

SPTF Social Investor Working Group
Reasonable Covenants Sub-Group: Background and Initial Meeting
July 8, 2020

Overview

The [SPTF Social Investor Working Group](#) (SIWG) has developed a sub-group to define reasonable covenants in the context of COVID-19. Below are the minutes from the group's first call, which was intended to define the purpose and explore potential outcomes of the sub-group. Visit SIWG's [webpage](#) to find minutes from other SMG meetings and details for our next call. Email Katie Hoffmann at katiehoffmann@sptfnetwork.org with any questions.

Background

From the beginning of the COVID-19 pandemic, it was obvious that repayment capacity of clients across the financial spectrums would be broadly affected and financial services providers would have to cope with situations of deteriorating portfolio quality and delays – at best – in repayments.

The inclusive finance sector has been exemplary in its pro-active coordinated response to address immediate challenges and align on best practices that protect both clients and staff and therefore contribute to better risk management in crisis times.

MIVs have committed to opt preferably for waiving breaches of financial or technical covenants, even informally. They agreed to make their best effort to provide specific, time-bound limited covenant breach waivers to give the institution needed breathing room. This approach has been instrumental to help MFIs manage the covenant breaches due to the initial surge in credit risk while they were negotiating rollovers and/or new funding from their lenders.

Now as the impact of the current health crisis increasingly reaches the economic sphere and the initial moratorium given to the end-clients will soon be over, even more MFIs will face an increase in credit risk, beyond the limits set in pre-crisis covenants.

To manage this situation, lenders and MFIs need to implement commitments taken in the initial gentle persons' agreements and agree upon revised covenants to monitor the sustainability of loan clients and FSPs.

A substantial amount of time goes into agreeing on the choices and definitions of most relevant crisis-related indicators that allow for the survival of the client and yet satisfy the minimum requirements of lenders.

Several investors from the SIWG, referring to the commitments of the [Pledge and MOU](#) for better coordination with an objective of a more efficient risk investment management, have suggested to work on a series of common, most relevant and reasonable covenants as well as their definitions and potentially target level ranges. To that end, the SIWG has created a sub-group of investors to discuss reasonable covenants during COVID.

Minutes from first sub-group call

I. The need for a renewed look at the covenants

- *Importance of defining guidelines and guidance.* MIVs have been flexible in providing waivers to MFIs, reflecting what is in the MOU and the Pledge. However, we will see an increase in credit risk in the next 6-12 months, and many covenants will need to be renegotiated. Guidance for MFIs on what is considered good practices will help make actions be clear as possible.
- *Added value in aligning on the definitions of specific covenants, using [Reasonable Covenants](#) as basis.* We need to develop best practices around monitoring and tracking covenant restructuring given the current context, as well as how to treat covenants and define covenants.
- *Need more clarity on how COVID is going to impact portfolio quality, P&Ls, and capital acquisitions.* We want to be in position to sit down with partners, examine how we think this will unfold, and set new limits

accordingly. Examples include providing an acknowledgement letter to grant time. After Q3, we will start to see effects of restructured portfolios in hard numbers, and we will be in better position to define new levels.

- *Need a general approach to monitoring and tracking to provide more clarity among partners.*

II. Issues to consider when reviewing covenants

- We need more than one set of covenants because the portfolios are diverse, and ultimately, it comes down to covenants that reflect the quality of the portfolio
- Include market standards (PAR, risk coverage ratios, capitalization, liquidity) but focus on defining covenants related to COVID, including rescheduling, how to create PAR, and best practices for following the advice of regulators.
- Identify a handful of key covenants and think through how to consider COVID: What reporting is required? How is this different from what is already being received?
- Put a level on open credit exposure ratio. It will be useful to explain to MFIs what they need is analysis by sector that can help predict what might happen.

III. Preferred outcomes of the sub-group

- 2-3 page note with general approach toward covenants, responsible monitoring, the type of data that should be required to have better forecasting and how that will evolve, and how to integrate into CAT (or use to revise CAT). The note should stress the need for forward-looking budgets and stress-tests from MIVs and stakeholders.
- Develop these guidelines with this sub-group group and then bring to the larger MIV group; important to integrate with initiatives that are ongoing, like CAT, MoU and Pledge. The note be presented as annex to both MoU and Pledge
- Having multiple meetings for multiple groups is very time-intensive – SPTF/ SIWG should coordinate, gather MIV-9 and Pledge

IV. Next steps

- Anna Kanze will start draft of monitoring guidelines that were discussed and send a draft to the group for comments. For this to be valuable, the document should be concise and have a quick turnaround.