Insights for Inclusive Finance

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Consumer Protection and COVID-19: Borrower Risks as Economies Reopen

Credit, if managed responsibly, can help financial services providers (FSPs) and their lower income customers resume economic activity and rebuild livelihoods damaged by lockdowns and other measures brought on by the COVID-19 crisis.[1] However, lockdowns have put consumers in financial need and providers under stress, setting the stage for consumer protection challenges to emerge around the provision of credit. In this Briefing, we offer preliminary recommendations for policy makers, regulators, and FSPs on how to keep borrower financial needs front and center without putting excessive stress on FSPs. These include suggestions on how to treat moratoria and other restructuring and how to provide new credit responsibly.

This Briefing takes a borrower and consumer protection perspective.[2] It is based mainly on secondary sources, published survey information, and stakeholder interviews. Ongoing research in selected countries aims to further assess and document the issues presented here.

Stressed consumers meet stressed providers

The rapid research conducted for this Briefing shows that the ability of credit markets to use fresh credit for economic stimulus has been overshadowed and hampered by the need to manage existing loans. In light of depleted savings and other assets due to the pandemic, many borrowers are asking for relief from their existing debts. Relatively few are seeking new credit. In response, many FSPs, with support from regulators, are offering

1 In this paper, the term "financial services provider" refers to any type of regulated, formal, or semi-formal organization that provides loans in the lower income market. Most of the survey information and examples cited come from regulated and nonregulated microfinance providers. See "Typology of Microfinance Providers (MFPs)," CGAP, https://www.cgap.org/sites/default/files/research_documents/Aug2020_CGAP_MFP_Typology.pdf.

2 CGAP (2020b) examines many of the same questions posed in this Briefing, but from the view of regulatory policy for microfinance providers.

temporary relief through moratoria or other forms of forbearance, while substantially cutting back on new lending.

Moratoria are being granted at an unprecedented scale across the globe, and we are finding enormous variation in whether they are offered with fair terms. FSPs in nearly every country are finding it challenging to reach borrowers and ensure that they understand the costs and benefits. While moratoria can be expensive for borrowers in the medium term, they also take a financial and operational toll on FSPs. As of this writing, many credit markets are still in moratorium periods and it remains to be seen how well borrowers will manage when repayments resume.

PAINTING THE BROAD CONTEXTUAL PICTURE

Consider the unusual and fraught situation confronting borrowers and lenders several months into the COVID-19 crisis. During the strict lockdowns early in the pandemic, many small businesses and farms lost much or all or their incomes. Other examples include the following:

- In India, two large microlenders, Ujjivan and Annapurna, surveyed their customers in April and found drastic income drops. Sixty-two percent of customers surveyed by Ujjivan reported "no income at this time," and among Annapurna's clients, most women (66 percent) lost more than half of their income.
- In VisionFund (2020) surveys of clients from eight African countries, 90–98 percent of survey respondents said their income had dropped. On average, week-on-week sales and household income both fell by about 90 percent. Households' immediate concern as early as April became how to secure food.
- In Pakistan, surveys conducted in April found that, on average, week-on-week sales and household income of microfinance borrowers operating microenterprises fell by about 90 percent (Malik et al. 2020).
- In June, 90 percent of the respondents to FINCA client surveys said that their incomes have dropped significantly. Decreases were especially severe among retail and service sector borrowers.

Furthermore, women were more heavily affected than men. A BFA survey in May showed that women were more likely than men to report decreases in income in all nine countries surveyed. Female clients in FINCA's surveys were more likely than men (39 percent versus 30 percent) to skip meals in order to cope with reduced income.

State of borrowers

When incomes drop, many people turn to their reserves and other strategies to support themselves. However, research shows that few lower income people have reserves sufficient to maintain their consumption for more than a few weeks or a month. Women may be especially vulnerable. In Uganda, women entered the COVID-19 crisis with six times lower median savings than men (FSD Uganda 2020). Among all clients surveyed by the Pakistan Microfinance Network in May, 40 percent claimed to be able to sustain themselves for less than one month, and an additional 31 percent said they could manage for 1–3 months. In a household survey conducted in late May, over half of the respondents in Ghana, Kenya, Nigeria, and South Africa reported that they had already used up more than half of their reserves (BFA Global 2020). Some have sold productive assets, which reduces their recovery potential. VisionFund reported in June that across eight African countries (i.e., Democratic Republic of Congo, Ghana, Kenya, Malawi, Rwanda, Tanzania, Uganda, and Zambia), 3–17 percent of surveyed clients had sold off assets in order to cope.

As lockdowns began to let up from late May on, some evidence has emerged of income recovery. For example, in India, food insecurity and lack of income appeared to be slightly less severe than in the previous month (Agrawal and Ashraf 2020). However, with lockdowns only partly lifted in many countries and incomes only minimally recovered, the situation remains dire for many people. Moreover, lockdowns could tighten again when and where the virus flares up, which would further deepen economic stress.

This level of economic stress has consequences for borrower behavior in terms of their ability to repay loans and their demand for new credit. In Pakistan, 70 percent of a sample of borrowers reported that they could not repay their loans. India's regional approach to lockdowns, in which the extent of restrictions depends on the severity of the outbreak, is leading to varied levels of borrower stress by location. At one extreme are highly stressed unemployed urban workers streaming into rural areas. At the other extreme, many farmers who are customers of Ujjivan want to continue to pay their loans in order to qualify sooner for new loans (Roy and Agarwal 2020).

As businesses and farms attempt to restart with no working capital to purchase inventory, materials, or seeds, many will need to borrow. In Ujjivan's May and June survey only 7 percent of customers reported needing loans now, but 19 percent said they would need loans within the next three months. While a rise in demand for credit can be anticipated as economies reopen, when this Briefing was written, lockdowns had not eased sufficiently for such demand to appear. At the household level, as reserves and other coping strategies are used up, some families will resort to borrowing for basic needs. Evidence from May indicates that Indian households are borrowing primarily from informal sources to meet their basic needs (Agrawal and Ashraf 2020).

State of financial services providers

At the same time, FSPs have been under great stress. They face multiple challenges, including high arrears and loss of income and liquidity because of loan moratoria to borrowers, withdrawals from accounts, and inability to operate branches. CGAP's Pulse Survey of microfinance institutions (MFIs) showed that 30-day portfolio at risk (PAR) among over 300 responding institutions at the end of April was 7.2 percent, which is elevated (Zetterli and Sotiriou 2020). An ADA, Inpulse, and Grameen Credit Agricole (2020) survey of 110 FSPs, mainly microfinance providers, showed 80 percent of organizations had elevated PAR, including 37 percent whose PAR had more than doubled. The reporting institutions in Sub-Saharan Africa, South Asia, and the Middle East and North Africa regions showed higher PARs, on average, than those in Latin America or Eastern Europe and Central Asia. Loan officers in Pakistan estimated that repayments in April would fall to 34 percent (Malik et al. 2020).

However, repayment rates may not be a reliable indicator of portfolio soundness if they reflect widespread use of moratoria. Sa-Dhan, a microfinance provider association in

India, estimated that the average repayment rate among its members for May was just 12 percent. It attributed this to formal moratoria and a drop in repayments created by office closures and movement restrictions. Low repayments create immediate liquidity stress, but how they affect longer term solvency will not be known until the loans come due. CGAP's Pulse Survey shows that many lenders are responding to liquidity stress, low demand, and operating restrictions by curtailing lending, with half of respondents cutting lending by more than half and a small fraction stopping altogether (Zetterli 2020). Some regulated financial institutions have received relief from policy makers through, for example, liquidity facilities, and relaxed reserve or provisioning requirements, but nonregulated and cooperative institutions, to which many lower income people turn, have received little of such assistance.

The challenges ahead

We can anticipate a rise in consumer protection issues, including problems with credit. We have grouped these risks into two main areas: (i) challenges with existing loans and (ii) challenges in lending new credit. Within these categories, other risks can arise as borrowers and lenders interact, including risks of harsh collections practices, unexpected fees, lack of transparency, and predatory lending, among others. FSPs, regulators, investors, and credit reporting systems can help ensure that credit markets at the base of the pyramid treat borrowers fairly during these uncertain times by anticipating some of the risks (Chhabra, Sankaranarayanan, and Masunda 2020).

This section describes how these challenges might play out, based on preliminary information from several countries. At this stage we know more about the policies regulators have announced regarding treatment of current portfolios than about how these policies are implemented by FSPs, and much less about how they are affecting borrowers. Issues relating to new credit remain even more speculative, since credit demand has yet to rebound.

CHALLENGES WITH EXISTING LOANS

The first set of challenges involves managing existing loans that borrowers may find difficult to continue repaying. These generally are managed through moratoria and other forms of forbearance. Regulators encouraged moratoria in response to lockdowns that would cause systemic repayment problems at no fault of borrowers and in the initial hopes that a short, sharp economic downturn would be soon followed by a rebound. The pandemic offers an unprecedented opportunity to examine the use and effect of moratoria, because unlike in other times, moratoria have been offered widely across loan portfolios and in many countries around the world. See Box 1, which describes some of the terms used when discussing moratoria.

During this crisis, regulators in many countries allowed FSPs to grant moratoria and other forbearance without downgrading loans and without increasing provisions, while they set rules on how and when moratoria could be implemented (CGAP 2020b). The degree of prescriptiveness varies widely across countries, but often, regulators give lenders great discretion to define terms, within certain norms, and selected recipients. In India, the Reserve Bank permitted all lenders to offer three-month moratoria starting in March and then extended the period for three months, through August (CGAP 2020a). In the Philippines the central bank mandated providers to offer a 30-day grace period with no fees or interest on interest for all loans during the lockdown. In most cases, interest accrual was allowed during moratoria, in accordance with standard accounting practices. Full payment holidays have been used far less often. This means that moratoria offer a temporary benefit, but they may increase the total amount of interest a borrower will have to pay over the lifetime of the loan.

FSPs have responded to the guidance on moratoria in different ways. And importantly, nonregulated FSPs have been on their own in determining their responses.

BOX 1. **Moratorium-related terms**

The terms related to various forms of debt relief are often used imprecisely and interchangeably, even though their consequences for both lenders and borrowers can be quite different. The following terms, among others, should be used with care:

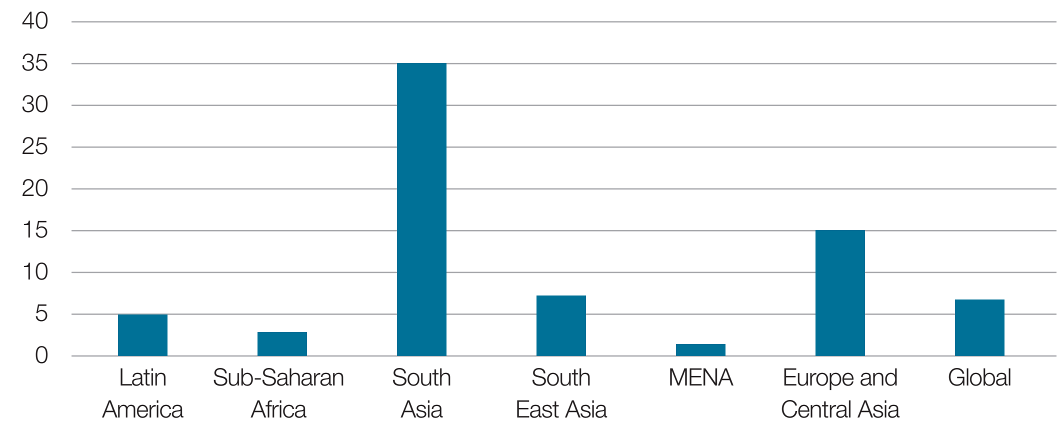
- **Forbearance.** Any change in loan terms intended to provide relief to borrowers. While the term generally refers to moratoria and other rescheduling, sometimes it also encompasses forgiveness of portions of interest and/or principal, interest rate reductions, etc.
- **Interest accrual.** The standard accounting practice of accumulating interest based on principal outstanding, even when payments are not made. In many moratoria, interest still accrues, though its payment is postponed.
- **Interest on interest or interest capitalization.** Interest charged on top of the amount of accrued interest. This may occur through converting accrued interest to principal.
- **Moratorium.** A set period during which loan repayments are permitted to be suspended. Many variations are possible.
- **Payment holiday.** A type of moratorium during which all payments are suspended and interest is not accrued. (Sometimes used as a synonym for moratorium, including with interest accrual.)
- **Refinancing.** Provision of a new loan that pays off an existing loan and results in a new repayment schedule.
- **Rescheduling.** A change in payment schedules, such as lengthening the loan term. Moratoria are one form of rescheduling.
- **Restructuring.** Similar to forbearance, any change in loan terms intended to provide relief to borrowers.

Who is actually receiving moratoria and other forbearance?

Moratoria are raising several important questions. One is the question of whether enough borrowers actually are receiving loan relief. In this global, systemic crisis, borrowers who need and want relief should receive as much relief as possible without jeopardizing the financial standing of their lenders. Both regulators and FSPs are struggling to get this balance right.

Data on the prevalence of forbearance suggest wide variation in use around the world. Many FSPs are offering some form of relief to at least some borrowers. For example, 75 percent of the 110 microfinance providers responding to the ADA, Inpulse, and Grameen Credit Agricole survey said they were restructuring loans. But the nature and extent of these efforts vary dramatically. Relief may be applied to most, some, or few customers, as seen by widely different microfinance providers reporting the percentage of the portfolio under moratorium or restructured as of the end of May to CGAP's Pulse Survey (Zetterli and Sotiriou 2020). The global median was 6 percent of the portfolio in restructuring or moratoria, but the regional variation was great (see Figure 1). The use of moratoria did not appear to vary systematically by size or type of institution; however, credit unions and small microfinance providers showed lower use.

FIGURE 1. **Microfinance Provider Use of Moratoria, by Region, median percentage of portfolio in moratorium**



Source: "Results Dashboard: CGAP Pulse Survey of Microfinance Institutions," CGAP, June 2020, https://www.cgap.org/research/data/results-dashboard-cgap-pulse-survey-microfinance-institutions.

While Pulse Survey respondents are a voluntary rather than representative sample, the numbers in Figure 1 indicate significant variation in the availability of relief to borrowers. Vietnam is at one extreme, where the economy has not been heavily curtailed. In interviews, FSPs in Vietnam report undertaking only a handful of moratoria, specifically for borrowers with COVID-19. At the other extreme, a FINCA manager reporting on operations in several African countries, described "a massive, massive project of loan restructuring underway in the organization" and estimated that this would affect 70–93 percent of the portfolio by value in various FINCA affiliates. Sa-Dhan in India reported that over 90 percent of all clients are taking advantage of the moratorium (Sa-Dhan and DFID/UKAID 2020). Also, many FSPs, especially group lenders, allowed the equivalent of moratoria simply because lockdowns prevented them from carrying out in-person payment collections. This occurred widely in Indian microfinance and in many other countries, and it may help to explain why FSPs that focus on serving female customers showed higher use of moratoria.

Payment relief can be offered either as a blanket moratorium for all borrowers (or all borrowers in a given segment) or on a case-by-case basis. Theoretically, in the former, borrowers can opt out if they prefer to continue paying and, in the latter, borrowers can opt in by requesting a moratorium if they wish. However, there are examples of blanket moratoria with no ready opt-out and case-by-case moratoria initiated by lenders. One would expect more people to receive relief when it is offered on a blanket rather than case-by-case basis, and this would be especially true for lower income people with greater challenges in learning about and making relief requests. In reality, the procedures used to implement moratoria varied widely, leading to different take-up rates. Differences stem from how the moratorium is initiated (imposed vs. requested), how borrowers are informed, and other process-related factors.

- In Peru, many loans were unilaterally rescheduled by FSPs without prior borrower knowledge or consultation. These changes led to many borrower complaints, in part because opt-out provisions were not well communicated to borrowers (CGAP 2020b).
- In India, different classes of FSPs and different types of loans have been treated differently. For example, many commercial vehicle loans and microfinance loans were given blanket moratoria with an opt-out possibility, while many small business loans were treated on a case-by-case and opt-in basis.
- In the United States, COVID-19 legislation required federal program loans to be placed under moratoria, resulting in far higher rates of moratoria for federal loans than for loans not linked to federal programs.

Large differences in use of moratoria may be partly explained by the ambivalence of both FSPs and clients. For FSPs, the first and obvious point is that they are reluctant to extend moratoria to borrowers who still can pay because they face financial pressure to maintain as large a flow of repayments as possible. On the other hand, if borrowers truly cannot repay, FSPs may welcome the moratorium option, if they are allowed to avoid showing deterioration on their balance sheets. FSPs that have received liquidity support may be better placed to offer moratoria. The more relief FSPs extend, the more they will need relief of their own from their creditors, regulators, and special liquidity facilities (CGAP 2020b). And in turn, greater relief will enable FSPs to extend more generous terms to their clients.

A less obvious reason for low use of moratoria may be the high level of effort involved in renegotiating loans. In India, many of the FSPs interviewed indicated that their IT systems are not programmed to handle restructurings, which means that each loan would have to be reprogrammed manually, and it would be a very time-consuming process. FSPs also would need to be able to let customers know about the opportunity for relief, explain to customers how the moratoria would work, and determine customers' preference to opt in or out. This is particularly challenging for FSPs that are not fully digital or that serve low-literacy borrowers. Borrowers who are less savvy or proactive may end up without moratoria because they did not know about the possibility or did not understand how to apply for one.

Borrowers also may be ambivalent about moratoria. They recognize that unless the moratorium offers a full payment holiday (and this is not the norm in most countries), the relief is only temporary, and over the life of their loan they will pay more in interest than had they not accepted a moratorium. This would be true especially for borrowers in the early stages of an amortization schedule where most of their payments are applied to interest. Borrowers also may wish to continue paying in order to qualify for a new loan sooner. Nevertheless, if a borrower is in genuinely dire straits, even a temporary respite would be welcome.

In India, Ujjivan offered moratoria on a blanket basis, and most borrowers (77 percent) reported being happy with the moratoria. A significant fraction (18 percent), especially those in rural areas, preferred to keep paying. Annapurna had similar results. Nearly everyone accepted the moratoria, although only 69 percent said that it benefitted them.

In a survey of clients across Africa, VisionFund and FINCA found that most wanted to reschedule existing loans or receive moratoria rather than new loans. When lenders offered moratoria only to borrowers who requested them, far fewer moratoria were granted. Some borrowers may fear that they will be penalized for accepting moratoria—and in some cases, they are right.

Our preliminary review has revealed some early lessons. When moratoria and other rescheduling protocols are established, regulators and FSPs must address the practicalities of administering these changes in terms of staff capability, borrower communications, and IT systems. Regardless of whether moratoria are offered on a blanket or case-by-case basis, regulators and FSPs offering them must reach borrowers with the information they need to make well-informed decisions.

Will moratoria end safely for borrowers and their FSPs?

A second question is how the ending of moratoria will be handled. The terms governing resumption of repayments are specified when the moratorium begins, but when the time comes to restart payments, many borrowers may not yet have the economic wherewithal to comply, and they may quickly become overindebted. In addition to the debt itself, borrowers may face harsh collection practices, unexpected fees, and deterioration of their credit ratings. As it becomes evident that movement and exposure restrictions in many countries are not going to end soon, the question arises of how long moratoria can be extended. Borrowers in weakened positions may be unable to service their existing debt load, which may require their loans to enter longer term rescheduling or even forgiveness.

As Isabelle Barrès (2020), former director of the Smart Campaign, suggests, some moratoria are fairer than others. Many regulators have stipulated parameters for fair moratoria, such as prohibiting fees and interest on interest. But the rules often are silent on key details, and regulators frequently lack the resources to enforce such rules, especially for smaller FSPs that serve poor people. Some consumer-unfriendly practices that may arise include retaining the original end date in the amortization schedule, which would cause weekly or monthly repayments to increase, or calling delayed principal in a lump sum when a moratorium ends.

As moratoria end, lenders may step up their loan collection activities. Evidence from Pakistan as early as April revealed that many microfinance loan officers were pressuring borrowers for repayments, even after moratoria were declared, and there are more recent indications from India and Pakistan that borrowers may be experiencing collections pressure (Malik et al. 2020). Domestic workers in Hong Kong from the Philippines and Indonesia reportedly have faced similar pressure (Carvalho 2020). Lenders that outsource to collection agencies may turn a blind eye to high-pressure tactics.

CHALLENGES TO NEW LENDING

The second group of challenges, possibly the most important for restarting the economy, is making new credit available to both previous and new borrowers. People need to be able to borrow—and to borrow safely. But with depleted reserves and assets, many formerly good borrowers will struggle to meet credit qualifications.

Many lenders—including BRAC and FINCA in several countries and 43 percent of FSPs surveyed in Rwanda—suspended new lending during the shutdown. It is not yet clear how or when they will restart. CGAP's Pulse Survey found that three quarters of its respondents had cut lending, many of them dramatically.

As of July 2020, lockdowns are easing on a rolling basis. Although some reopening already has occurred, credit demand has not yet started to rise appreciably, according to client surveys by Ujjivan and Annapurna in India and FINCA in Africa. Many more clients still are asking for debt relief rather than new credit. In the FINCA survey, about 12 percent of borrowers wanted a new loan. However, many of these same clients—three quarters in the case of Ujjivan and Annapurna—stated that they would be able to recover their business levels within one or two months of being allowed to restart. At that point, demand for credit may pick up, especially as people who previously relied on savings can no longer do so.

As they restart, FSPs that use cash flow analysis for underwriting decisions will find their clients are less creditworthy because their cash flows and monthly surpluses have shrunk. FSPs that make collateral-based loans will find that many borrowers have drawn down the compensating savings balances in their accounts and in some cases sold off their collateral assets. If the credit ratings of borrowers under moratoria are lowered, it will be harder for them to qualify for new credit.

At the same time, FSPs with tight liquidity and concerns about their long-term solvency may tighten credit standards and lend only to well-known customers. This scenario is the opposite of what is needed if fresh infusions of credit are to help jump-start economic recovery. As demand begins to grow again, tight credit standards could lead to a credit crunch that affects lower income borrowers. There are reports of loans becoming less available in the United States and in the Philippines (Dickler 2020; Rivas 2020). Fearing a credit squeeze, the Kenyan government announced that it would fine lenders that reject loans only because of negative credit scores (Guguyu 2020).

In the immediate post-crisis situation, responsible underwriting will look different from business as usual, and it is important for regulators and providers to establish responsible guidelines. One shift, for example, could be a greater emphasis on a customer's repayment history, human capital, and social capital relative to collateral. More people than usual may need loans, but those loans may be smaller. For some people, resources will be depleted and economic prospects too limited to support loans. Direct relief or graduation programs may be the best approach, despite their drain on government budgets.

To support the revival of economic activity using budgetary resources, some governments are developing emergency loan programs, such as Reactiva Peru and FAE MYPE, that provide government guarantees for loans granted by microfinance providers to companies and micro and small enterprises (CGAP 2020a). Lessons from past experiences show that directed lending programs can become politicized over concerns that elites will capture benefits intended to assist those of less means. Evidence of this is seen, for example, in controversies surrounding the CARES Act loans in the United States. Such programs also can distort the re-emergence of normal credit markets. A full discussion of the relative merits of different types of fiscal interventions that work through the financial system is beyond the scope of this paper.

The bridge from old to new credit: Credit reporting practices

As we look toward new lending, credit reporting protocols during periods of moratoria or other forbearance will affect the ability of borrowers to qualify for new loans. Many credit bureaus (in some cases per regulator mandate), for example, in the Philippines, have agreed not to downgrade the credit reports of borrowers under moratoria (Agcaoili 2020). However, customers may not receive this benefit in South Africa or India if their lender fails to submit information correctly or if their loans were in arrears when lockdowns began (de Wet 2020).

Avoiding harm to a borrower's credit status for moratoria or other restructuring is a surprisingly complicated challenge that requires lenders, credit bureaus, and prospective lenders to follow agreed or mandated procedures. For credit bureaus that report only negative items, FSPs simply may refrain from reporting a paused loan. For credit bureaus with positive reporting, the data FSPs submit are likely to reveal payment gaps. In those cases, a code may be used to flag that the loan is under pandemic-related moratorium. Credit bureaus would then agree not to use these codes or other information to mark down credit scores. Highly automated scoring systems may be difficult to adjust. Finally, if prospective lenders can see the information in a credit report, they still may use it in lending decisions. Given the complexity of this situation, it is no surprise that problems surface, including in sophisticated systems such as in the United States. (See Box 2.)

BOX 2. **Pandemic-related loan forbearance and credit reporting in the United States**

In the United States, coronavirus relief legislation known as the CARES Act mandates forbearance for federal-backed mortgages and federal student loans. As a result, nearly 80 million student loans went into forbearance as of the end of May, along with about 4.5 million mortgages.

When lenders place a loan into forbearance, the CARES Act requires them to freeze the client's credit status in reports to credit bureaus—that is, an existing loan remains current as long as borrowers comply with the forbearance terms. However, these provisions are inconsistently applied and coded in credit reports, which has led to a surge in consumer complaints, despite efforts by credit bureaus to adjust their models.

Source: FinRegLab, 2020..

Aggressive and reckless lending

Another possible concern about new credit is that some lenders will aggressively market loans under loan terms that are unfair or unsafe for the borrower at a time when borrowers are especially vulnerable—and desperate for money—even though they are less able to sustain debt than in normal times. They may step into a breach left by responsible FSPs themselves that are constrained by difficult financial situations. Payday lenders in the United States have remained active during the lockdown period, for example, and there are news reports in India of app-based lenders operating with predatory practices—a phenomenon that also has appeared in our preliminary analysis of social media complaints (Jones, Eaglesham, and Andriotis 2020; Mallikarjunan 2020). Such practices are most likely among nonregulated lenders, though at this time regulators also may fall short in monitoring the practices of the institutions they supervise.

Preliminary recommendations

The credit market for lower-income customers is in for a difficult and possibly chaotic period. Moratoria and other forbearance are unavoidably complicated topics, and pandemic-related guidance in many cases turns standard practices upside down. Moreover, as circumstances change and more is learned, regulators are adapting on the fly. With so much change to respond to, FSPs and their staff—not to mention their IT systems—may become overwhelmed in the effort to reconcile new policies with their own financial situation and their customers' needs. It is likely that current and prospective borrowers also are confused, poorly informed, and susceptible to misinformation. Our preliminary research on the prevalence of consumer risks has shown a very wide range of circumstances and responses around the world.

This paper represents our initial inquiry into the challenges associated with credit for lower income people and their small businesses as countries emerge from pandemic lockdowns. It offers preliminary hypotheses based on current information. As the situation evolves and unfolds, we will have a clearer idea—and firmer recommendations—about the prevalence of risks and the effectiveness of solutions. Nevertheless, in light of our findings so far, we offer the following recommendations to FSPs to help them better serve lower income customers and to policy makers and regulators to help them ensure a responsible and inclusive financial system.

GENERAL PRINCIPLES

Put lower income consumer needs front and center. Supporting households and businesses should be the overriding policy objective, both from a humanitarian perspective and to help the lower income economic segment rebound. People will need debt relief and fresh credit to help them begin economic activity after lockdowns. Maintaining the survival of FSPs is necessary to help meet this objective, but when trade-offs surface, the exceptional needs of consumers during the crisis should be given as much weight as possible. Some groups shown to be especially vulnerable, such as female heads of households, may require special attention.

Use the shock-absorbing mechanisms of the financial system. The financial system is purpose-built to help absorb economic shocks, at both the central bank level (liquidity facilities, etc.) and the individual FSP level, through their internal resilience mechanisms, including equity capital, provisioning, and liquidity reserves. Since resilience is the express purpose of such mechanisms, they should be deployed actively at times of stress, such as now during the COVID-19 crisis, to increase the capacity of providers to safely extend relief to their borrowers. Allowing FSPs to offer moratoria and restructuring without loan reclassification is a form of relief that benefits customers directly, and it is already widely used. Another approach, which does not appear to be as widespread, is to allow FSPs to forgive portions of interest or principal.

Communicate proactively. It is hard to overstate the importance of communications by policy makers, regulators, and FSPs. Initial research suggests that many clients may be unaware of or unable to access relief that is intended for them. Governments have a duty in this extraordinary situation to ensure that the population is well informed. At a time when standard lending policies and procedures are not operating in a predictable way and may be changing quickly, FSPs also will need to take extraordinary measures to communicate clearly and proactively with staff, customers, and relevant third parties. Moratoria, rescheduling, and reporting to credit bureaus are complicated and may be difficult for borrowers to understand. Borrowers must be clearly informed about the possibility of obtaining moratoria or other restructuring, fair moratorium terms, and what to expect when payments resume. Policy makers, regulators, and FSPs need to hear directly from borrowers to understand their questions and concerns.

Monitor the market through complaints data, social media, and direct surveys. In this situation the risks and problems clients experience may vary from those they experience in normal times. Analysis of complaints data is especially important to gain insight on emerging risks, though policy makers and regulators should note that customers may face unexpected barriers to making complaints during the crisis. Policy makers should be concerned about overall recovery. Hence, they need to reach out to borrowers from nonregulated institutions through consumer surveys to identify and assess the main problems they are facing. These borrowers may be among the most vulnerable, and they may need additional protection. Where possible, customer data should be disaggregated by segment, including gender, to provide greater insight into the incidence of risks.

TREATMENT OF MORATORIA AND OTHER RESTRUCTURING

Offer relief broadly and easily. In countries that have sharply curtailed economic activity, large portions of the borrower population should have access to moratoria and other forbearance. Where feasible and appropriate, FSPs should offer (not require) moratoria on a blanket basis with opt-out provisions, rather than on a case-by-case and opt-in basis, to make it is as easy as possible to reach eligible borrowers. Preliminary findings suggest that the percentage of borrowers that receive moratoria differs from country to country—from many or most microfinance clients in India to very few in East Africa. In countries with severe curtailment of economic activities but low use of moratoria, and where policy makers have issued enabling guidance, there is an urgent need to determine why moratoria are not reaching borrowers so that barriers to access can be quickly addressed. While it may not be appropriate to make blanket offers with opt-outs to all borrowers, it may make sense to do so for specific segments, especially for small loans and lower income borrowers. These vulnerable borrowers may need relief to prevent them from falling into greater poverty. The extent of relief must be calibrated to the ability of FSPs to withstand the drop in payments, but widespread moratoria for lower income segments will not significantly affect the balance sheets of the larger, diversified FSPs.

Ensure that the terms of moratoria and other forbearance accord with sound client protection principles, especially when moratoria are imposed. Regulators often prescribe terms for moratoria that would prevent lenders from penalizing customers for participating in moratoria. However, these provisions may not be specific enough to address the full range of possible gaps. Appropriate terms may include:

- No imposition or mandate without easy opt-out processes.
- Suspension of interest accrual (i.e., full repayment holidays) is most beneficial to borrowers, but most regulators endorse accruing interest to support FSP solvency.
- If interest is accrued, no interest on interest or capitalization of interest.
- Automatic extension of the loan term by the length of the moratorium. Avoid requiring immediate payment of large lump sums or other terms that would make resumption of regular payments especially difficult.
- No fees or penalties associated with processing moratoria, especially if moratoria are imposed.
- Credit score not damaged and future discrimination against borrowers using moratoria prohibited.

As moratorium periods are ending, it will be important for regulators to monitor how clients are being treated, to ensure that consumer protection principles are followed and to determine how clients are faring under the resumption of payments. At present little or no data are available.

NEW CREDIT

As lending reopens, avoid pulling back to the least risky clients. If credit is to do its work in stimulating recovery, many people will need new loans. However, the loan amounts they will need may be smaller than usual because demand for their goods and services likely will be smaller than normal and their ability to service debt likely will be lower. Underwriting criteria that emphasize past and expected business performance and social capital should take precedence over collateral-based lending where possible, given that many households and businesses will have depleted their collateral during the lockdown period.

Ensure that clients in pandemic-related moratoria or rescheduling are not penalized in credit reporting. Although many countries intend to avoid reducing customer credit scores or standing in credit bureaus as a result of moratoria, reports from various countries suggest that it has been difficult to achieve this. Additional research should focus on how FSPs are reporting on credit and how credit bureau systems treat codes that denote moratoria and other forbearance.

Distribute government subsidies fairly. Efforts to use government budgets to assist borrowers are well intended, and in this crisis, loan capital, loan guarantees, or interest rate subsidies may be useful. Loan guarantees are especially relevant when credit providers are more risk averse than usual. However, history has shown that directed credit may be politicized and diverted to elites. Ordinarily, these policies may not be recommended because of their potential to distort credit markets, but the needs brought on by the crisis may outweigh these concerns, at least temporarily. The relative merits of the different forms of government support at this time are beyond the scope of this paper, but they offer an important topic for further exploration.

Recommendations for research going forward

This paper covers the treatment of borrowers during the pandemic and primarily focuses on the role of FSPs, policy makers, and regulators. We have not reported on the direct voice of consumers. This gap points to the lack of information about what customers are experiencing at this time. Policy information is readily available from governments, and information about the state of FSPs is available through surveys such as the CGAP Pulse Survey and the ADA, Inpulse, and Grameen Credit Agricole study. However, these surveys delve much more thoroughly into the financial health of FSPs than their treatment of customers or their financial health. Some customer-based information on the economic stress of low-income people is available from numerous pandemic monitoring surveys, but few surveys provide significant information on borrowing and repayment. Possibly more surprising, relatively few reports offer gender-disaggregated analysis, even though women are disproportionately affected by the economic consequences of the pandemic.

It is important that FSPs, policy makers, and regulators understand what customers actually are experiencing with regard to moratoria and other forbearance as they find their way through the crisis. Policy makers have issued guidance intended to provide relief to borrowers, but we know little about how much of the intended relief is reaching them and whether it is provided in a beneficial way. As moratoria periods come to an end, it is especially important that FSPs, policy makers, and regulators know more about whether borrowers are in a position to resume repayments and whether FSPs are using fair practices. This requires customer-focused information, which can be obtained through market-monitoring tools that identify and assess consumer risks and outcomes.

This information can come from several sources, starting with credit reporting systems, as discussed in this paper. Customer complaints data are another source of relevant information, though they often are closely held, which reduces its value. Complaints data also are better at flagging problems than at gauging their frequency or severity, which may be better understood through independent demand-side research. Social media also can indicate problem areas, as can press reports, though given the interests of the press in highlighting a certain aspect or angle of a story, such reports must be followed by more direct and dispassionate research.

In these unpredictable and unprecedented times, FSPs, policy makers, and regulators play an important role in ensuring lower income borrowers are treated fairly and responsibly. By understanding some of the key risks and challenges early on, we, as a community, can help these important players to successfully meet the needs of low-income customers.

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