
6. Repayment and loan recovery procedures

In a successful lending programme, loan repayment is the primary goal. Revolving funds will not revolve unless loans are repaid. A high percentage of non-performing loans means that funds are not available to provide loans to new borrowers and if loans are not repaid, they become grants. The lesson of how credit can be used productively is lost. Those who fail to pay are rewarded with a gift equal to the amount of the unpaid loan, while those who pay lose face. Future development efforts involving credit are hampered by cynicism generated by failed loan programmes of the past.

Loan repayment must be designed into a lending programme from the start, not added as an after-thought. Before the first loan is made, goals for repayment should have been set. A system of accounting, auditing, monitoring and evaluation must be established to provide project management with accurate information on the achievement of these goals, so that appropriate action can be taken if they are not being met.

There are basic rules which if followed will make the achievement of high levels of loan repayment possible:

- (1) borrowers must recognize that they are receiving a loan rather than a subsidy or grant;
- (2) payments must be scheduled at times and in amounts which can be paid from current income;
- (3) borrowers must be made aware of the consequences of failure to pay;
- (4) the first borrower judged to be in willful default of loan payments must suffer the consequences.

UNDERSTANDING LOANS

Grants were the central elements of many development efforts in the 1960s and 1970s and reached large numbers of fisherfolk in many countries. Many other programmes included subsidies on loan principal and interest. It is now thought that subsidies on capital and interest are not required by financially viable projects and obscure the obligation to repay loans. Even in the most remote fishing villages, fisherfolk have had either direct experience of frequently failed credit programmes or know other fisherfolk who have. Many development banks with which revolving funds must operate have a poor record of loan recovery; in the past many put political considerations ahead of sound banking criteria. Within fishing communities, there are often people in positions of power, outside the official power-structure, who have vested interests in seeing credit and other development programmes fail.

To counteract these pressures, programme representatives have to clarify that what is being proposed is the loan finance of productive activities, that the loans must be repaid by those who receive them, that the lending programme is voluntary and that fisherfolk who do not want or need loans are under no obligation to take them. When loan programmes are part of projects with other components, staff must make clear to fisherfolk that failure to take out a loan will not exclude a member of the community from other benefits offered by the project (cash purchase of inputs, marketing services or technical assistance). Above all, though, staff must make it clear that those who take out loans must pay them back. Given the low level of education of most fisherfolk, the concept of a loan and the reason interest is charged, will take several meetings, talks and training sessions to explain to potential borrowers within the community. At the risk of labouring the point, it is important to put substantial effort into educating potential borrowers in the benefits of formal credit and the responsibilities which accompany it.

SCHEDULING REPAYMENT AND REPAYMENT RECEIPTS

Repayment should be scheduled to follow the income flow from the activity being financed as closely as possible. Thus, payments should not

start until income starts flowing from the project. In most cases, there will have to be a grace period during the time that the assets used in the activity are being purchased or until the time of the year they can be used effectively. Even though finance charges will increase, it is best to plan for the assets to be available before the beginning of the main fishing season, but to delay payments until the income is derived from the activity. If there is a delay in the arrival of the assets required by the project, there will not be sufficient income to service the loan; the supervisory officer should see that the loan is promptly rescheduled and that the new loan payment schedule reflects the revised estimate of income. Grace periods should be written into the repayment schedule to cover the period from the time of the first disbursement until income begins to flow from the project. Interest payments should be required during the grace period.

Once income has started in a fisheries activity, it is not spread evenly throughout the year. More accustomed to lending to farmers and wage earners, banks sometimes find it difficult to adapt their repayment schedules to the needs of fishermen. In months with lower income, payments should be lower; in months with high income, payments should be higher; in months with no fishing income, no payments should be scheduled.

Monthly payments will require fishermen to save earnings from several days' catch to meet them, even in good months. Large amounts of cash in hand call forth many legitimate demands for increased spending to cover the needs of the family and some less legitimate demands such as gambling and alcohol. Wherever possible, the bank's claim to part of the earnings of its borrowers should be exercised as soon as income is received. Where it can be linked to marketing, as it can in places where all fish pass through a single auction block, such a system can facilitate loan recovery. In a port with no single fish auction but where a large number of borrowers bring their fish for sale to middlemen, the bank might pay a collection agent to collect its loans each time a borrower brings her/his fish for sale. There may still be problems with diversion of the catch to ports without collection agents or with its sale at sea. The basic rule for the establishment of a good loan repayment schedule is that it should correspond to the income derived from the activity financed by the loan. Payments should be high enough to

recover the full amount of the loan well before the end of the economic lifetime of the asset.

Another possible way of enforcing payment on loans in countries where boats are licensed is to make licensing contingent on satisfactory payment. If licences are annual, the bank could provide the fisheries department with a list of the names of borrowers in technical default and of the numbers of their boats so that they cannot be licensed until an arrangement is made with the bank for repayment. Boat numbers should be provided so that fisherfolk cannot avoid their obligations by selling their boats or putting them in someone else's name.

Ideally, the loan schedule and pre-printed payment receipts should be one and the same. Thus, the borrower would be given at the time of signing the loan a small booklet like a chequebook with individual receipts giving the installment number, the amount payable, the date due and the account number of the borrower. The borrower would then go to the bank/fund (or its agent in the local village), pay the amount due and have the receipt in his book stamped and signed as proof of payment. The other part of the page accompanies the payment which is entered into the loan accounts. It might be worthwhile to print the total amount due on the loan as of that date on each receipt in order to encourage pre-payment by fisherfolk able to pay off their loans ahead of time.

If borrowers are not given a payment booklet, standard receipts should be made up providing this same information. The receipts to be valid should be stamped and initialled by the officer or agent authorized to receive the payment. Each officer or agent should be issued a stamp of his own so it is clear to whom a loan payment was made.

ARREARS CONTROL

Notices of payments due

In countries where the postal system works reasonably well, a notice should be sent to the borrower before the first payment is due, giving the amount and the date. It should arrive 30 days before the payment is due. If a payment is more than 15 days late, the borrower should be reminded of this fact. Annex 4.5 shows samples of Repayment Notices. If the postal

system is inadequate, rural buses can often provide the same service. In some places, banks/funds may have to employ messengers to deliver reminders. Even when the borrower is contacted personally, the prepared notification should be left as a reminder; when the borrower cannot be contacted, the reminder can be left at his home. A record of reminders sent and the response to them should be kept; it can be used in decisions on loan rescheduling or legal action. In the latter case, it will prove that the bank has exhausted all other remedies for repayment.

Visits for loan recovery

Contact between the bank/fund and the borrower should always be maintained. Visits for loan recovery should start before the first payments becomes due. When a number of borrowers in the same community have loans due at the same time, a meeting should be organized to remind the borrowers that payments are due and to explain again the mechanisms for payment. Meetings with borrowers before the first payment make it possible for the project to learn of any problems that may affect repayment. If the problems are serious enough consideration should be given to rescheduling loans.

Borrowers who fail to make a loan payment should receive a reminder within 15 days of the due date. If the borrower fails to contact the bank/fund, a bank officer/fund representative should visit the borrower before the next installment falls due. The purpose of the visit is to try to understand why the borrower has not met the loan installments and to find a mutually acceptable solution for the problem. Although natural calamities are blamed for more loan repayment problems than are caused by them, in an occupation as risky as fishing, there are often good reasons that full loan repayments cannot be made. If full payments cannot be made, part payment of the interest should be demanded. It is important to maintain the borrower's habit of fulfilling his obligations by making token payments during the period in which full payments are not possible. Annex 4.6 shows a sample of an Arrears Control Schedule.

Loan rescheduling

If problems in repaying the loan are more than transitory, a new payment schedule should be drawn up. If months are allowed to pass without working out a solution to the problems of repayment, the likelihood of recovering a high proportion of the loan decreases in proportion to the time the borrower has been allowed to go without either repaying or coming to a new agreement with the bank.

Whether a loan should be rescheduled or enforced in law depends on how much effort the borrower makes to service the loan and to carry out the loan-funded activity. If income is unavailable due to circumstances beyond the control of the borrower, but sufficient income to repay the loan will be available, the loan should be rescheduled. The new schedule should be drawn up by the bank officer/fund representative and the borrower, based on their best estimates of what the income will be. The schedule should not extend beyond the average economic life of the asset on which the income depends. A new payment schedule and booklet of receipts should be issued. Project officers should give high priority to monitoring rescheduled loans.

Should the borrower's circumstances change so radically that the loan can never be repaid, the bank officer/fund representative should know and report to management with a recommendation on what action to take. If a borrower dies leaving assets to his family who can only operate them by paying crewmen, sufficient income to repay the loan may not be available although the assets still exist. The bank/fund may be willing to settle for partial payment in such a case rather than repossession. Where no fraud has been committed by the borrower, the bank should accept part payment rather than lose the entire loan. Unpredictable changes in fishing conditions, such as the effect of El Niño current on fish catches on the west coast of South America, might also force banks to choose between part payment or complete loss.

LEGAL ENFORCEMENT

Fisherfolk are no different from anyone else: some will try to avoid payment of loans if they think they can. People who act in this way with respect to loans will normally have done other things of dubious honesty,

including having defaulted on other loans. Credit checks before granting loans will weed out most but not all of such applicants. Once a loan officer is sure that a borrower's reasons for not paying the loan are invalid and that income is being used for purposes other than paying off the loan, he should make this known to the borrower. He should set a date no more than 30 days in the future for full payment of all amounts due on the loan and should explain that if full payment is not made, legal action will be taken. If payment has not been made by that date, the borrower should be advised in writing that the bank/fund will immediately begin legal proceedings against the borrower to recover the value of the loan. Co-signers on the loan should also be advised in writing that they will be held liable for the amount due on the loan and that their liability will be enforced in law if necessary. It may also be worth informing the village chief or local authorities of the impending legal proceedings. Annex 4.7 shows a sample of a Repossession Notice.

Even at this stage, should the borrower make a reasonable attempt to settle the differences outstanding with the bank/fund, management should consider rescheduling or acceptance of less than full repayment of the loan. Litigation for litigation's sake is pointless if other solutions exist, particularly as litigation takes so long.

In many developing countries, the legal system cannot enforce repayment of a great number of small debts. Every effort should be made to pursue repayment through negotiation with the assistance of local chiefs and other authorities.

If a borrower is defaulting willfully, enforcement is important for its effect on other borrowers. The bank must make it clear that it can distinguish between problems of repayment and willful default and will deal promptly and effectively with default. Some development banks do not have the political will to do so, particularly in the case of locally powerful borrowers. In this case, arrears and default rates will be very high. Loan officers should not threaten legal action if the will to carry it out is absent. If legal action is threatened, it should be carried out.

Many banks have their own legal departments or legal counsel. In view of the remote locations in which most fisherfolk live, it may be cost-effective

to employ local lawyers. If possible they should be paid a percentage of what they recover. Often the amount recovered is less important than demonstrating to borrowers that the bank will not allow willful default to remain unchecked.

INTEREST CALCULATIONS

Pre-payment bonuses

Informing the target population of the existence of a new fisheries credit fund may take some time and will require substantial effort and advertising. Once the first set of loans has been made, there may be an excess demand for credit. If loans are repaid as soon as possible problems of repayment are fewer. An incentive could be provided for borrowers to repay loans ahead of schedule. One possibility is to offer a percentage point reduction in the interest rates on all amounts repaid above that scheduled.

Standard interest

Interest is normally charged on amounts loaned from the date that the loan is made. It therefore makes sense for the borrower to use the loan for the shortest time possible. Where assets are readily available locally, they should be purchased as needed. Annex 5 shows examples of interest calculations.

Penalty charges

When loans are paid late it costs the bank/revolving loan fund money in several ways: there are costs associated with reminding the borrower of failure to pay, accounting costs increase, and some percentage of the loans will have to be set aside for collection. The additional costs should be paid by the borrowers through a charge which will cover the fixed costs caused by late payment. It will provide an incentive to small borrowers to make their payments on time. To a certain limit, the late charge alone should be levied provided loan instalments are not more than three months in arrears. Above the chosen limit or when more than three months elapse without repayment, a substantial interest penalty should be charged.

In determining the late fee, all costs should be taken into account. An additional amount should be added so that loan officers do not have to calculate interest penalties on loans below a certain limit; this amount should be sufficient to provide an incentive for paying installments on small loans on time.

The interest penalties to be charged on loan balances above the limit should be high enough to provide a real incentive for prompt repayment. As in setting overall interest rates for the revolving fund, inflation should be taken into account. It should never be financially attractive for the borrower to pay a loan late because the erosion of its value by inflation is sufficient to offset any incentive provided by the normal and penalty interest rates. If inflation increases over the period of the loan, the bank should re-evaluate all interest rates, but in particular should raise penalty rates so that they continue to be strong incentives for payment of loans on time.

CHECKLIST

1. Understanding loans

- Does the borrower education/information programme incorporate explanation as to the difference between loans and grants? Does the education/information of potential borrowers sufficiently spell out the meaning and purpose of rural credit as well as the obligations of borrowers?
- Is the type of information media to be used as well as contents and messages adequate with regard to educational standards and socio-cultural background of borrowers?

2. Scheduling repayment and payment receipts

- Are repayments scheduled at times and in amounts which can be paid from current income?
- Are interest payments continued during grace periods?
- Does repayment schedule consider the income fluctuations between different months of the year?
- Are there arrangements for collection of loan repayments at places where fisherfolk obtain large amounts of cash from fish traders at times of good catches and sales of fish?
- Is there an arrangement or scope for linking outstanding loan balances to licensing of fishing craft and gear?
- What system is followed to certify for the borrower that an installment has been paid toward repayment of the loan: payment book with stamped and signed receipt, vouchers?

3. Arrears control

- Are there standard procedures or forms for arrears control, including notices of due payments on a regular monthly basis and special reminders in case of overdue repayments?

- Do the loan recovery arrangements envisage visits for loan recovery on a regular basis as well as in case of overdue payments?
- Do they involve the conduct of village meetings and contacts with local leaders?
- What criteria are being followed to find out whether problems in repaying the loan are not merely transitory in nature but require the rescheduling of the loan?
- What procedures are being followed for loan rescheduling?
- What criteria are applied to decide whether a loan should be rescheduled or whether it should be turned over to lawyers for legal enforcement?

4. Legal enforcement

- Are there arrangements made to deal with cases of wilful default, including procedures to inform borrower and guarantors of forthcoming legal action?
- To whom is legal enforcement assigned: to local lawyers, to legal departments of financial or government institutions?
- Has any thought been given to conditions and circumstances under which a loan would have to be foreclosed and/or equipment could be gainfully repossessed?

5. Interest calculation

- Does the interest calculation include prepayment bonuses?
- Are penalty charges envisaged in case of late repayments?

