CONDITIONS THAT CREATE A HEIGHTENED RISK OF OVER-INDEBTEDNESS

Over-indebtedness is not an absolute level of debt but is commonly understood as a situation where a client has to make unacceptable sacrifices in order to repay a loan. Management and board should develop a definition of over-indebtedness for your institution's context (i.e., "what does over-indebtedness mean for our clients, and how do we identify it?"), and they should define indicators and benchmarks that serve as early warnings for over-indebtedness. Examples of such indicators include: PAR by product; number/percentage of clients with multiple loans; number/percentage of clients repaying loans early; early repayment by product; calls on guarantees; delinquent loans; and client exit. In particular, the provider should track rescheduled loans, and produce reports at least monthly, as a rising number of rescheduled loans may reflect rising over-indebtedness.

The institutional and market conditions that create a heightened risk of systemic over-indebtedness are listed below. Consider whether the following conditions are true in your context:

- There are many, or an increasing number of, informal sources of finance available.
- There are many, or an increasing number of, lending institutions in the market.
- Consumer lenders are moving into the same market as microfinance.
- Multiple institutions often compete to serve the same customer.
- Credit bureaus are not available, are inadequate, or not widely used.
- Due to high growth targets or rapid growth, your systems are overstretched, and your risk controls are no longer sufficient.
- Clients complain about not having the right product fit, including the price and/or the size (especially too-small loans).
- You experience high staff turnover and/or difficulty providing adequate training to staff given the new for many new loan officers.
- Your incentives place a very high value on portfolio growth.

One study of over-indebtedness in Ghana highlights the seriousness of client repayment difficulties. The study examines debt stress in over 500 Ghanaian microfinance borrowers. The data below demonstrate how many times the borrowers in the study sample reported each of the common "sacrifices"—things that the borrower gave up in order to make a loan repayment. The list emphasizes how indicators like debt service rations, default, and delinquency often do not reflect the true state of client over-indebtedness.

Number (%) of borrowers making each sacrifice	Sacrifices
325 (61%)	Work more than usual
240 (54%)	Postpone important expenses
179 (34%)	Deplete savings
96 (18%)	Reduce food quantity/quality
67 (13%)	Use family/friends' support
51 (10%)	Suffer psychological stress
26 (5%)	Reduce education
20 (4%)	Borrow anew to repay
20 (4%)	Sell or pawn assets
15 (3%)	Feel threatened/harassed
14 (3%)	Suffer from shame or insults
4 (1%)	Seizure of assets

In high-risk markets the conditions for over-indebtedness are present~~s~~, efforts should be heightened to monitor client over-indebtedness based on an analysis of both client level indicators and portfolio analysis. Under these conditions, your institution's credit approval policy should explicitly address borrower debt thresholds. Your institution should also gather client feedback on possible cases of over-indebtedness. This client feedback is important because over-indebted clients are not necessarily delinquent, as they may use informal sources of funds or sale of assets to meet contractual obligations, especially in saturated markets. Moreover, delinquency is a lagging indicator: by the time PAR starts rising, there is already a problem. Ask your clients: Are you making major sacrifices to meet your loan obligations? Have you had to borrow elsewhere, use savings, or sell an asset to make a loan payment? These are questions that should be integrated into regular procedures (exit surveys, audit visits, etc.) as they will give management a more complete picture of client over-indebtedness.