PLEDGE

Key principles to protect microfinance institutions and their clients in the COVID-19 crisis

FOREWORD

As the COVID-19 health crisis is in full swing, a group of Microfinance Investment Vehicles (MIVs) and microfinance stakeholders convened in April 2020, on the initiative of the Grameen Crédit Agricole Foundation, to exchange views and draw a common pledge to guide their response to the crisis in a responsible and concerted manner.

By signing this pledge, the signatories commit to complying with some key principles. The pooling of available information, analyses and anticipations, followed by the concerted implementation of shared decisions are vital today for our industry. At the cost of this transparency, this concertation and a necessary adaptation of our intervention principles, we aim to overcome the effects of this exceptional health and economic crisis that could knock down many microfinance institutions (MFIs), leaving fragile populations in desperate situations. Because we know the crisis will hit the most vulnerable populations first, we must work together to live up to the issues of this humanitarian challenge.

1. THE CONTEXT OF THE CRISIS

The COVID-19 situation is changing extremely fast, and the signatories all agree that **it is still very difficult to assess the full extent of the consequences of the crisis**. Some regions of the world are now completely locked down leading MFIs to halt their operations altogether, and practically all institutions, regardless of their location, are anticipating a sharp decline in operations.

Not all MFIs seem equally exposed to the crisis. Depending on their sector, their size, their degree of digitization or their methodology, and their location some will find it easier to cope with the situation. A massive slowdown in the real economy leaves the clients of MFIs exposed, leading them to cease their activities and to request postponements or restructuring of their loans. The COVID-19 crisis will have impacts on MFIs’ operations, portfolio, and liquidity as well as on the value of the local currency, the price of raw materials, cost of hedging and of new funding. Investors are starting to receive requests for moratoriums and restructurings and expect to see many more in the days and weeks to come.

Moreover, local authorities already started to implement policies to lighten the burden for clients of financial institutions. **Thus, MFIs may be required or encouraged to delay repayments or to restructure their loan***s*; such requests will most probably have an impact on how MFIs manage their liabilities and therefore request support from their lenders and investors.

2. LENDERS' COMMITMENT FRAME

Issues to overcome: The issue of liquidity will be a challenge for the Debt lenders, who also have commitments with their own funders. However, the signatories will do their best efforts to maintain the MFIs' access to funding. More than just restructuring, MFIs may need additional funding. It will be necessary to be efficient in these processes as well, despite the context. It is becoming very clear that liquidity will be the key element in this crisis.

Commitment: the signatories agree on the following principles with the aim to engage in fluid and efficient processes to address the liquidity issues of MFIs linked to the COVID-19 crisis.

The signatories agree to coordinate their action in the best possible timeframe and in all transparency as they respond to requests from MFIs for moratoriums or restructuring of their debt. Adopting principles of efficient cooperation and transparency in this time of crisis helps convey the message that lenders stand united in order to face the current situation.

In each case needed, and as soon as it will be possible, the outlines of the solutions agreed between the lenders and the MFIs will be formalized through gentlepersons' agreements and be followed by swift and clear action, through the setting up of standstills, rollovers or other actions. Such an approach allows us to move faster, in the best interest of all parties, rather than engage upfront in longer and often expensive agreements.

The signatories recognise that these gentlepersons' agreements do not replace the formal agreements that may be needed to deal with the long-term consequences of the crisis. Lenders hereby agree to engage in discussions and agreements on such formal deals when needed. The systematic approach is on a case-by-case basis, within the framework described below.

2.1. Commitment to client centricity as well as client and staff protection[1]

Issue to overcome: Populations served by MFIs are uniquely vulnerable. Their livelihoods are unsheltered from the impact of Covid-19 and they are less likely to have adequate savings or insurance to weather the shock. Similarly, populations employed by MFIs are fragile and strongly depend on their employment to ensure their livelihood. Responsibility towards final clients and MFI staff is critical during the COVID crisis and beyond in order to help them face this crisis and protect their health.

In order to minimize clients' hardship, MFIs commits to great caution in handling their clients that might have repayment problems; when creditors grant specific conditions to the MFIs, they expect the latter to echo such conditions or facilities to their end clients. The MFI shall commit to taking actions in particular to ensure that i) their staff abides by the best practices in terms of debt collection practices and recoveries which includes banning harsh recovery measures/pressures and actions that are prohibited in case of default; ii) to the best possible extent, continuing collections and/or interest accruals do not exacerbate overindebtedness of vulnerable clients. The MFIs should also commit to restructure operations to protect clients from health risks.

Commitment: The signatories will require from any ***debtor MFI benefiting from a period of relief that it commits to great caution in handling its end clients***, especially those that might have issues in repaying their loans.

[1] Detailed guidance on: https://sptf.info/resources/covid19. The SPTF published a "Crisis Checklist for MFIs based on the Universal Standards for Social Performance Management" available here and a collection of good practices from the field entitled "A customer-centric response to the Covid-19 pandemic: Social Performance Management in Practice", available here.

Signatories will also ***encourage MFIs collect regular information to understand the situation and needs of clients***, especially the most vulnerable, so that they can respond to client needs by providing financing when relevant. Signatories agree to take into account the results of such field surveys in their decision-making.

Signatories will also require from a debtor MFI benefiting from a period of relief that it ***commits to treating staff responsibly***, which includes protecting staff from health risks and making every attempt to limit staff termination, even during inevitable cash shortages.

2.2. Shared information and reporting format

Issue to overcome: In order to facilitate the monitoring of an MFI, the constitution of a lenders group is essential, and information sharing is vital to manage the crisis. The MFI must ensure equal communication with all its partners, in accordance with the principle of fair treatment of each lender. This in turn applies to the lenders themselves, who are also responsible for the smooth running of the lenders group. Though lenders need additional information beyond regular reporting requirements at this time, their intention is not to overburden MFIs and their staff. Lenders also recognize the difference between information meant for lenders and that meant for the governance of the MFIs.

Commitment: ***The signatories agree on designating a leader among the lenders in each lenders group, to facilitate coordination within the group and with the MFIs.*** Lenders agree they need to be cautious to establish a balanced and fair relationship with the MFI, to avoid imposing any unilateral decisions coming from the lenders' side. Dialogue and transparent communication remain key.

*The signatories agree that the additional information requested from MFIs in this time of crisis shall be **harmonized*** between lenders. This includes business continuity plans, stress tests, liquidity plans, country updates, and for some MIVs, a switch from quarterly to monthly reporting. **The signatories agree, when relevant, to join the on-going initiatives in the sector on this matter.**

2.3. Coordination of technical assistance

Issue to overcome: Not all MFIs have the same capacity to work on projections or liquidity analyses. It is especially true for Tier 3 MFIs and regionally in Sub-Saharan Africa. Some MFIs have already started asking for help in obtaining tools to monitor the crisis and anticipate its future consequences. In order to adapt to the crisis, technical assistance programmes should focus on the provision of trainings and preparation of key documents and tools for crisis monitoring at the MFI level. Training should be available on how to develop continuity plans, prepare stress tests or liquidity monitoring, information that could be shared among the various stakeholders of the sector. TA programmes could be proposed to MFIs depending on their needs and capacities.

Commitment: ***The signatories agree to coordinate technical assistance and training efforts and resources*** among MIVs, in order to avoid any duplication. The technical assistance agenda must also work on identifying potential funding for such new programmes.

2.4. Managing the MFIs' exposure to foreign exchange risk

Issue to overcome: The creditors recognise the importance and relevance of providing funding in local currency to MFIs, and the importance for the MFIs to limit the increase in their FX risk exposure especially at a time when local currencies are depreciating due to the crisis. The creditors provide local currency funding to the MFIs thanks to specific hedging arrangements; the costs linked to modifying such hedging arrangements are charged to the debtor MFIs. Opting for simple restructuring, such as rollovers, and appropriate modalities (e.g. on duration) requires limited changes to the hedging arrangements, thus reducing the cost for the MFIs. On the other hand, converting local currency instalments into hard currency is likely to increase the MFI's exposure to FX risk. When such a conversion is inevitable, the creditors shall strive to limit the exposure (duration, amount).

Commitment: ***The creditors shall together strive to minimise the impact for the debtor MFIs of additional hedging costs related to debt work out*** (whether simple rollovers or more sophisticated restructuring). In this respect, the creditors shall take into account the constraints and the costs of hedging solutions as they coordinate their response and adapt the proposed restructuring in the best interest of all parties. This includes favouring simple solutions, such as rollovers, which have limited impact on the initial repayment schedules and thus limit the extent to which hedging arrangements need to be adjusted. ***Moreover, the creditors shall strive not to increase the debtor MFI's exposure to foreign exchange risk, beyond what it is able to manage and to absorb***.

2.5. Restructuring rules

Inspiring rules: the signatories agree that IAMFI Microfinance Voluntary Debt Workout Principles[2] are a relevant source of inspiration. These principles were developed after the 2008 financial crisis in 2011 to guide struggling Microfinance Institutions (MFIs), their creditors and other stakeholders as they chose to participate in voluntary debt workouts rather than turn to litigation or court-administered insolvency or bankruptcy proceedings for the enforcement of claims against debtor MFIs.

Commitment: ***The signatories agree on adopting these high-level following principles,*** adapted to the current context:

a) **Shared goal of a long-term, going-concern solution**: as impact investors, we aim at making our best effort to preserve and maximize the long-term, going-concern value of the debtor MFI for the benefit of all involved parties, committed to create positive social and environmental outcomes during the COVID-19 crisis and beyond.

b) **Timely and effective creditor coordination:** we will favour prompt solutions (as possible and feasible) through timely lenders group coordination and gentlepersons' agreements to help MFIs create a feasible plan that rolls-over, reschedules, restructures, or refinances the debt before it is in danger of default. Creditors will cooperate to design formal agreements at a later stage when required due to the severity of the crisis.

c) **Legal and regulatory regime applicable to the debtor MFI:** if and when required due to the severity of the crisis, we will engage reliable local counsel to ensure that formal agreements are enforceable and adapted to legal and regulatory requirements.

d) **Conflicts of interest disclosed:** Each creditor or equity holder that participates in the voluntary workout process should disclose, at the outset of the proceedings, to the other creditors and equity holders the extent and nature of its relationship to the debtor MFI, be it through direct or indirect investments (e.g. through funds). In order to avoid misunderstanding on the information made available to creditors, such information shall be clearly defined and if possible required in a shared reporting format.

e) **Reasonable period of relief and moratorium:** we are willing to cooperate in giving a reasonable period of relief and timely moratorium(a) to a viable debtor MFI that is acting and negotiating in good faith. We refrain during that time from enforcing our claims against, or reducing our exposure to, the debtor MFI. If and when required due to the severity of the crisis, a more formal agreement may be formalized. We agree to make our best effort to provide specific time-bound limited covenant breach waivers to give the institution needed breathing room. We

[2] Charting the Course: Best Practices and Tools for Voluntary Debt Restructurings in Microfinance, IAMFI, Morgan Stanley, 2011. The document is available on Findev Gateway.

will be transparent with other lenders on our existing covenants and related waivers with the MFI and agree to harmonize them as much as possible.

f) **Debtor MFI's responsibilities and reporting burden:** a debtor MFI that is benefiting from the period of relief should not take action that affects the prospective return of relevant creditors as compared with their positions at the commencement of the period and should provide to its creditors reasonable and timely access to all relevant information . The debtor MFI also should provide and allow creditors and their advisors reasonable, transparent, and timely access to all relevant information relating to its assets, liabilities, business and prospects, as well as inform creditors of any formal communications between the debtor MFI and its local supervisory authority.

g) **An achievable proposal:** at each key juncture, the voluntary workout(s) should be based on achievable proposal(s) that address governance, operational and financial weaknesses of the debtor MFI, as well as the investment horizons and any relevant social objectives of the creditors participating in such workout.

h) **Fair-burden sharing among stakeholders:** If and when required due to the severity of the crisis, creditors should be willing to absorb a fair share of any losses that result from the debtor MFI's difficulties in line with the *pari passu* principle for creditors in a single category, provided, however, that equity shareholders of the debtor MFI also make the financial effort expected from their rank in order to prevent the risk of failure of the MFI. For cases of debt rollovers, creditors shall define a minimum rollover period applicable to all creditors.

i) **Flexibility, responsiveness and priority status of additional debt funding:** additional debt funding will be needed to ensure the continued access of MFIs and their clients to funding during the Covid-19 crisis. In order to facilitate the access of MFIs to additional debt, the repayment of such additional debt, so far as practicable, should be granted priority status as compared to other claims of indebtedness of the debtor MFI. Creditors shall be responsive and look for flexible solutions to help MFIs access short term funding. When exploring a funding opportunity from a new creditor, the debtor MFI shall inform the existing creditors and request a non-objection from its lenders before it signs the new agreement.

j) **Debtor MFI's responsibility for workout costs:** In case of work out costs, the lenders acknowledge that the debtor MFI is responsible for the costs of the voluntary workout when creditors are enforcing their claims. To the extent such costs are under the control of creditors, however, these costs should be both clearly defined and minimized.

The signatories agree to abide by these principles to the extent they are not in contradiction with rules imposed by international and/or national authorities.

The signatories agree to maintain open communication with their peers during the crisis to share their decisions and to comply with these principles.

27 April 2020

3. PLEDGE SIGNATORIES

Organisations	Signatories
ADA ASBL	Laura Foschi, Executive Director
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*Agreement in principle