questions need to be answered. Does the official exchange rate for the purchase of imports reflect the scarcity value of hard currency in the national economy? Where multiple exchange rates are used, capital goods are charged at the lowest possible exchange rate which does not reflect scarcity value; comparisons can be made with rates in parallel or black markets which often provide a better indication of the scarcity of foreign exchange to the domestic economy. Given the debt pressure under which many countries operate, their ability to maintain their local currencies at overvalued rates is increasingly called into question; when the time comes to replace equipment, its cost is likely to be higher, even if duty-free privileges are maintained. The cost of handling imports will be borne by the project or the cooperating institutions; these costs are substantial and in the future will have to be borne by the fisherfolk purchasing the equipment. If adjustment is made for these costs, the advantage of imports over local goods is reduced. Imported equipment may not have service available on the local market. Local dealers will often refuse to service equipment not sold by them though it is made by the manufacturer they represent. Many manufacturers supply only a restricted range of products to developing countries. Even if a locally recognized brand is selected, spare parts may be impossible to obtain. Due to the unpredictability of exchange rate movements, local currency loan repayments will often be insufficient to replace the same amount of foreign currency originally used to purchase the equipment. If suitable equipment is available on the local market for immediate delivery, it may be wiser to pay a premium for the prompt supply of goods of specified quality rather than to risk delays in delivery or other problems associated with imported goods.

SUPERVISION OF LOAN USE

Adequate supervision during disbursement is essential to ensure loan repayment. It involves making sure that loan conditions have been met before the first loan disbursement, that conditions for subsequent disbursements have been met, that loans are used to buy the items agreed in the loan document, that assets pledged as loan guarantees are still sufficient guarantees of loan repayment, and that the objectives of loan-financed activities are being achieved.

Some lending institutions separate the functions of loan application and supervision. There are advantages in having the same person responsible for all stages of a loan. Supervision begins before the conclusion of the loan agreement, with a review of the application and supporting documentation and their certification by the supervisory officer as reflecting the borrower's ability to carry out the activities to be financed.

If the disbursement schedule has been designed properly, each disbursement will correspond to a specific activity supported by the loan. The supervisory officer ensures that these advances are made, that they are the ones specified in the loan programme and that they increase the earning capacity of the borrower. Supervision has to be performed in a timely manner. If a disbursement is for the purchase of materials, it is important to make certain that the materials have been purchased. If it is a payment for work performed, for example completion of a stage of boat-building, the officer must certify that the work specified has been completed. The supervisory officer's certification should be provided to the supplier who is then paid by the bank. If the loan is a cash advance to the borrower to pay for specified inputs, it is essential to make certain that these inputs are purchased. The successful supervision of fisheries loans requires prior experience or on-the-job training. Where there is a lack of supervisory staff, additional staff should be recruited. It is useful to involve staff/members of non-governmental organizations and fisheries administrations in loan supervision.

Supervisory officers need transport appropriate to local conditions. It has been found useful to assist bank officers to purchase these items (through low interest loans) and to provide them with mileage allowances.

Another task of supervision is to check that assets pledged as security for loans remain the property of the borrower and retain their value; for example, boats and other gear can vary in value depending on their age and the quality of their maintenance. The value of pledged assets should be substantially higher than the outstanding amount of the loan since liquidation value of many assets is substantially lower than "fair market value".

The basic goal of supervision is to uncover problems which affect repayment so that prompt corrective action can be taken. Problems should be addressed as soon as they are discovered. No further disbursements should be made after the supervisory officer reports a problem with a previous disbursement until that problem has been be resolved. Problems should be reported promptly to branch management or project authorities so that appropriate action can be taken. Fraudulent use of loan funds or their diversion to non-productive purposes should be justification for suspending disbursements and making the loan repayable immediately; a clause should be included into the loan document empowering the branch manager or project authorities to require repayment upon notification by the supervisory officer.

Other problems which might delay loan repayment beyond the dates specified in the repayment schedule, or reduce the borrower's ability to repay the loan should be reported to, and investigated by, the supervisory officer who should make recommendations of the action to be taken. Many problems occur before the repayment period begins and can be best handled as soon as they occur. Hopefully, a rapport between the borrower and the supervisory officer will exist. The borrower will then be willing to report problems immediately so that appropriate solutions can be found. The supervisory officer may find that significant costs were omitted from the project appraisal; if the project is still technically and financially viable, the officer can recommend a supplement to the loan to bring resources to the level necessary to make the project viable. The demand for working capital is often underestimated; if this is the case, the officer can recommend an addition to the loan. If loan repayment capacity is sufficient but the loan cannot be repaid as planned, the officer and the borrower should agree a feasible repayment schedule. Rescheduling can even be done during the grace period of the loan. Failure to reschedule loans when it is obvious that the original schedule cannot be met is responsible for many of the problems of revolving fund programmes.

If the repayment capacity of the borrower is reduced to the point where the outstanding value of the loan cannot be repaid, the supervisory officer should decide what the borrower can repay and management should decide how much of the loan should be written off as uncollectable.

The supervisory officer should know whether a borrower is still sufficiently involved in fishing for repayment to be expected from fishing derived income. If a borrower abandons fishing to take up another activity, no further disbursements should be made on the loan without management approval. Management may also want to include a clause in the loan document making the loan payable immediately by borrowers who abandon fishing.

Proper supervision is the key to achieving high rates of loan repayment. Where supervision is inadequate, substantial problems of loan repayment develop, and full loan repayment may be impossible despite strenuous collection efforts.