ALSF SOVEREIGN DEBT KNOWLEDGE PRODUCT AND CAPACITY BUILDING PROJECT: GOVERNANCE AND TRANSPARENCY DEBT GUIDE

CONTRIBUTING AUTHORS

PROF. DR. RODRIGO OLIVARES-CAMINAL

at Pari Passu Consulting Ltd.

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Acronyms	Meaning Relevant
ADF	Agence Française de Développement
AfDB	African Development Bank
Afreximbank	African Export–Import Bank
BRD	Development Bank of Rwanda PLC
CAC	Collective Action Clause
CBI	Climate Bonds Initiative
CBS	Climate Bonds Standard and Certification Scheme
CEPR	Centre for Economic Policy Research
CF	Common Framework for Debt Treatment Beyond the DSSI
ESG	Environmental, Social and Governance
HIPC	Highly Indebted Poor Country
IFI	International Financial Institution
IIF	Institute of International Finance
IMF	International Monetary Fund
LIE	Low Income Economy
LIOA	Lending into Official Arrears
LPN	Loan Participation Note
MDRI	Multilateral Debt Relief Initiative
MTDS	Medium-Term Debt Management Strategy
NTP	Non-Toleration Policy
PFM	Public Financial Management
PSI	Private Sector Involvement
SEC	Securities and Exchange Commission

Executive Summary

ALSF Sovereign Debt Knowledge Product and Capacity Building Project:

Governance and Transparency Debt Guide

Prepared by Prof. Dr. Rodrigo Olivares-Caminal, Pari Passu Consulting Ltd.

For the African Legal Support Facility (ALSF)

A state principally exists to provide essential functions to its citizens, such as security, infrastructure, transportation, education, and health. Each of these services are costly, and a sovereign state needs to ensure that it has available funds to provide them effectively and without interruption. To achieve this, governments have two options, namely, taxation and debt financing. When countries use debt as a financing tool, the debt is termed sovereign debt, and the country is known, in its status as a borrower, as a sovereign debtor. The lender is then known as a creditor. Various types of financing are available to sovereign debtors, and these exist under different types of financial markets each of which operates differently. These markets include, among others, capital markets, derivatives markets, money markets and loan markets.

A sovereign debtor in search of financing will consider its needs in deciding what market to turn to. Within these different markets, are different types of creditors that countries, including official sector
creditors who are multilateral institutions such as the International Monetary Fund and the World Bank, bilateral lenders such as sovereigns or sovereign entities, as well as the private sector
which includes commercial creditors and bondholders.

Borrowing is not intrinsically bad and sovereign borrowing does not entail per se negative consequences. However, the key aspect of sovereign borrowing is how such debt is managed and
administered in the long term, to avoid detrimental economic consequences. In the 1990s for instance, when numerous African countries were in debt distress, the World Bank together with the
IMF developed the Highly Indebted Poor Country (HIPC) initiative supplemented by the Multilateral Debt Relief Initiative (MDRI), to assist African countries to efficiently manage debt and grant relief to them from their sovereign debt burden, through low-interest loans. However, despite the initial success of these initiatives, the World Bank, and the IMF estimate that 13 African countries that
were originally part of the HIPC and the MDRI initiatives have currently reached high risk levels of debt distress.

Public debt management, as an element of debt governance, is essential for the prevention of debt crises. Moreover, in Africa, whereas several factors have contributed to debt problems, one of the most prevalent issues is shortcomings in recording, transparency, and governance of debt. Public debt management involves establishing and executing a strategy for managing the government's debt to raise the required amount of funding, achieve its risk and cost objectives, and meet any other sovereign debt management goals the government may have set. Public debt management has a number of advantages such as risk management, macroeconomic stability, efficient domestic securities market, and a positive sovereign image, among others. Debt management by a sovereign involves various aspects, including:

a. developing a debt management framework. This refers to a set of rules and guidelines that help government authorities to maintain debt within sustainable levels or to design and implement a debt management strategy focusing on a diversified portfolio in terms of maturity risks, interest rates risks and exchange risks to prevent issues that might make the debt unsustainable; and
b. developing a debt management strategy. This is based on medium-term decisions considering the country's fiscal situation, costs and risks the country is willing to take and potential payment difficulties. The debt management strategy goes hand in hand with the macroeconomic policy of the country, in coordination also with both the fiscal and monetary aspects of the country. In addition to debt management and governance, an essential aspect of sovereign debt is transparency, especially regarding terms and conditions of the debt. Transparency involves making information publicly available. If more infomation is publicly available, borrowers and lenders can make better informed and more conscious decisions on lending, being less likely

to have a debt crisis and ultimately also lowering lending costs. Debt transparency enables society as well as the judicial and legislative branches to determine if the executive is making the right decisions, and ultimately hold them accountable for any negative impact their decisions may cause. This helps lower corruption and the mismanagement of public funds. Transparency is also important because all debts can have an impact on the debt management strategy.

An example of the dire consequences that lack of transparency can have can be seen in the case of the Mozambican scandal. In this scandal, three Mozambican state-owned companies incurred debt obligations that were guaranteed by the central government. However, the public was given information regarding only one of the loans. The other two loans were allegedly used to acquire military equipment for the security services and the Ministry of Defence and were kept private by the executive branch. In 2016 when the IMF was informed about these other two loans, it triggered an economic crisis that brought default on all external commercial debt. This caused the IMF and bilateral donors to suspend their budgetary support, the local currency depreciated by about 65% within six months and economic growth plummeted to 3.8 % in 2016 from 6.6% the year prior.

The single most important benefit of transparency in proper debt management is information asymmetry which reduces lending costs and accountability. If information from the country's debt is unavailable, potential future lenders may not be able to properly assess potential repayment risks. If they do not have clear information, lenders may tend to adopt a more conservative approach and increase interest rates, therefore increasing the borrower's total costs. Additionally, the IMF prevents and resolves debt crises based—among others—on debt information. It is important to highlight that diverse types of lenders entail distinct levels of debt transparency. The private sector does not require the same debt transparency as Multilateral lenders. Bilateral sovereign lenders also present different challenges regarding debt transparency. Multilateral lenders, such as the World Bank or the IMF or development banks, have their own strict procedures and policies on debt transparency and accountability that make multilateral lending not problematic in terms of transparency whereas with bilateral sovereign lenders, the loans may have geopolitical implications and are negotiated at governmental levels with minimal transparency, if any. With private sector lenders within the capital markets, issued bonds are usually publicly listed securities that follow strict listing requirements that include disclosure of key terms.

On the other hand, loans granted by commercial banks are private and the terms of commercial loans are not generally disclosed. The Institute for International Finance (IIF) Transparency Principles are generally used for the disclosure of lending terms associated to loans by commercial banks. From the borrower's perspective, transparency requires two key components: information recording and disclosure. Information recording involves collecting and recording accurate data. Information tracking must also be effectively done. Secondly, transparency cannot be achieved without disclosure. Disclosure requires the sovereign to make relevant terms and conditions of sovereign debt publicly available to allow creditors as well as citizens to monitor the borrowing activity. From the lenders perspective, both the G20 and the Institute for International Finance (IIF) have issued guidelines and principles that should be followed to improve transparency. The main information that must be disclosed is the names of the parties, the amount of the loan, purpose of the loan, interest rate, grace and maturity period, and collateral (if any). It is important to note though, that transparency is not without obstacles. These include confidentiality or non-di closure provisions included in loan agreements as well as the fact that both G20 Guidelines and IFF Principles are voluntary, so the parties do not have a strong incentive to comply with them. To address the issue of confidentiality and non-disclosure provisions, the parties to the loan, can negotiate a carve-out and make an exception to the confidentiality of the agreement to allow disclosure for transparency purposes. For example, by including a reference to the G20 Guidelines or the IFF Principles to justify disclosure of certain information. To solve the voluntariness issue, it has been suggested that compliance lists should be issued, as this could serve as an incentive for countries to disclose so that they be listed among the compliant countries. For better transparency, the creation of a centralized database could also be a better solution than having each country publish their own information on their own websites.

Additionally, engaging independent professional advisors is a particularly important aspect of debt management. Advisors should be hired from the beginning of the borrowing negotiations and should cover at least financial, legal, and public relations or communicational aspects of the transaction. These advisors are essential as they all have unique roles. Firstly, financial advisors are crucial in helping the government develop a medium/long-term strategy for sustainable borrowing, finding ways to mitigate risks and assist the country in defining its funding strategy, helping the country implement tools to manage its liabilities and risks and assessing the possibility of a country to access certain markets and on which financial conditions. Secondly, legal advisors are key due to their expertise in debt financing, regulatory frameworks, litigation, and possible limitations to the liability and risk assessment strategies. Legal advisors are also essential during debt restructuring negotiations that may take place with private investors, multilateral agencies (such as the World Bank or the IMF) or bilateral sovereign lenders. Legal advisors also serve as intermediaries between the government and the lenders, particularly when the lender is the IMF, and the country is part of a programme supported by the IMF. Thirdly, communications advisors work together with the financial and legal advisors, and the governmental authorities to make sure the country is giving its lenders and others (civil society, stakeholders, etc.) an effective, credible, and transparent message on the country's debt situation, development strategies, financing requirements and macroeconomic and financial status. Debt governance and transparency requires the rule of law. Strengthening the rule of law enables countries to foster accountability by enabling the detection of wrongdoing and the adoption of relevant measures to prevent its recurrence. Accountability is the other side of the coin of the rule of law. It refers to the processes, norms, and structures that hold individuals

(including government officials) legally responsible for their actions and that impose sanctions if they violate the law. The goal of providing transparent information is to enable citizens, institutions, civil society, and lenders to scrutinise what the government does with debt and to hold authorities accountable for negligent and unlawful actions. Also key in debt governance and transparency is fighting opportunism and corruption. Corruption contributes to institutional fragility and debt situations in two ways: directly by deviating the funds raised from debt for other purposes or indirectly by creating issues with key exporting sectors like oil and mining that generate the most needed revenues in foreign currency to repay debt. Therefore, accountability also requires a commitment to fight corruption and opportunism. Although it is true that the focus of the debt burden issue is mostly on the ex-post responses of debt restructuring, this needs to change to an ex-ante analysis, that requires cooperation by all stakeholders in the debt build up as it remains critical. Lenders should provide incentives by including robust loan clauses and covenants such as accurate presentation of financial information, inclusion of certain financial ratios, and even debtors' compliance with some of the guidelines described above so to have more suitable contractual tools. The downside is that sometimes these are difficult to implement as sovereign borrowers feel restrained in their options. To achieve debt sustainability, good lending practices are equally as important as good borrowing practices. Debt sustainability requires a sense of shared responsibility among all stakeholders. Although it is a long and tedious path, this is the only way to make debt sustainable over the long term. The final building block is that of the rule of law and accountability, i.e., assuming responsibility, which can only be built on the back of a strong rule of law. Finally, it is important to stress that the onus should be on measures of debt prevention, which are preferable to ex-post debt- restructuring. Otherwise, even with the most efficient debt restructuring mechanism, crises will continue to occur

I. INTRODUCTION

For all the talk of sovereignty, countries and their governments are not omnipotent. They have limitations just like the citizens that compose them. Much like its citizens, a country will face pressures in paying all of its bills on time, and in creating wealth through sound investments. Much of this is handled by fiscal policy, which is the discipline linked to the use of government revenues: who to collect them from; and how to spend them. However, much like with a person living day-to-day from a salary, fiscal policy has its limitations, in that a government that has to spend in services what it raises in taxes will never be able to save money for large expenditures of the sort that are sometimes required for necessary public investment.

Thus, countries, like corporations, turn to the financial markets for their financing needs. When countries use debt as a financing tool, the debt is termed sovereign debt, and the country is known, in its status as a borrower, as a “sovereign debtor”. The lender, for its part, will be known as a creditor. Creditors to sovereign debtors come in all shapes and sizes and can be either public or private in character.

While the focus of this Debt Guide is on governance and transparency in sovereign debt, any discussion touching upon on this type of debt must be grounded, first, in an introduction to the financial markets; the type of debt instruments commonly used; and its main players. This will in turn guide the main issues on governance and transparency on sovereign debt. While governments principally access the bond and loan markets to satisfy their financing needs, they also occasionally engage in transactions in other markets, such as the money markets and the derivatives markets, when they require the liquidity or risk management offered by these, respectively. Thus, in understanding the wide gamut of markets in existence, policymakers increase the tools at their disposal for addressing the myriad needs of government.

II. THE FINANCIAL SYSTEM AND TYPES OF FINANCING

The financial system is divided into different types of markets, each catering to a broad class of financial instruments. Any entity in search of financing will consider its particular needs in deciding what market to turn to. Broadly speaking these markets may be defined as the capital markets (consisting of the stock markets and the bond markets), the money markets, the derivatives markets, and the loan markets.

2.1. Capital Markets

The international capital markets are characterised by two main characteristics: (1) their main purpose as fund raising sources for entities, and (2) the negotiability of the instruments they encompass.

Tradeable financial instruments are known as securities, but not all securities are used for fund-raising. Some are used for hedging (i.e., managing risk), as explained below with the derivatives market, or for short-term liquidity needs, such as the money markets. The capital markets, thus, concentrate on those securities that are used to raise relatively long-term capital, namely, equity and bonds.

Securities are issued by entities such as corporations and sovereigns and initially subscribed by a syndicate of specialist firms known as underwriters, who then sell them forward to the wider market and take-up any issued securities to the extent they are undersubscribed. This initial issuance is done in what is termed as the “primary market”, while the market for successive trades of already-issued instruments is known as the “secondary market”.

For the secondary market to function smoothly, financial instruments must be negotiable. Negotiability allows for an instrument to be traded legally and without any encumbrance or previous conditions, so that the acquirer can easily feel secure in knowing that it is the legal owner with full rights over the instrument it has purchased. In facilitating the tradability of assets, negotiability appeals to investors that require assets that are liquid. Liquidity is important for market players because it allows them to rapidly convert assets into cash in order to facilitate other transactions, meet their liabilities, or comply with regulatory capital requirements.

Securities regulators heavily regulate the international capital markets. This is precisely because of the open nature of the market and the tradability of its instruments. These markets are open to any investor that wants to participate in them; as such, there is a need to protect unsophisticated investors from misrepresentations or fraud. These regulations, aside from prohibiting fraudulent statements, also require disclosure of certain material information to investors about the nature of the investment they are to undertake, both at the moment of the instrument’s issuance, and throughout its existence. Sovereigns listing their debt instruments (also known as bonds) in the United States, for example, have disclosure requirements imposed by the Securities and Exchange Commission that require them to periodically submit reports on their financial condition, and to inform investors when a material event has occurred that may impact the bond’s future performance.

There are two principal capital markets: the stock markets; and the bond markets.

2.1.1. Stock Markets

The stock or equity markets trade in corporate shares. Shares constitute equity ownership in a particular company. They encompass two principal rights: an unsecured claim of ownership over all assets of the particular company, which also entitles the owner to a share of the profits that the company may from time to time disburse to its shareholders as dividends, and voting rights over the company’s affairs. Stock markets are irrelevant to sovereign financing because countries cannot sell away ownership and voting rights over their political decisions that completely undermine their sovereign prerogative.

2.1.2. Bond Markets

The other principal type of instrument traded on the capital markets is the bond instrument. Bonds, like stocks, are tradeable instruments. A bond instrument represents an outstanding debt to the owner of the bond (or bondholder) from the issuer of the bond. Unlike shares, bonds will have a maturity date, at which point the principal amount and any remaining due interest at a fixed or floating rate on the bond must be fully paid off and the bond will be retired. Also, unlike shares, a bond does not endow its owner with voting rights

over the issuer's affairs. Rather, the rights that the bondholder has to enforce its money claim are contractual.

Bonds can be issued in one of two forms: bearer or registered. Historically, bonds were issued in bearer form so that ownership was evidenced solely by physical possession of the bond instrument. However, bonds are now more likely to be issued in registered form because laws in certain jurisdictions require most securities to be registered. Today, it is unlikely that the owner of a bond will have physical possession of the instrument. Rather, common depositaries like Euroclear and Clearstream hold the physical instruments in the form of a "master" or "global" bond, which is a single document representing the whole issuance. These common depositaries hold the bonds and register the ownership interests over them as they are traded in the market. It is also possible that the instrument is not in a paper copy, in which case they are considered to be 'dematerialised', and in those cases, the common depositary will also be responsible for recording the transferral of ownership as the instrument is traded in the market.

Today, countries borrow funds principally through the bond markets.

2.2. Money Markets

The money markets are securities markets characterised by the trading of debt instruments that have a very short-term maturity. Their maturity may range from one day to a year. This market includes both government-issued (such as United States T-Bills, the German bunds, or the UK gilts) and private instruments (such as commercial paper). These instruments are mainly traded between financial institutions to address any short-term liquidity problems. Central banks also buy and sell them for monetary policy purposes.

Governments may choose to issue money market instruments to address fiscal shortfalls. They can be useful to address the mismatch between the time when a government receives its revenues and the moment in which it requires money to fund its services during the fiscal year. For example, in the United States, most state governments rely on income taxes, and they will receive most of the proceeds from the tax close to the filing deadline day. As such, state governments and municipalities will issue Tax Revenue Anticipation Notes or other similar debt instruments with a maturity of no more than a few months, which helps them address funding gaps. They then retire this debt when they receive the tax proceeds.

2.3. Derivatives Markets

Derivatives are financial instruments whose value will depend on the value of another financial instrument, known in market jargon as the 'underlying'. These are most often financial contracts related to the underlying, such as: (i) options (the right to buy the underlying at a certain point in the future); (ii) futures (a contract of purchase for the underlying at an agreed amount at a time in the future); (iii) and swaps (an exchange of certain obligations in underlying instruments, such as interest rates). Derivatives are not principally used to raise capital or to address immediate liquidity shortfalls, although they can form part of a strategy to do both of these things. Rather, their main purpose is to address risks such as price volatility, interest rate risk, exchange rate risk, default risk, etc.

A sovereign debtor may see a need to access the derivatives markets in order to address some of these risks. For example, by entering an interest rate swap, a sovereign debtor can ensure that it can pay a fixed interest rate instead of a floating one, and thus have predictable interest payments throughout the life of the debt instrument.

2.4. Loan Markets

The loan markets, although used for raising capital like the capital markets, fundamentally differ from the capital markets because they do not deal in tradable instruments.

Loans represent a debt just like bonds, but they cannot be traded freely. The lender in a loan can divest itself of the loan by assigning its rights under the loan, effecting a novation of the loan, or engaging another investor as a sub-participant in the loan. However, none of these forms of divestment reach the level of negotiability because the acquirer will not assume full rights over the loan, without any encumbrance, by the mere purchase of the loan. However, as discussed below, loans offer a flexibility for debtors that bonds do not because of their highly customisable nature, and debtors are willing to pay a premium to lenders for that flexibility.

The international loan markets are dominated by syndicate lending. A syndicate is a group of banks that pool their funds to offer large loans to meet borrowers' funding needs under a master agreement. Syndication is done both because the borrowers' funding needs may be too high for any one bank, and because banks do not want to (and often under regulatory requirements, cannot) have large risk exposures to any one borrower whose default can threaten the existence of the bank.

In the sovereign lending context, lenders may also be multilateral lending institutions such as the International Monetary Fund (IMF) and regional development banks, as well as other countries. These 'official' loans are often accompanied by 'conditionalities' or 'adjustment programmes', by which the sovereign debtor commits to implementing certain public policies or reaching certain fiscal goals in exchange for the financing.

Because loans are not publicly traded, loan markets are not subject to the same regulation that the capital markets are subject to. Any trade of loans is private and usually involves sophisticated investors, some of whom may be subject to regulatory requirements and follow best practice (albeit non-binding) guidelines issued by the Loan Market Association.

III. WHAT IS SOVEREIGN FINANCE?

A state principally exists to provide essential functions to its citizens, such as security, infrastructure, transportation, education, and health. Each of these services are costly, and a sovereign state needs to ensure that it has available funds to provide them effectively and without interruption. To do this, governments have two options: taxation; and financing (debt financing, as sovereigns cannot obtain equity financing).

3.1. Taxation

A government can use its taxing power to raise funds, either by raising funds from its citizens directly (through an income tax, for example) or by taxing economic activity within its territory (through import and export tariffs, for example). Taxation, however, has its limitations. Any form of tax takes funds from the private sector to redistribute as the government sees fit. As such, it may have a deleterious effect on the economy if the redistribution effected by the government is less productive than the use that the private sector would have given the funds otherwise. Furthermore, and more relevantly, a government's taxing power only extends to its economic base. This means that taxation by itself may not be enough to finance government initiatives that are capital intensive and long term, because the outlay of funds required to begin a particular project may surpass the government's ability to extract the required monies through taxation without unduly harming the country's economic activity. If taxation is insufficient, a government can attempt to fund its projects through debt finance.

3.2. Debt Finance

A government can also turn to the loan market or capital markets for credit. This has advantages and disadvantages. Not unlike a residential mortgage that an individual uses to buy a house they may not otherwise be able to afford; sovereign debt permits a country to make necessary investments for its future in the present time by borrowing the required moneys. Similar to the residential mortgage, it is expected that the sovereign will apply the funds that it receives from contracting long-term debt towards long-term investments; otherwise, it will run into balance of payments problems, because it will have large new liabilities without a corresponding increase in government revenues to endow it with capacity to repay. Among the worst practices in sovereign borrowing is taking long-term debt and directing the funds towards covering operational deficits for a defined fiscal year. This creates what is known as an "intergenerational problem", where future generations are left to pay for the liabilities incurred and unsustainable benefits enjoyed by existing generations. However, even following best practices, contracting debt always involves an element of risk. For that reason, it is important for government officials to bear in mind the specific characteristics of the debt instruments they issue to maintain effective sovereign debt management practices.

IV. DOMESTIC AND EXTERNAL DEBT

One of the traditional distinctions made in the sovereign debt context is that between domestic and external debt. The percentage of gross external debt a country has, defined as the totality of outstanding liabilities of residents of a country to non-residents of the country, is a traditional macroeconomic indicator. However, this distinction, simply based on the place of residence of the lenders and borrowers, is insufficient for proper management of public external debt. Simply considering the place of residence of the parties is an outdated consideration, because due to the loosening of controls on international capital flows, non-residents now regularly invest in instruments that were traditionally targeted for residents, and vice-versa. Instead, in sovereign debt management, governments must also pay special attention to the governing law, the choice of jurisdiction, and the currency under which they issue their bonds. These issues are analysed below.

4.1. Governing law

Bonds can be issued (and loans contracted) under the domestic law of the country that incurs the debt, or their terms and performance can be submitted to a foreign law regime. This may be done because the sovereign wants to list its bonds in a foreign exchange, and its financial advisors consider that it will be unlikely that the bond will be adequately subscribed if it is issued under domestic law, which can be perceived as risky by investors. In the case of a loan, it may be that the lender specifically requests that the loan be contracted under a foreign law regime to make the loan more transferable on the secondary loan market.

A sovereign that owes a debt governed by its domestic law has more tools at its disposal to manage its indebtedness if it finds itself in a distress scenario where it faces difficulties in making repayment. Under a domestic governing law, the sovereign can use its law-making power to effect changes to its domestic law so that the debt's terms are interpreted differently under the law, made invalid in one way or another, or altered altogether. According to the rules of private international law, if a creditor contracts under the law of a particular sovereign state, for example, by acquiring bonds issued under the governing law of that State, then any changes made by the State, to that governing law are built into the contract. In other words, you cannot freeze a legal system at a particular moment in time. A sovereign is at the apex of its power when restructuring or re-profiling debt issued under its domestic law because the sovereign itself is in position to define what is legal and what are the 'rules of the game'. As such, a borrower cannot contest the legality of a sovereign's actions unless the sovereign is somehow in violation of the rules that it itself has the power to impose. This is not to say that a sovereign will readily exercise a power that is likely to alienate its creditors in the future.

A sovereign that owes debt governed by foreign law will, on the other hand, be committing itself to paying a debt under a law imposed by another sovereign, which it is unable to affect. This does not mean that the sovereign debtor will lack any options in a distress scenario, but it does mean that it will have to concentrate its restructuring strategy on the contract terms, and not on a shift in the legal regime under which the contract is performed.

Foreign law-denominated debt is mostly issued under the laws of the State of New York or English law, due to the roles of New York City and London as global financial centres and objective and impartial well-reputed jurisdictions.

4.2. Choice of jurisdiction

Bond instruments and loan contracts will also have a jurisdiction provision, which will give creditors the right to sue for repayment in a particular court. Like governing law, the relevant distinction here will be whether the court is a domestic one or a foreign one. Domestic judges, whose re-appointment by the political authorities or re-election by the citizenry may depend on how they rule on a sovereign debt case with massive national implications, may be more reticent to issue a ruling that favours private creditors, especially if these creditors are principally non-residents of the country. Foreign courts, especially those in large financial centres, may be both more impartial in their consideration of such a case and more attuned to the commercial considerations and market practices that may be relevant to the litigation.

4.3. Currency

If a debt is denominated in a foreign currency, there will be a mismatch between the currency in which the sovereign receives funds to repay the debt (because tax revenues will invariably be in the sovereign's domestic currency) and the currency in which the debt must be paid. As such, the ability of the sovereign to repay that debt will depend on the exchange rate between that currency and the sovereign's domestic currency. This may become a problem if the domestic currency depreciates against the foreign currency, in which case the debt will become more and more expensive in practical terms.

On the other hand, if a debt is denominated in domestic currency, this problem will not exist. Additionally, if necessary, the sovereign can use its seigniorage (money printing ability) power to simply print enough currency to pay off any debt denominated under its domestic currency (at the risk, of course, of rising inflation).

It is not necessary for all the aforementioned factors to converge for debt to be understood as domestic or foreign. Although academics have proposed different definitions to distinguish between domestic debt and external debt, this distinction must be grounded, first, on its practical consequences for a government's management of its sovereign debt.

V. BONDS AND LOANS: WHAT IS THE DIFFERENCE?

When you issue a bond or take out a loan, you are doing much the same thing: borrowing money, which you need to repay at a certain point in the future. These forms of borrowings, however, differ in several respects: liquidity, customisation, repayment, investor base and the private v. public nature.

5.1. Liquidity

As previously mentioned, bonds are negotiable instruments. This means, in general terms, that the bondholder can be sure that it has good title to the instrument it purchased (due to the role of common depositories). Loans, on the other hand, are not negotiable instruments, and their transferral often involves more than a simple purchase. Thus, bonds are more liquid than loans, in that it is easier for an investor to quickly convert their bonds into money by selling them compared to loans. This is mainly due to their "standard" format plus the fact that they are traded on an established platform that facilitates the creation of a market.

5.2. Customisation

Loan facilities generally offer much more flexibility than bonds because they are negotiated to suit the borrower's very specific needs. For example, a loan facility can allow for borrowing in multiple currencies, it can be structured so that the borrower only draws down the money that it needs at any particular time, it can allow for early repayment under certain conditions, and it can have a revolving nature so that the borrower can withdraw more money from the facility after repaying previous drawdowns. A bond issue, on the other hand, will usually not allow for early repayment (unless on the occurrence of certain pre-agreed events, such as an event of default or a change of control of the issuer), will be in a single currency, and the borrower will receive all the money at once. While the customisable quality of loans appeals to borrowers, it can also act to the benefit of the lenders. Provisions that protect the lenders' investment, like covenants, representations and warranties, and events of default tend to be more robust in loan facilities than in the terms of a bond.

5.3. Repayment

With bonds, the issuer promises to pay interest at a fixed or floating rate at regular intervals throughout the life of the debt (except with zero coupon bonds) and repay the principal at the maturity date. With a loan facility, the loan may last twenty years, and be made on a revolving basis, so that the borrower may repay the principal it owes and re-draw available funds in the facility many times over. Interest will vary accordingly but is usually at floating rather than fixed rates.

5.4. Investor base

Bondholders can range from individuals (known as retail investors) to large investment firms and banks (known as institutional investors). Loans are generally only offered by specialist banks. This means that that borrowing under bonds will be cheaper because of their higher demand/ number of lenders.

5.5. Private or public nature

Bonds are usually issued through public transactions, unless there is a private placement to a very limited number of investors. If it is a public transaction, there is first a distribution of information about the bond issue through a document called a 'prospectus', which will give financial information about the issuer and give an outlook for the future that will hopefully entice potential investors to subscribe to the issue. Since bonds are issued in regulated markets, issuers must ensure that any information they offer in the prospectus does not mislead or deceive investors regarding their financial status. Loans are private matters between the borrower and a limited number of lenders. Their terms can remain confidential, and regulators do not scrutinise loan documentation as they do bond documentation.

5.6. Bills, Notes, and Bonds: Different Maturity, Similar Terms

Different terminology is usually used when dealing with the bonds issued by a sovereign. Until now, all negotiable debt instruments have been referred as bonds. However, the market refers to negotiable debt instruments in different ways depending on their maturity date:

- Bills, where previously mentioned when discussing the money markets, they can have the shortest maturity date, which can range from a day to no more than a year.
- Notes, have a maturity date of one to ten years.
- Bonds, usually have a maturity date of more than ten years.

These distinctions are mainly used in market parlance, and they mean little in terms of how these instruments will be legally treated. They should be taken into consideration, however, when considering market appetite for a particular type of instrument to be issued, and, more importantly, when considering a sovereign issuer's financing needs. While a bill may be issued to address a short-term funding gap, notes or bonds may be issued if the sovereign needs to finance a medium to long-term investment.

Eurobonds are a type of bond that are issued in a currency other than that of the issuer. Eurobonds usually have a maturity of more than 20 years. 'Single Jurisdiction Registered Bonds' can refer to a type of Eurobond but registered in a single jurisdiction and therefore with a more specific name linked to the jurisdiction in which they were issued (e.g., Yankee, Panda, Samurai bonds, etc.). This terminology is also sometimes seen just as a particular common type of Eurobond based on the currency and jurisdictions involved. 'Foreign bonds' in turn refers to a bond issued by a foreign issuer and registered for sale to investors in the country where it is being issued and in the currency of legal tender in that jurisdiction. 'Global bonds' are like Eurobonds but can also be issued simultaneously in the country of the issuer. Finally, another possible term used in the context of debt issuance is 'international bonds', which covers both Eurobonds and global bonds.

5.7. Secured and Unsecured Debt

The use of security reduces credit risk for a creditor by providing it with a specific avenue for recovery of the debt. A security over an asset gives a creditor a right to execute on the security and sell that debtor's asset to satisfy the creditor's monetary claim in the event of non-payment by the debtor.

As well as reducing credit risk, the primary purpose of security is to obtain priority over other creditors over a particular asset/s. While an unsecured creditor has a general claim against the assets of the debtor, this may not be enough to recover on the debt, especially if the creditor is competing with other creditors to recover from an insolvent debtor. A security not only gives a creditor a specific asset to recover from, but it also gives priority over other creditors for the proceeds from that asset (subject to certain classes of unsecured claim, such as employee claims, which, for policy reasons, most legal systems award priority over certain classes of secured creditors). Sovereign bonds and loans are mostly unsecured when issued or incurred by central governments, but secured debt instruments are issued as well, especially by state-owned companies (such as government-owned utilities) that can offer security over their revenues.

Finally, although not strictly a security, sovereign debtors can also obtain loan guarantees from multilateral institutions or other countries. Loan guarantees assure the creditors that the guarantor will repay the debt in case the debtor defaults on the same. As such, a loan guarantee reduces the cost of borrowing since the creditors will charge a lower rate of interest due to the lower probability of default on the debt.

An interesting example of the use of guarantees can be drawn from the Government of Seychelles when it approached the African Development Bank in 2009. It requested a partial credit guarantee to be applied to the interest payments of the new instruments offered by the Seychelles to its commercial creditors as result of a restructuring.

VI. THE PRINCIPAL ACTORS IN SOVEREIGN FINANCE

The relevant actors in sovereign finance will depend on whether the sovereign seeks a bond or a loan, the financial condition of the sovereign, and the legal structure it uses to repay the debt. These are, among others, the following:

6.1. Debtor / Issuer

Sovereign debtors are, of course, central governments, but they can also be political subdivisions, state-owned companies or central banks. State-owned companies may contract loans and issue debt like any other private corporation and be treated as such, but depending on their juridical status and operational reality, they could instead be considered an alter ego of the central government. For example, this happened recently in Crystallex International Corp. v. Bolivarian Republic of Venezuela, a case in the United States that concluded that PDVSA, the Venezuelan state-owned oil company, was an alter ego of Venezuela.

6.2. Central Bank

Central banks act as the fiscal agent for governments, supervising and sometimes conducting their governments' issuance and servicing of debts. They also formulate monetary policy, which affects the domestic currency's exchange rate, and can thus be important if the debt is paid in a foreign currency, as seen before.

6.3. Arranger / Underwriter

In a syndicate loan, the main bank of the syndicate will be known as the arranging bank. It will take care of preparing the necessary documentation for the loan and conducting the due diligence process with the borrower.

In a bond issuance, the sovereign will engage with investment banks to act as underwriters. Underwriters will advise the sovereign on how to price the bond, and they will guarantee that they will purchase any unsubscribed bonds at the time of issuance. This, of course, may vary on each transaction based on the commercial understanding between the sovereign and the investment banks acting as underwriters.

6.4. Agent Bank / Fiscal Agent / Trustee

In a syndicate loan, a bank will be appointed as the agent bank, which is responsible for receiving payments from the borrower and distributing them in a pro rata manner among all the members of the syndicate.

A bank fulfils this role in a bond issue as well, but in that case, it is called a fiscal agent. A fiscal agent is an agent of the issuer which assists the issuer in making its necessary payments.

Bond issues often take an alternative approach, in naming a trustee who represents the bondholders and manages payments to them. The trustee (typically a division of a major bank such as Barclays, Citigroup, Deutsche Bank, or a specialist corporate trustee services provider such as Law Debenture Corp) acts for the bondholders and not for the debtor, and as the name suggests, any funds which it receives are put in a trust for the benefit of the bondholders until they are disbursed to them. The "trust" created under this arrangement is not a true trust in the property law sense, but rather an irrevocable authority given by the issuer to the trustee and consented to by the bondholder, to act on behalf of the bondholders collectively in monitoring performance by the issuer and taking enforcement measures in the event of default. Since the trustee acts for the bondholders, the trust agreement will often give it robust enforcement powers against the issuer, exercisable at the direction of a specified majority (in value) of bondholders.

The trustee figure also offers more legal protection for the funds destined for repayment to the bondholders. If anyone sought to attach the assets of the sovereign, any funds already placed with a trustee would be out of their reach because such funds would be beneficially owned by the bondholders.

6.5. Credit Ratings Agencies (CRAs)

Credit ratings agencies, as the name suggests, will assign

credit ratings to sovereign bond issuers and to particular bond issues of the sovereign. Credit ratings are essentially an estimation of the issuer's ability to repay the debt, also known as default risk. A good credit rating will make borrowing much cheaper. Since repayment will be more likely, investors will not feel the need to price in a high default risk into the debt instrument.

6.6. Creditors / Lenders

The investor profile for sovereign debt will largely depend on the credit rating of the debt. As noted, private syndicated loans are almost exclusively undertaken with banks. However, International Financial Institutions and other countries also extend sovereign loans. This sovereign debt is termed "official debt" and is provided by international financial institutions (multilateral lending) or bilateral lenders.

6.6.1. International Financial Institutions (IFIs)

International Financial Institutions, like the World Bank and the African Development Bank, offer development loans at favourable rates to countries that may otherwise not be able to secure financing from the markets. While the World Bank offers loans to meet development goals, the IMF offers loans that help countries address balance-of-payment problems, and due to the IMF's role as a lender of last resort for countries, it is treated as a senior creditor of debtor countries as a market convention.

6.6.2. Bilateral Lenders

Developed countries also offer loans to less developed countries. In this context, the lending countries are known as bilateral creditors.

6.6.3. Private Creditors

With bonds, due to their tradability, it is possible for the investor base to change completely during the life of the instrument based on the credit outlook of the bond. These usually include institutional and retail investors and, occasionally distressed investors.

6.6.3.1. Institutional Investors and Retail Investors

Traditional purchasers of bonds are institutional investors with a long-term investment outlook. Institutional investors are large, non-bank entities that pool funds to purchase assets. This includes private wealth managers, sovereign wealth funds, pension fund managers, and the like. Institutional investors invest in fixed income products like bonds because they tend to offer a steady, measurable return, and are generally safer than stocks. This approach is sometimes also followed by unsophisticated retail investors.

6.6.3.2. Distressed Debt Investors

Distressed debt investors, known pejoratively as 'vulture funds', are typically hedge funds that specialise in purchasing assets in financial distress. Their strategy is as follows: they take advantage of the fact that assets in distress are sold at deeply discounted values to purchase them cheaply, and then engage in aggressive debt recovery strategies to multiply their investment. For example, take a country like Venezuela which is currently in default on its debt; institutional investors that hold Venezuelan bonds will want to sell them to divest themselves of that financial position because they prefer safe assets with a steady return. Since institutional and retail investors would not be willing to buy, there would be no buyers and consequently no liquidity in the market. However, distressed debt investors will come in, buy the bonds at a price far below their par value, and then spend their considerable resources in ensuring that the sovereign pays the par value for the bonds, or a quantity close to the par value that allows them to multiply their original investment based on the assumed risk.

6.7. Clearing Houses

Clearing houses are important cogs in the financial system, because they facilitate the exchange of payments between market participants, they record the exchange of financial instruments, register their ownership, and often hold the physical copies of the instruments.

VII. SOVEREIGN DEBT MANAGEMENT: AN INTRODUCTION

Borrowing is not intrinsically bad and sovereign borrowing does not entail negative consequences per se. Borrowing helps sovereigns to improve infrastructure, achieve their economic goals and develop social planning, enhancing the country's overall economic health. However, the key aspect of sovereign borrowing is how such debt is managed and administered in the long term, to avoid detrimental economic consequences. Several tools have been developed to improve debt management of sovereign nations and assist them in achieving successful economic policies.

As a way of example, during the 1990s the World Bank together with the IMF developed the Highly Indebted Poor Country (HIPC) initiative supplemented by the Multilateral Debt Relief Initiative (MDRI), to assist African countries to efficiently manage debt and grant relief to them from their sovereign debt burdens through low-interest loans. These programs provide debt relief and help countries to get out of unsustainable debt burdens. However, strict criteria must be met to be eligible for assistance. Despite the initial success of these initiatives, the World Bank, and the IMF estimate that 13 African countries that were originally part of the HIPC and the MDRI initiatives have currently reached high risk levels of debt distress.

Several factors have contributed to Africa's debt problems, including, increased lending by non-traditional financial creditors such as China and Saudi Arabia, growing participation of non-traditional commercial creditors, such as state-owned financial entities and oil companies, and shortcomings in recording, transparency, and governance of the debt.

To prevent debt crises, sovereigns must have a solid debt management policy. This policy should contemplate many factors including developing a debt management framework to ensure that borrowing is done within the context of the debt management strategy internal approvals. The debt management strategy, among other aspects, should design the structure of the debt portfolio according to the risks, costs and needs of the sovereign. Finally, transparency is a key component of any debt management framework to induce confidence in the creditors.

What exactly is sovereign debt management? The joint IMF-WB Guidelines for Public Debt Management (21 March 2001), define it as "the process of establishing and executing a strategy for managing the government's debt in order to raise the required amount of funding, achieve its risk and cost objectives, and to meet any other sovereign debt management goals the government may have set, such as developing and maintaining an efficient market for government securities".

Debt management involves the management of key financial obligations of governmental entities. Debt terms including currency, interest rate and maturity of the loan are elements that have an essential role when defining a debt management strategy and should have as its goal the maintenance of financial stability and therefore, the avoidance of a financial crisis. Deficiencies in the debt management process can negatively impact a country's fiscal sustainability, affecting its financial flow and credit rating.

7.1. Importance of Debt Management

Debt management is essential for the following purposes:

i. Decreasing borrower's cost: A first step in every borrowing is to determine the cost of the borrowing and the servicing costs (and risks) for which the government must provide, as cumulative future debts could affect the use of funds for other needs (such as health, security, education, and other essential functions).

ii. iiRisk management of debts: complex financial structures used for borrowing can generate risk to the country's financial stability. These risks must be identified and properly handled, so the country does not end up with unexpected higher costs because of its public debt.

iii. Macroeconomic stability: a deficient policy in debt management can undermine the macroeconomic and monetary stability of a country. Debt management should help achieve the macroeconomic objectives of a country and improve its financial situation, which will lead to sustainable development and growth.

iv. Efficient domestic securities market: the domestic

securities market of a country is deeply interconnected with its debt management. Decisions on best issuance methods, market infrastructure and types of instruments, are affected by the management of sovereign debt. An efficient management of debt may also improve the private sector, as local banks or financial institutions may be positively impacted by public debt instruments being available.

v. Positive sovereign image: the way in which a country manages its public debt has a direct effect on the image and reputation of the country in the international scene. This will of course have a direct impact on the credit rating and risks of the country. Transparency and accountability, besides responsible practices and risk hedging tools, are quintessential for a positive image.

7.2. World Bank's Debt Management Performance Assessment

The Debt Management Performance Assessment launched by the World Bank in 2007 is a program that has as its main objective assisting developing countries in enhancing their debt management abilities. Through a list of different indicators related to government debt management, the program identifies main strengths and weaknesses of the management of debt in different countries. Its aim is to improve the capacity of government to manage public debt efficiently and in a sustainable manner, by aiding in implementing different measures or necessary reforms.

Through the mentioned indicators, the program evaluates the following factors of each governmental activity related to debt management to determine the performance level of each country:

i. Debt recording and operational risk management: It is key to record and monitor debt management operations to make sure records are accurate and help find potential errors or fraudulent activities.

ii. Cash flow forecasting and cash balance management: It is essential to establish a reliable and well calculated budget of cash balances before entering financing plans. Countries should always make sure that there are sufficient funds to meet the financial obligations of the country.

iii. Borrowing and related financial activities: Borrowing plans are made up of domestic financing, external borrowing, derivatives, and loan guarantees. Governmental officials need to have sufficient legal, financial, and operational knowledge to deal with these available sources of funds, being able to identify risks or potential sources of conflict.

iv. Coordination with macroeconomic policies: All areas of government related to fiscal expenditure, monetary policies and borrowing must work in coordination to make sure their macroeconomic policies are aligned, especially since these three areas have a diverse range of objectives and use different instruments to meet their respective goals. For detailed information on fiscal policy and management, please see the ALSF Debt Guide on Fiscal Policy and Management.

v. Governance and strategy development: It is basically aimed at pursuing coordination between the executive and legislative branches of the government, to comply with the decision-making process, making sure borrowings are duly approved and debt management responsibilities are delegated in a correct form, to promote accountability and transparency.

The Figure 1 below illustrates a summary of the World Bank's debt management criteria used for performance assessments.

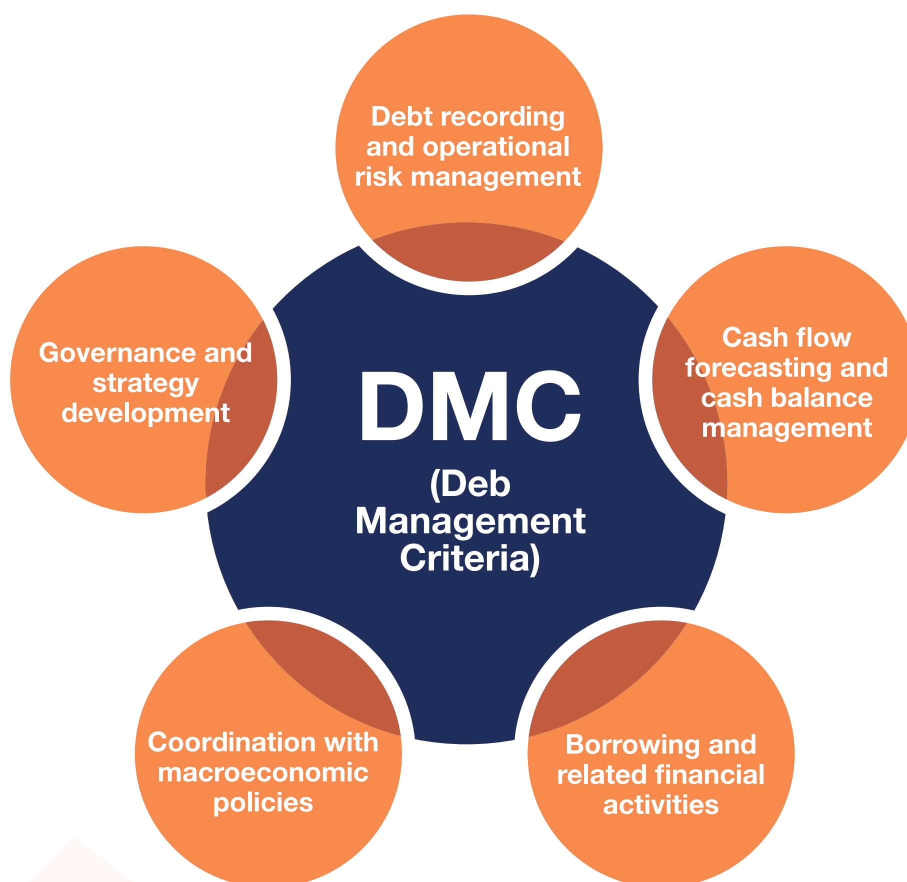


Figure 1: Debt management criteria

7.3. Debt Management Framework

A debt management framework can be defined as a set of rules and guidelines that help government authorities to maintain debt within sustainable levels or in other words to design and implement debt management strategy focusing on a diversified portfolio in terms of maturity risks, interest rates risks and exchange risks to prevent issues that might make the debt unsustainable.

The main pillars of a proper debt management framework are:

i. Definition of objectives: debt management strategy and objectives are key elements to the macroeconomic plan of a country. Defining the objectives to be achieved with the debt, will help determine the best structure for debt, maturity, interest rate, payments, etc.

ii. Decision-making process: transparent decision-making process for approving debt and guarantees by governmental institutions are important. The legislature should pass a law with the formalities and requirements needed to enter into a financing agreement, conducting a legal and economic analysis of the checklist that should be complied with before authorizing such financing. The law should also determine which governmental entities may enter into a financing agreement; establish a list of purposes for which the debt may be requested, or a process for having each purpose analysed and approved on a case-by-case basis; and develop an approval process.

This clear decision-making and approval requirements will help prevent crises like the Mozambique scandal explained below, in which the legal standing of the debt was challenged. This is not a unique situation as similar cases have ensued with Ukrainian and Venezuelan debt contracts.

Now it is useful to analyse the decision-making process in Argentina to exemplify how this can be done in practice and consider the several acts that are required in the process. The Law on Financial Administration of the Public Sector, Law No. 24.156 regulates the borrowing of the public sector. Article 60 of this law establishes that the National Administration cannot contract any credit or financing that is not contemplated in the public budget for the reference year. The same law sets forth that the National Administration may carry out public credit operations to restructure the public debt through its consolidation, conversion, or renegotiation, to the extent that this implies an improvement in the amounts, terms and/or interests of the original operations.

In turn, according to Decree No. 1,344, issued by the National Administration, the functions of the body responsible for coordinating the financial administration of the national public sector are jointly exercised by the Secretariat of Treasury and the Ministry of Finance.

Considering this, in 2017, the National Administration issued Decree No. 29/2017 authorizing the Ministry of Finance to issue and register bonds before the US Securities and Exchange Commission for up to an amount that does not exceed the sum of USD20 billion.

This Decree also authorized the Ministry of Finance to include clauses that establish the extension of jurisdiction in favour of the state and federal courts of New York and London, to include collective action clauses and the pari passu clause, in accordance with the current practices of the international capital markets, and to include clauses that provide for a waiver to oppose the defence of sovereign immunity, save for Central Bank reserves, and public assets located within the territory of Argentina, or assets located outside of Argentina that serve to render an essential service to the country, as well as military and diplomatic assets.

Decree 29/2017 further authorized the Ministry of Finance to: (a) determine the opportunity, terms, methods and procedures for the issuance of the new public bonds, (b) designate financial institutions that will participate in the placement of the new public bonds; (c) sign agreements with financial entities that place the new public securities to be issued, providing for the payment of commissions under market conditions; (d) prepare and register a program of bonds before the SEC; and (e) sign agreements with fiduciary agents, payment agents, information agents, escrow agents, registration agents and risk rating agencies that are necessary both for debt cancellation operations and for the issuance and placement of new public securities, anticipating the payment of the corresponding fees and expenses in market conditions.

Under the authorization of this presidential decree, the Ministry of Finance issued Resolution 219-2017 authorizing the issuance of new public debt instruments up to an amount of EUR2,750,000,000 and approved the prospectus for the issuance. This resolution also designated (i) Banco Bilbao Vizcaya Argentaria, S.A., Banco Santander, S.A. and Citigroup Global Markets Limited, as joint underwriters in accordance with the underwriting agreement included in Annex II of the resolution, and recognized a total placement commission of 0.12% on the total amount of capital of the new public securities that are placed in accordance with the offer, (ii) The Bank Of New York Mellon as Fiduciary Agent and Paying Agent and Listing Agent, and (iii) Banco de la Nación Argentina, as Process Agent.

Resolution 219-2017 also authorized The Secretary of Finance and/or the Undersecretary of Legal and Regulatory Affairs, indistinctly, to sign the rest of the documentation necessary to issue the securities.

iii. Independence of the debt management body: the debt management department should be impartial from political decisions and have enough independence and autonomy to freely make its own choices and decisions, with professional and well-prepared personnel having clear functions and duties. In many countries, debt management is directly carried out by the Ministry of Finance, which can create difficulties from the independence point of view, given that the Ministry of Finance is generally appointed by the President or Prime Minister. Central Banks usually play an important role in debt management given their independence and the role they play in conducting the monetary policy of the country.

The decisions of the debt management body should be solely based on debt-management strategies, without political interference from other areas of government. A prerequisite for achieving this is to establish a clear framework including the required processes; and responsible parties with clear job descriptions, functions, and decision powers. To clearly distinguish distinct roles and responsibilities, the debt management body may be divided into back office, middle office, front office, and debt audit:

a. Back office: This area has the function of: recording every aspect of the financing agreement; registering the debt; making payments and settlements; and keeping track of all loan agreements, amendments and refinancing or guarantee documents. It is also in charge of the budget planning.

b. Middle office: This area provides advice and analysis to the government to make sure it complies with the country's financial needs, with a manageable level or risk and cost. It controls if the front office follows the defined costs, risks and strategy parameters determined for each borrowing, and performs an assessment of the different potential risks previously mentioned.

c. Front office: This area oversees the implementation of the financing based on the criteria determined by the middle office. It conducts negotiations with creditors and handles all communication and information-sharing with international financial institutions, commercial banks, and creditors in general.

d. Debt audit: This area has an essential function in debt management. Undertaking financial and loan performance audits on a regular basis reduces the risks of cost deteriorations and helps identify potential issues beforehand. It is also a valuable tool for identifying mismanagement issues in case a problem arises related to the debt management. This area also helps improve efficiency and transparency, the latter is a key element in sovereign debt, as explained below.

v. iv. Debt management strategy: the strategy should consider objectives at a short, medium, and long term and perform an analysis of the needs of each financing agreement. Also, the analysis should consider other domestic and external borrowings that the country may have, to coordinate the new lending with other existing debt obligations. This is further analysed in the section 7.4 below.

vi. Coordination with fiscal and monetary policies: Although independent, the debt management authority should

coordinate strategies and macroeconomic policies with other government areas. For example, a sovereign may need to issue debt to balance the fiscal deficit or may have fiscal surplus but still decide to issue debt to develop certain projects. On the other hand, monetary policies are usually designed and controlled by central banks, which are responsible for building up international reserves to back up the value of local currency as well as ensuring the payment of external debt in foreign currency. Central banks decide how much money to print and when. Printing money in excess or financing fiscal deficit in excess can create foreign exchange risk (depreciation of the local currency) and roll over risks because of lack of confidence of the market. Therefore, although it will depend on the structure of each sovereign, while the Ministry of Finance is usually in charge of sovereign borrowing, the debt management strategy should be coordinated with the Central Bank and the Treasury.

vii. Coordination with investors is also key, to determine their own objectives, making sure that the government's needs and the investor's objectives are aligned, thereby making the financing more efficient for both parties.

viii. Transparency Policy: Transparency policy is key for sovereign debt. This must be done through: the tracking of payment obligations; providing information about sub-sovereign debt, collateral, and the use of guarantees; and the publication of statistics, to allow the full and accurate evaluation of debt. This is further analysed in section 7.5 below.

7.4. Debt Management Strategy

The debt management strategy of a borrowing country is based on medium-term decisions considering the country's fiscal situation, costs and risks the country is willing to take and potential payment difficulties. The debt management strategy goes hand in hand with the macroeconomic policy of the country, in coordination with both the fiscal and monetary aspects of the country.

Based on the debt management strategy of the country and its objectives, the government can then decide to incur (or not) debt and on which conditions. The debt management strategy should be reviewed on an early and ongoing basis to make sure it appropriately reflects the economic and financial situation of the country each given year (unless it is necessary to be done with more frequency), which could change significantly due to market conditions.

The main objectives of developing a debt management strategy include:

i. to achieve the necessary funding the country requires to meet its financial needs;

ii. to try to reduce the cost of funding by taking on risks up to the level or degree that is acceptable for the debt management strategy; and

iii. making sure that the country can comply with its payment obligations.

The World Bank and the IMF, for example, have created the Medium-Term Debt Management Strategy (MTDS) which links borrowing with macroeconomic policy, helping countries to design a debt portfolio that reflects costs and risks preferences of the borrower while also helping to manage the exposure to debt. Many African countries have developed a MTDS including, without limitation, Angola, Ethiopia, and Ghana. For example, in 2019, the Ministry of Finance of Ethiopia developed a MTDS with support from the IMF and World Bank. Ethiopia's MTDS showed that the debt portfolio was exposed to foreign exchange risk and that the country should also focus on developing the domestic market to diversify sources of debt.

7.5. How to develop a debt management strategy?

Regrettably, most countries have already incurred debt (sometimes considerable amounts) before developing a debt management strategy. This is not the best scenario. Therefore, it is important to have accurate information on the incurred debt at the time of developing the debt management strategy, and the terms and conditions of the same (such as currency, interest rate, maturity, payment terms, governing law, guarantees, etc.). Knowing the cost and risks of the current borrowings is key to drafting a debt management strategy that makes sense and is feasible.

Once that is determined, a yearly borrowing plan should be drafted, taking into consideration the budget for the given fiscal year. After the yearly borrowing plan is determined, the following steps should be taken:

i. Establish the scope and objectives for debt management, which in most cases are to make sure the country's financing needs and payment obligations can be met, at the lowest cost and with a reasonable level of risk.

ii. Find potential lenders/investors and analyse which would be the risks and costs of entering a borrowing relationship with each potential source of funding.

iii. As mentioned above, take into consideration the macroeconomic, monetary, and fiscal policies of the country, and reach consensus with the authorities in charge of each of these governmental areas.

iv. Consider different alternatives or different possible scenarios.

7.6. Foreign or domestic funding

Another weighty decision a sovereign borrower must make is whether to incur the debt in a foreign currency or in its own domestic currency. However, this decision is sometimes limited by market situations. Most emerging economies, including African borrowers, tend to fund themselves in foreign currencies, because of the limited sources of financing available in their domestic markets, the volatility of the domestic market, etc. The main drawback of taking loans in foreign currency is the exchange rate risks, which some economists have referred to as the "original sin" in debt financing.

Developing domestic markets helps mitigate exchange risk exposure and helps shift capital to domestic developments.

The debt management strategy should consider the development of domestic markets as an objective and establish measures to try to achieve that goal. Continuing with the African example, certain African countries have been successful at issuing debt denominated in local currency and slowly developing their domestic markets (e.g., Ghana, Kenya, Namibia, Nigeria, and Tanzania).

7.7. Debt portfolio: Identifying potential sources of financing.

Another essential element when determining the debt management strategy of a country is to consider the potential sources of financing available to the country. Sovereign borrowers need to understand the different types of creditors, each with their own legal structure, aims and approaches, to determine from whom they may receive financing. Understanding the financing options available is critical to developing a debt management strategy as each option entails different obligations towards the lenders. A recent IMF policy paper pointed out that there are new challenges in debt resolution and that, for example, the debt restructuring process of Gambia took two years complicated by the large role of non-Paris Club creditors and plurilateral creditors (IMF Policy Paper, The Evolution of Public Debt Vulnerabilities in Lower Income Economies, 2020). The composition of debt portfolio can therefore affect the rollover of the debt and the debt restructuring. Table 1 below shows how the debt composition in Low Income Economies (LIEs) has changed in the past decade:

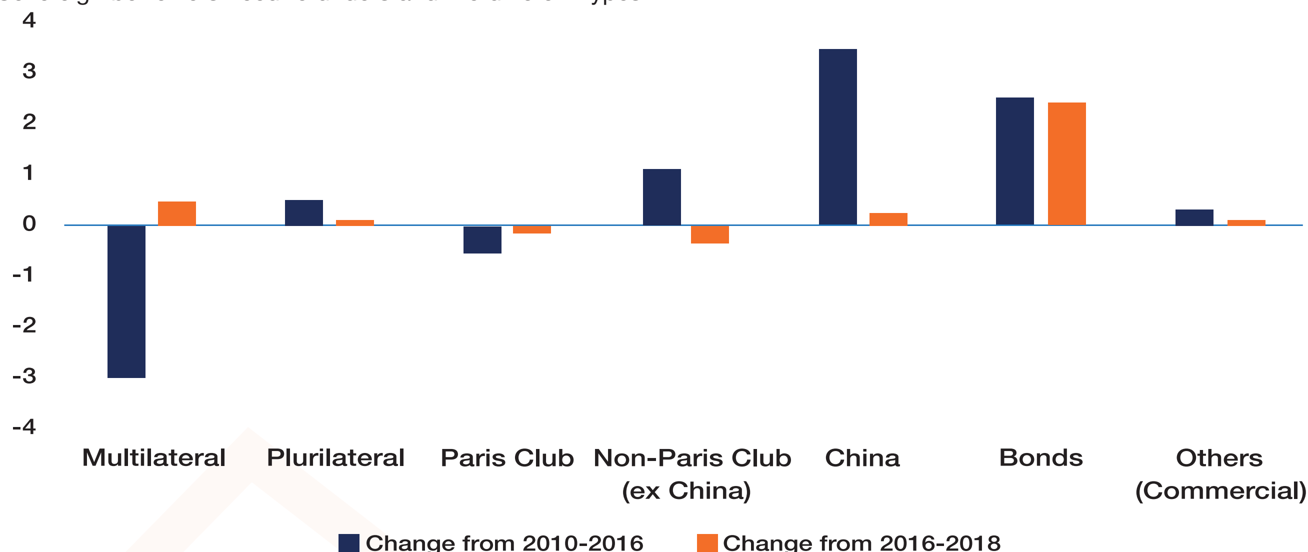


Table 1: Changes in Outstanding Debt as a Share of Total LIE GDP (Simple averages)

Source: IMF Policy Paper, The Evolution of Public Debt Vulnerabilities in Lower Income Economies, 2020

For example, a multilateral lender will grant better financial terms (concessional lending) but will have a specific policy for eligibility and the borrower must follow strict conditions relating, for example, to domestic monetary and fiscal policies (e.g., to cut fiscal spending). This is because a multilateral loan is granted within a specified development program or policy. On the other hand, when issuing a bond, a sovereign can access a broader market without the need to commit to specific programmes or policies. In fact, the prospectus of a bond includes a section titled “risk factors” where the issuer lists all the potential risks that creditor may face if it chooses to buy the bonds, including excessive fiscal spending, monetary instability, foreign exchange risks, among others. The structure of the portfolio can have a great impact on the debt restructuring process.

7.8. Type of creditors

7.8.1. Public Sector

a) Multilateral Creditors

Multilateral creditors, such as the IMF and the World Bank are international organizations that use funds contributed by sovereign members to grant loans to other countries. Their general objective is to improve stability and economic growth in developing countries, helping them achieve their macroeconomic objectives. For example, the World Bank and the African Development Bank also have as their objectives fighting poverty and enhancing economic development in countries in need. The IMF, on the other hand, has as its objective seeking financial and monetary stability by giving members financial assistance to solve urgent economic problems relating to balance of payments and technical assistance to help improve the bases of their economic framework.

Multilateral creditors can deliver grants on an exceptional basis or lend money through concessional loans. In general terms they have long maturities and grace periods and interest rates that are below market standards. These loans are the best borrowing option for countries. However, these types of loans usually require the borrower to comply with certain conditions imposed by the lenders, such as limit the use of funds for a particular purpose or make the country adopt certain economic measures.

Each multilateral creditor has its own legal structure and its own unique terms and conditions for granting the required financing. One important note is that multilateral creditors generally benefit from a special treatment or preferred creditors status, over other creditors. In other words, a priority of payment vis-à-vis other creditors. This is not a legal status, but rather a de facto preference granted mainly by the Paris Club or other bilateral lenders, but also by private creditors, in recognition of the concessional lending terms. This is based on the public good of multilateral creditors, which tend to benefit all other creditors, and on the fact that they provide lending when no one else would. The IMF, for example, is said to be the international lender of last resort, because it aids in circumstances where no other creditor would, not only by granting economic assistance, but also, as mentioned before, by giving technical assistance (which includes resources) to countries to help tackle their economic crisis.

b) Plurilateral Creditors

Recently new IFIs have risen in the market known as "plurilateral creditors". Some regional development banks are an example of this category of creditors. The distinction between multilateral and plurilateral is difficult to make, but the essential aspect is in the context of a debt restructuring because of the treatment they will be given. Since many plurilateral creditors are expecting to be classified as multilaterals with same preferred creditor status, it has created a problem because, as explained by the IMF, as the number of IFIs receiving that treatment increases, the value of special treatment decreases (IMF Policy Paper, Reviews of The Fund's Sovereign Arrears Policies and Perimeter, May 18, 2022).

Just recently, whether an IFI in the form of a plurilateral creditor was considered a multilateral creditor depended on membership (global rather than regional), treatment in Paris Club restructurings (whether the Paris Club had considered the IFI to be a preferred creditor), and participation in the HIPC Initiative. As explained by the IMF this was problematic because many new IFIs have no track record.

c) Bilateral Official creditors

Bilateral creditors are sovereign or sovereign entities such as state-owned banks and export credit agencies that provide loans to other countries, subcategorized as traditional and non-traditional bilateral creditors. For example, traditional bilateral creditors are members of the Paris Club (an informal group of lenders that meets in Paris since 1956) while emerging non-traditional creditors are countries that are not members of the Paris Club. China, India, and Saudi Arabia are the most relevant non-traditional bilateral lenders because of the amount of lending these countries have deployed in the recent years in contrast to the classic G20 bilateral lenders who are members of the Paris Club.

Traditional bilateral creditors focus on governance and providing development assistance to borrowers, which generally are developing and emerging countries. On the other hand, non-traditional bilateral creditors have emerged as key players in the lending framework of African countries. Contrary to traditional bilateral creditors that focus on the borrower's macroeconomic policies and grant loans not tied to specific projects, non-traditional lenders place their focus on micro-economic projects, and provide lending on specific economic activities or sectors (most commonly regarding infrastructure). Although they provide loans for more specific projects, in general terms, non-traditional lenders do not interfere with the internal economic policies of borrowers, as traditional lenders tend to do.

As explained by the IMF, debt owed to non-Paris Club creditors has increased after 2010 while debt owed to the Paris Club bilateral creditors has declined (IMF Policy Paper, The Evolution of Public Debt Vulnerabilities in Lower Income Economies, 2020).

7.8.2. Private Sector

a) Commercial creditors

Commercial creditors include private financial institutions and other non-financial commercial creditors. The key difference with multilateral or bilateral creditors is that commercial creditors grant loans to countries based on market standards and their terms are negotiated between lenders and borrowers, as in any commercial agreement.

Generally commercial creditors include the following provisions in lending agreements:

i. increased costs clause: to make sure lenders are covered if there is an increase in the cost of the funding or if their gain will be reduced due to any market situation, or tax or regulatory policy;

ii. negative pledge clause: to make sure that no asset or flow of funds is pledged to guarantee the repayment to a third party;

iii. pari passu clause: to make sure the credit ranking is preserved;

iv. events of default clause (including a cross default or acceleration provision): to be able to terminate the agreement and ask for the funds back in case any negative or serious situation happens;

v. intercreditor clauses: used in syndicated loans regarding voting and recovery sharing; and

vi. assignment to third parties' clause: provisions allowing the creditors to assign or transfer their credit and/or their obligations to third parties with the consent of the debtor which usually cannot be unreasonably denied.

The funds may be granted in either domestic or foreign currency, depending on the risk appetite of the lender/s as well as other factors such as the exchange rate and potential

exchange control restrictions in the borrowing country. Also, when the lender is a bank, there could be a single lender or a syndicated group lending, where various banks participate in the lending, and one of them acts as an arranger or organizer of the financing.

b) Bondholders

Short term paper (i.e., treasury bonds), notes, bonds, Eurobonds are another alternative for obtaining funds, by offering them to investors. Bonds can either be in domestic or foreign currency, and bonds denominated in foreign currency can also be marketed locally or in international capital markets. Sovereign bonds can also be privately placed or publicly traded.

The main category of bondholders are domestic banks, insurance companies or pension funds, and are the preferred type by sovereign lenders because they follow a “buy to hold” strategy and will likely keep, or “be forced to keep”, their investments during a potential economic crisis. Other categories of investors freely trade debt securities and most likely sell their bonds in the event of a crisis. Such bondholders typically hold the bonds as long as they receive periodic interest payments by the issuer, but eventually trade them in the secondary market either to minimize losses or to achieve a capital gain.

It is important to note that while bondholders trade sovereign bonds in the secondary market to create more liquidity, they may also sell quite quickly pushing the price of the securities downward. Then, once the price has decreased considerably, distress investors might take a position hoping that they will be able to have a say in a restructuring and sometimes can be seen as less cooperative with the debtor.

As reported by the IMF, since 2010, foreign currency denominated bonds have been the fastest growing source of financing for frontier LIEs, mainly in sub-Saharan Africa (IMF Policy Paper, The Evolution of Public Debt Vulnerabilities in Lower Income Economies, 2020).

7.9. A case study.

To exemplify the concepts described above we can refer to Egypt’s MTDS. As explained in Egypt’s 2019 base prospectus regulating the country’s USD 20 billion Global Medium Term Note Programme, the country established its MTDS to establish a cost-risk analysis process to manage the country’s debt portfolio and to provide for adequate funds for the government’s funding. The MTDS is planned for three fiscal years ahead and considers “the lowest long term cost relative to the general level of interest rates, at an examined degree of risk consistent with prudent fiscal and monetary policies frameworks.”

Figure 2 below shows Egypt’s MTDS analysis process:

Figure 2: Egypt’s MTDS analysis process.

7.10. IMF lending policies: Official Sector Involvement (OSI) vs. Private Sector Involvement (PSI)

The IMF has recently revised its lending policies that provide special protection to credits of other multilateral institutions that are aligned with the IMF goals. In other words, for the IMF to step in and lend money as a last resort to a sovereign in default or arrears, the borrower shall consider whether the OSI is needed into the equation. In essence, the IMF has two main policies and will apply one or the other depending on whether the debt restructuring requires or not the official sector involvement to restore debt sustainability of the debtor. Table 2 below explains how these policies work:

Policy	Non-Toleration Policy (NTP)	Lending Into Official Arrears (LIOA)	Lending Into Arrears policy
Application	Applies to certain claims of IFIs and official bilateral creditors that are outside the scope of a debt restructuring	Applies to claims of official bilateral creditors and IFIs that are within the scope of a debt restructuring	Applies to claims of external private creditors on sovereigns.
Lending	Prevents the IMF from lending in the presence of arrears to official creditors (bilateral or IFI).	Allows the IMF to provide financing despite sovereign arrears to official bilateral creditors and some IFIs (namely when these fall outside the scope of the NTP).	Allows IMF to provide financing despite sovereign arrears to external private creditors if the sovereign is pursuing appropriate policies and making a “good faith” effort to reach an agreement with its private creditors.

In other words, the IMF will lend money and require or not an effort from the official public sector, for example, in the form of debt relief, depending on whether this is necessary for the borrower to restore debt sustainability. Figure 3 below show how these policies are applied in practice to the official sector involvement:

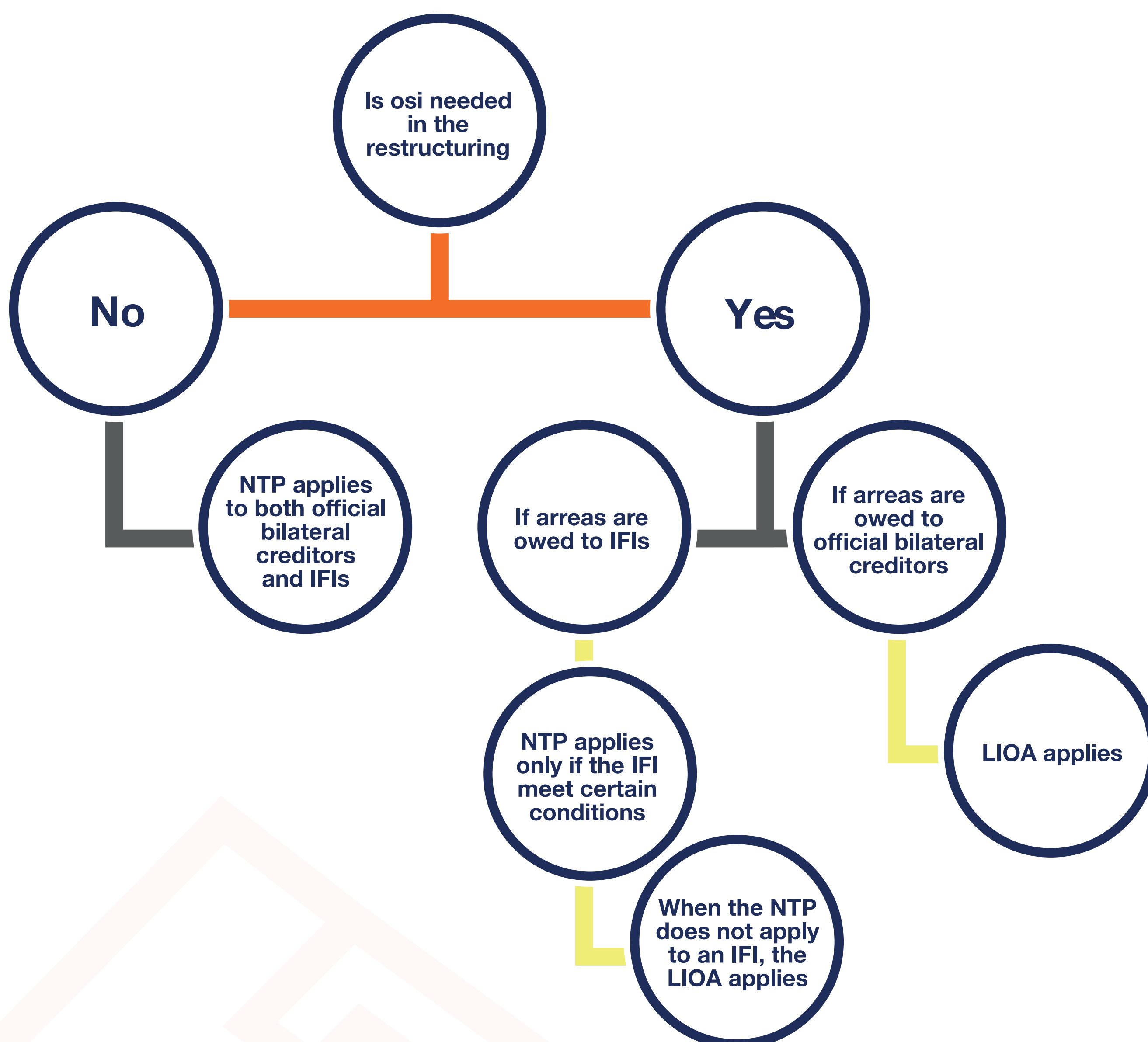


Figure 3: Application of Non-Toleration Policy (NTP) and Lending into Official Arrears Policy (LIOA)

When the OSI is needed, for example, in form of debt relief, the IMF proposed to restrict the NTP to certain IFIs only. For an IFI to benefit from the policy, it shall have a mandate aligned with the IMF (i.e., lender of last resort) and it shall be treated as a preferred creditor by a representative standing forum, i.e., the Paris Club, unless several other factors apply, including, whether the IFI has a global membership or not. If the IFI is outside this scope, the IMF defers the decision whether to apply the NTP to the official bilateral community. In other words, the LIOA policy was extended to some IFIs when the IMF considered that the NTP should not apply.

Finally, when it comes to the PSI, the LIOA policy considers that for private creditors the IMF may lend money if prompt financial support is essential for the IMF-supported program. Additionally, the good faith negotiation requirement entails that creditors are engaged in an early stage and provided an opportunity to participate in the debt restructuring process.

VIII. DEBT TRANSPARENCY

One essential aspect of sovereign debt is transparency, especially regarding terms and conditions of the debt. Transparency is understood as the action of making information publicly available. Inadequate disclosure has led developing countries to face debt distress risks, proving that if more information is publicly available, borrowers and lenders are able to make better informed and more conscious decisions on lending, making them less likely to have a debt crisis and ultimately also lowering lending costs.

In addition, debt transparency enables society as well as the judicial and legislative branches to determine if the executive is making the right decisions, and ultimately hold them accountable for any negative impact their decisions may cause. This also helps lower corruption and the mismanagement of public funds.

In this scenario, the role of creditors and international financial institutions is also key. The G20 countries, the Organisation for Economic Co-operation and Development's sustainable lending, the Institute of International Finance (IIF), and the United Nations Conference on Trade and Development have issued guidelines and principles to tackle debt transparency related to bilateral loan agreements.

Although improvements have been made in terms of debt transparency, recent cases have shown that more effort is yet to be done. As explained in detail below, three Mozambican state-owned companies incurred debt obligations that were guaranteed by the central government, but the debt was not recorded in the estimates of public debt stock. The same happened in the Republic of the Congo with pre-financing contracts for the oil industry entered by the government, which were never officially reported. Sovereign debt transparency is a phenomenon that needs to be addressed as it can generate great uncertainty.

Transparency is important because all debts can have an impact on the debt management strategy. As the debt position of many countries and its long-term sustainability have been extensively scrutinised—and debt premia have increased as a result—the importance of assessing the real need to incur new debts and therefore to improve transparency in sovereign borrowing has been also recognised. Several recent debt scandals confirm that sometimes debts are wrongly incurred, or the purpose of their use is not the appropriate one. Transparency is key to dealing with these risks. Transparency should apply to all government indebtedness, including all governmental bodies and SOEs.

8.1. Benefits of debt transparency

The single most important benefit is proper debt management by avoiding information asymmetry and increasing accountability, which reduces lending costs. As already mentioned, insufficient information or unclear terms undermine the possibility of responsible lending.

If information from the country's debt is unavailable, future lenders may be unable to properly assess potential repayment risks. If they do not have clear information, lenders may tend to adopt a more conservative approach and increase interest rates, therefore increasing the borrower's total costs.

Another aspect worth mentioning is that the IMF prevents and resolves debt crises based—among others—on debt information. If the IMF lacks information to determine a country's risk of debt distress, it cannot make recommendations or adjust their borrower's programs.

Finally, if the information is not sufficient, it is exceedingly difficult to deal with crisis resolutions. In an event of default, information is needed to determine the perimeter of the debt, an orderly process of repayment and fair burden sharing.

8.2. The Mozambican scandal

The Mozambican scandal is a clear example of the detrimental consequences of poor transparency policies.

During 2013 and 2014, the former government of Mozambique established three state-owned companies that requested loans for an aggregate amount of just over USD 2 billion . The original financing arrangements were: (a) a USD 622 million loan to ProIndicus, a state-run security firm, to perform coastal surveillance; (b) a USD 53 million loan to the Mozambique Asset Management Company to build and maintain shipyards; and (c) a USD 850 million loan to Ematum, a state-run fishing company, to build a tuna-fishing fleet. The loans were arranged by the banks VTB and Credit Suisse.

The national government acted as guarantor for the loans entered into by the three state-owned companies. However, information on only the Ematum loan was given to the public. The Ematum loan was later converted into loan participation notes (LPNs), which were traded in open markets. The Ematum LPNs were, in turn, legally extinguished in April 2016 through an exchange for USD 727 millionof sovereign Eurobonds issued by the government of Mozambique—

creating an entirely new legal obligation.

Figure 4 below summarises the original financing structure and the ensuing transformation in LPNs and the government issued Eurobond, the latter in relation to the Ematum obligations.

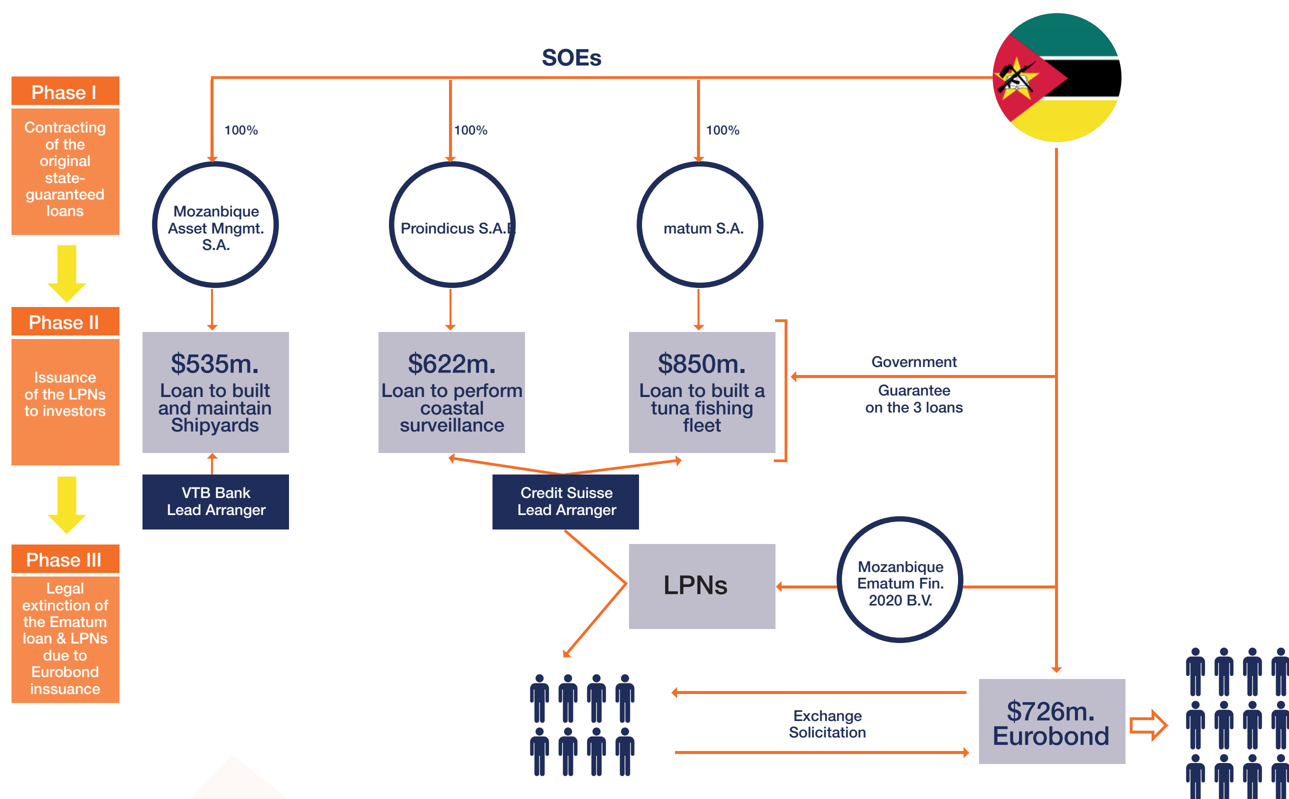


Figure 4: The structure of the financing arrangements that led to the Mozambican debt scandal.

The other two loans that were used to acquire military equipment for the security services and the Ministry of Defence, were kept private by the executive branch. In 2016 the IMF was informed about these other two loans, and it triggered an economic crisis that brought default on all external commercial debt. This caused the IMF and bilateral donors to suspend their budgetary support, the local currency depreciated by about 65% within six months and economic growth plummeted to 3.8 % in 2016 from 6.6% the year prior.

Since 2016, scandals continued as evidence of bribery and large-scale fraud started to emerge, putting into question whether the mentioned loans should be recognized and restructured, or repudiated.

Worried about the increased levels of debt compared to GDP, the government announced in October 2016 its intention to restructure all its external commercial debt. In its presentation to creditors, the government noted that while external commercial debt represented only 13% of total external debt, it accounted for over 40% of debt service.

Making matters even more complicated, the country's administrative auditing court declared the state guarantees of the ProIndicus and MAM loans illegal for violating the constitution and previous budgetary laws.

As explained before, the Mozambique scandal serves as an example of why accountability and transparency are of key importance to any country. Implementing a feasible economic recovery program, reducing corruption and strengthening economic management should be the focus. Mozambique has a bright light at the end of the tunnel due to the large fiscal cash flows expected from its LNG projects. Finalising agreements and implementing policies supporting the country's financing and development should be of foremost importance.

8.3. Levels of transparency based on lender.

Diverse types of lenders require distinct levels of debt transparency, or lack thereof. Multilateral lending does not have the same debt transparency as lenders from the private sector. Bilateral sovereign lenders also present different challenges regarding debt transparency.

i. *Multilateral lenders:* Multilateral lenders, such as the World Bank or the IMF or development banks, have their own strict procedures and policies on debt transparency and accountability that make multilateral lending not problematic in terms of transparency.

Multilateral lenders generally publish repayment conditions and the terms and conditions of the loans they grant and tend to use the same terms and conditions for

countries in similar positions.

ii. _Bilateral sovereign lenders:_ When the loan is provided by other countries or governmental agencies, debt transparency becomes an issue. These loans may have geopolitical implications and are negotiated at governmental levels. However, it also depends on which country is the lender.

iii. _Private sector lenders:_ This category includes capital market-issued bonds and loans granted by commercial banks, both either on a national or international level. Capital market-issued bonds generally are publicly listed securities (private placement is an exception to this), that follow strict listing requirements that include disclosure of key terms.

On the other hand, loans granted by commercial debt are private and include the lender and borrower as parties to the same. Based on this, the terms of commercial loans are not generally disclosed. The IIF Transparency Principles are generally used for the disclosure of these type of lending, mainly as a reaction to the Mozambique scandal explained above. Those principles are explained below.

8.4. Best practices for transparency policies

8.4.1. Borrower's perspective

From the borrower's perspective transparency requires two key components: information recording and disclosure.

i) Information recording

To make transparency an achievable goal, information recording is an especially important aspect. If there is a failure in the way in which data is collected and recorded, transparency will not be achievable because accurate information will not be available to the public, creditors, and international financial institutions.

First, it is important to determine which type of information is important to disclose in terms of debt transparency. Once that is determined, information tracking must be effectively done, otherwise even if the most accurate information is in place, if tracking and recording is not done in an orderly manner, it will serve no purpose. Information must be recorded daily, but also there must be a procedure in place for data recording in exceptional circumstances.

(a) Tracking on a daily basis

Information must be collected in a centralized manner and consolidated in a single database that includes all debt and borrowings incurred by the government, state-owned companies, national banks, and other governmental entities. Every indebtedness or liability that may have an impact on the financials of the country must be included in the consolidated database. For example, loans from multilateral agencies (World Bank, IMF, etc.), foreign currency sovereign debt, interest, and currency swaps, etc.

Although it may seem an easy task, many countries do not have in place a clear procedure for data recording, and information on debt and liabilities is scattered throughout the different governmental entities or departments. If the country does not have a clear idea of the amount of sovereign debt it has incurred, it may easily underestimate its debts and liability.

There must be a public debt document depository. It should use up-to-date technology and include all documentation in connection with each loan (loan agreement, addendums, supplements, waivers, notices, receipts, and each communication between the parties).

It should also have in mind to whom the information that is recorded is going to be provided, to adapt the format in which the information is given, and the technicalities, to each specific recipient:

i. _legislative power:_ usually the executive branch of the national government must report to congress, or the legislative branch about the sovereign debts and liabilities;

ii. _multilateral agencies:_ countries have a duty to annually report their borrowings and liabilities to the IMF for the agency to prepare a report on the economic and financial situation on each country, based on the information received; and

iii. _international investors:_ as part of the lending agreement, investors usually require that information is given to them periodically.

Technology can help to accomplish proper recording. For example, the Commonwealth Secretariat recently developed Meridian, a new debt recording and management system which is based on the on the IMF and World Bank Public Sector Debt Guide, ensuring that debt instruments are reported according to the recommended statistical methodology (for example, contingent liabilities). Nigeria, Ghana, Sierra Leone, The Gambia, and Liberia are some of the countries that use Meridian to improve debt management capacity. Other countries, like Egypt, use a software system developed by the United Nations Conference on Trade and Development named Debt Management Financial System for Analysis and Statistics. As explained in Egypt's 2019 base prospectus, the Debt Management Financial System for Analysis and Statistics records Egypt's domestic debt, generates various reports, including domestic sovereign borrowing, contingent liabilities and on-lent loans and grants.

(b) Tracking in exceptional circumstances

In certain special times, lenders require that information be delivered to them within shorter periods of time and in a more comprehensive manner. This is usually required during debt relief negotiations. In such cases, the borrower must have in place a procedure to address the information requirements in a timely manner, with the level of detail required for the specific situation.

ii) Disclosure

Transparency cannot be achieved without disclosure. Disclosure requires the sovereign to make relevant terms and conditions of sovereign debt publicly available to allow creditors as well as citizens monitor the borrowing activity.

If investors have accurate and timely debt information, this will boost the confidence of creditors in the debtor. As mentioned, insufficient information or unclear terms undermine the possibility of responsible lending. This is why securities' laws require the issuer of securities that trade in the capital market (e.g., bonds) to make quarterly reports and why bonds include a chapter on risk factors.

Transparency therefore increases borrowers' negotiating power. If creditors have the full package of information available, they can properly assess risks and offer interest rates according to these risk factors. This, ultimately, could make a difference if the time comes to conduct a debt restructuring.

8.4.2. Lender's perspective

From the lenders perspective, both the G20 and the IIF have issued guidelines and principles that should be followed to improve transparency. These are:

i. The G20's Operational Guidelines for Sustainable Financing (2017) (G20 Guidelines)

ii. The IIF Voluntary Principles for Debt Transparency (2019) (IIF Transparency Principles)

The G20 Guidelines were issued in 2017 and include a chapter on transparency and disclosure of information. These guidelines are used together with a standardized diagnostic tool developed with the IMF and the World Bank that is used by bilateral creditors to measure their level of compliance with the guidelines.

The G20 Guidelines are used by central banks, governmental agencies, national banks, and any other entity of the public sector of the creditor country. The main information that must be disclosed is the amount of the loan, the debtor, for what purpose is the loan going to be used, interest rate, grace and maturity period, and collateral (if any).

The best level of transparency is acquired when a governmental agency publishes information on the loans on a website used for all the country's public lenders and that information is updated on a quarterly basis. If the creditor only discloses the loan information to the IMF and World Bank and updates it once every year, the creditor will have a "sound" practice rating.

However, these guidelines still have important limitations. For example, the lack of participation of non G20 countries; the results from the evaluation tool are not disclosed by the World Bank and the IMF; there is no way to record if the terms and conditions of the loan have been disclosed to the public in general or only to the IMF and the World Bank; and there is no way to determine if the borrower included the loan in the country's statistics or debt measurements.

The IIF Transparency Principles are voluntarily adhered to by lenders, and although they can be applied to any type of lending, it is generally aimed at transactions in foreign currency incurred by the most vulnerable low-income countries, including direct transactions (loans) and indirect transactions (guarantees).

Information to be reported includes the name of parties, currency, interest rate, amount of the loan, use of collateral, governing law, and dispute resolution, among others. The entity responsible for sharing the information is the lender and should disclose the same in a period of up to four months from the time the loan is disbursed.

The IIF Transparency Principles therefore promote consistent and timely disclosure in connection with financial transactions entered with sovereigns (central governments), sub-sovereigns or any other state-owned enterprises (SOEs) and by any other entity which is guaranteed by a sovereign or sub-sovereign or SOE (contingent liabilities).

In 2019, the G20 countries endorsed the work of IIF Transparency Principles to improve debt transparency and sustainability.

However, the principles have some limitations, for example, interest rates are not disclosed in a specific manner, but rather in a range, which does not allow an exact estimation of the financial consequences of the loan (this responds to antitrust limitations) to be made, or they currently only apply to loans that have loan-income countries as participants (although its application can be extended to more countries).

8.5. Improving transparency initiatives

One main obstacle to transparency is confidentiality or non-disclosure provisions included in loan agreements. These clauses are a common feature in bilateral and sometimes also in commercial loans. However, the parties to the loan can negotiate a carve-out and make an exception to the confidentiality of the agreement to allow disclosure for transparency purposes. For example, parties may include a reference to the G20 Guidelines or the IFF Principles to justify disclosure of certain information.

Another barrier is that both G20 Guidelines and IFF Principles are voluntary, so the parties do not have a strong incentive to comply with them. Some argue that to solve the voluntariness issue, lists should be issued with compliant and noncompliant countries, as this could serve as an incentive to be part of the compliant countries list.

Also, the creation of a centralized database including not only commercial loan information, but also multilateral, bilateral, and bonded debt obligations could be a better solution than having each country publish their own information on their own websites.

As mentioned before, the IIF Principles currently only apply to low-income countries. It is key for debt transparency that these principles apply to as many countries as possible, including other developing countries that are currently out of the threshold determined for low-income countries, but that still have serious transparency issues.

Finally, borrowing countries need to improve their data reporting and information sharing. This measure must be determined by the highest levels of government and receive aid to develop a better approval structure and debt recording system.

IX. ROLE OF ADVISORS IN DEVELOPING AN EFFECTIVE DEBT MANAGEMENT STRATEGY

Engaging independent professional advisors is a particularly important aspect of debt management. Advisors should be hired from the beginning of the borrowing negotiations and should cover at least financial, legal, and public relations or communication aspects of the transaction. It is important to understand that advisors are necessary not only during crises or exceptional situations, but also in normal times. Advisors can help the country design macroeconomic frameworks, design the debt portfolio, access the capital market through bonds, as well as implement new laws and legal frameworks. The private sector can be consulted formally through a procurement process or informally through a public consultation in which the governments receive opinions from experts on how to implement a policy or a new law. Either way, external advisors can be a great aid to public authorities in providing a second view as well as transparency.

9.1. Type of advisors

9.1.1. Financial advisors

Certain financial advisors have vast experience in providing advice to countries on macroeconomic and financial aspects of loans, either regionally or more globally depending on the type of advisory services required. They are hired usually to assist debt managers, central bank officials and economy ministries.

Financial advisors oversee the following:

i. help the government develop a medium/long-term strategy for sustainable borrowing;

ii. find ways to mitigate risks and assist the country in defining its funding strategy;

iii. help the country implement tools to manage its liabilities and risks; and

iv. assess the possibility of a country to access certain markets and on which financial conditions.

9.1.2. Legal advisors

Legal advisors are key due to their expertise in debt financing, regulatory frameworks, litigation, and possible limitations to the liability and risk assessment strategies. Many law firms and a limited number of consulting firms have a more global approach and work together with local advisors to deliver the most accurate advice to sovereigns.

Legal advisors are also essential during debt restructuring negotiations that may take place with private investors, multilateral agencies (such as the World Bank or the IMF) or bilateral sovereign lenders. They work jointly with financial advisors trying to find a long-term solution for the debt situation of the country.

Legal advisors also serve as intermediaries between the government and the lenders, particularly when the lender is the IMF, and the country is part of a programme supported by the IMF. Depending on the project, the legal advisor may engage in the following tasks:

i. assist the country to engage in negotiations with the IMF for a plan or to determine the debt relief required to make sure the country is on a sustainable debt path;

ii. draft legal strategy and determine legal risks and analysis; and/or

iii. work together with the financial advisors on the best way to issue debt or approach creditors, depending on the circumstances.

9.1.3. Communications advisors

In certain situations, countries may also consider hiring advisors specialized in media and communications. These advisors work together with the financial and legal advisors, and the governmental authorities to make sure the country is giving its lenders and others (civil society, stakeholders,

etc.) an effective, credible, and transparent message on the country's debt situation, development strategies, financing requirements and macroeconomic and financial scenario.

Their main objectives therefore are to make sure communications reach:

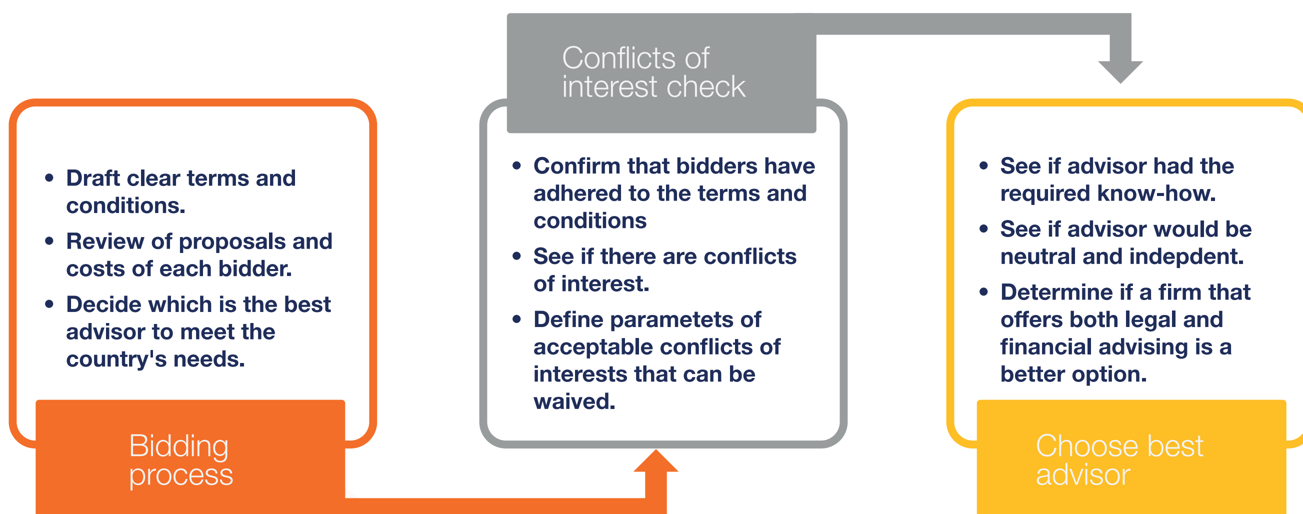
i. Governmental officers within the country (congress, ministries, etc.);

ii. Domestic investors, non-governmental entities, and the population of the country; and

iii. International investors and international financial entities.

9.2. Procurement practices for hiring advisors.

Procurement practices are needed to make sure that the process of hiring the advisors mentioned above is transparent, objective, and competitive. Figure 5 below illustrates the steps to be followed in procurement:



X. THE RULE OF LAW

Upholding the rule of law is essential for the functioning of every society. According to the rule of law, everyone is equally subject to the law and is governed by impartial courts, including government officials. Effective judicial protection is at the heart of the rule of law, which calls for independent and effective national judicial systems.

The IMF has found that fragile states are often characterized by low levels of administrative capacity and a fragmented rule of law (see IMF, Republic of Congo: First Review under the Three-year Extended Credit Facility Arrangement, Annex I: Drivers of Congo's Fragility, 18 July 2022). According to studies conducted by the World Bank, it has been demonstrated how important justice is for promoting a positive economic climate, reducing corruption, and restraining the misuse of authority. Countries are therefore working to make improvements in this area. For example, the government of Benin has recently reaffirmed the importance of governance and the rule of law as the main pillar of its action program for 2021-26 and will conduct and publish with the IMF technical assistance team a governance diagnostic assessment by end-February 2023. This will include regulation and supervision of government contracts to enhance transparency in government spending and strengthen transparency of beneficial ownership information about government contractors. Zimbabwe has also put in place a National Development Strategy which focuses on strengthening the rule of law to unlock private investment and facilitate the respect of property rights.

Working on strengthening the rule of law is quintessential to make sure that if things are improper, there will be accountability and, in this way, correct wrongs and make sure that all has been done to prevent them from happening again by curving behaviour.

10.1. Accountability

Accountability is the other side of the coin of the rule of law. While the rule of law comprises several principles (supremacy of the law, equality before the law, accountability to the law, fairness in the application of the law, separation of powers, participation in decision-making, legal certainty, avoidance of arbitrariness, and procedural and legal transparency) under which all persons, institutions, and entities are accountable; accountability refers to the processes, norms, and structures that hold individuals (including government officials) legally responsible for their actions and that impose sanctions if they violate the law.

The goal of providing transparent information is to allow citizens, institutions, civil society, and lenders scrutinise what the government does with debt and spending and hold authorities accountable for negligent and unlawful actions. Accountability cannot be achieved if data collection and recording processes are flawed since the public, creditors, and IFIs will not have access to accurate information. For example, the IMF has stressed that South Sudan needs to increase the accountability of those that hold public power. Particularly, that the oil sector needs more transparency, including the use and accounting of oil revenues and that the country "needs to create appropriate fora (not limited to its Parliament) for the discussion of public policies, leaving space for civil society to scrutinize the conduct of government." (see IMF, Republic of South Sudan: 2022 Article IV Consultation and Second Review Under the Staff-Monitored Program, 3 August 3, 2022).

In the case of the Republic of Congo, the IMF recognized that an efficient leveraging of oil and other resources has been hampered by institutional deficiencies and that the lack of accountability in the administration of public revenues, spending, and debt are significant difficulties (see IMF, Republic of Congo: First Review under the Three-year Extended Credit Facility Arrangement. MEFP July 18, 2022). Niger, with technical assistance from the IMF, is working to adopt an oil revenue management strategy to enhance governance and transparency of oil exports, establishing safeguards so that Ministry of Finance can control oil revenues. In the case of Zimbabwe, the country is enhancing the public financial management (PFM) system to reduce the number of transactions that take place outside the records and control of the PFM that can result in a build-up of arrears and extra-budgetary expenses that endanger the viability of the budget (see IMF, Zimbabwe Article IV Consultation, 8 April 2022). Therefore, policy initiatives across the board are emphasising the importance on improving accountability to maximize the use of resources and prevent unpleasant surprises that can affect debt sustainability.

Multilateral lending transposes a high degree of accountability and scrutiny imposed on multilateral lenders by their own internal policies and procedures (see S. Mustapha and R. Olivares-Caminal, Improving transparency of lending to sovereign governments, ODI Working Paper 583, July 2020). Another issue is the accountability of SOEs as they can have a serious impact on budgetary provisions, particularly due to the contingent nature that the distress or collapse of an SOE. South Africa was suddenly saddled with around USD 25 billion of debt due to liabilities in one of its SOEs (see J. Cotterill, "South Africa to transfer up to two-thirds of Eskom

debt to government", Financial Times, 26 October 2022). In July 2022, as an example of corrective measures to prevent episodes similar to that of South Africa, the Congress of Pakistan enacted a new law to regulate oversight and ownership arrangements of SOEs. The country is also collaborating with the Asian Development Bank to adopt a SOE ownership policy that clarifies ownership arrangements and the division of roles within the federal government (see IMF, Pakistan MEFP, August 29, 2022).

Finally, given the increasing trend on Environmental, Social and Governance (ESG) bonds, accountability will be the centre of the spotlight since investors will want to corroborate that the funds are effectively used to fulfil the ESG purpose. In other words, ESG pressure means that countries will need to check their accountability regarding the use of capital raised to satisfy ESG criteria. In this sense, in 2021 Belize achieved a deal with a committee of institutional investors that held around 50% of the outstanding principal amount of Belize's 2034 bond, after six months of negotiations with creditors. This also extends to debt restructuring situations where debtors and lenders could reach an agreement, as in the case of Belize, to issue new ESG-compliant debt to replace old debt. In the case of Belize, the so-called "debt for ocean swap" was the restructuring's defining characteristic. According to the planned restructuring, Belize used money from the Nature Conservancy's Blue Bonds for Ocean Conservation program to partially pay for both the acquisition and redemption of its old bonds. The Nature Conservancy helps sovereigns refinance a portion of their national debt as well as secure money for conservation initiatives through the Blue Bonds for Ocean Conservation program, offering credit upgrades to enable sovereigns to restructure debt on better terms (see Government of Belize, Press Release, Belize Announces Final Results of Its Offer to Bondholders and Memorandum from Belize to The Bank of New York Mellon, as Trustee, 10 September 2021). For more details on ESG bonds, please refer to the ALSF Debt Guide on Sustainability Financing.

The U.S. International Development Finance Corporation provided political risk insurance to support the transaction while the country raised USD 364 million through the "Blue Bonds" and use the proceeds to repurchase the 2034 bonds at a discount. The Government of Belize also agreed to pre-fund the "Marine Conservation Endowment Account" with USD 23.4 million as a significant component of the deal. Future maritime conservation initiatives in Belize will be supported by this account, which is run by a Nature Conservancy affiliate. Additionally, Belize vowed to strengthen conservation efforts to save the ocean and pledged an additional USD 180 million over the next 20 years for the conservation of its marine habitats.

This is a paradigmatic transaction and the accountability to which the Belizean authorities will be held is paramount to determine the success of the transaction and whether similar transactions can be structured in the future.

10.2. Fight opportunism and corruption

Fighting opportunism and corruption might seem a cliché, but countries should be aware that corruption contributes to institutional fragility and to debt situations in two ways: directly by deviating the funds raised from debt for other purposes or indirectly by creating issues with key exporting sectors like oil and mining that generate the most needed revenues in foreign currency to repay debt. The Mozambican tuna scandal is a clear example of this.

Therefore, accountability also requires a commitment to fight corruption and opportunism. Countries have been focusing lately on improving the legal framework to combat corruption more effectively. For example, Zimbabwe's overall and external public debt is in distress and unsustainable. In 2020, the IMF issued a Governance Diagnostic Report that identified governance weaknesses. In the latest Article IV consultation, the IMF urged the authorities to finalize the whistle-blower bill and implement an asset declaration policy for top public officials in accordance with global standards and best practices and ensuring that the Zimbabwe Anticorruption Commission has enough fiscal resources to carry out its responsibilities. Furthermore, IMF required the Auditor General's audit and regular publications on the utilization of the new Special Drawing Rights allotment are publicly available (see IMF, Zimbabwe Article IV Consultation, 8 April 2022).

Angola's 2018 Article IV consultation noted the country's limited ability to enforce the rule of law. Since then, satisfactory progress has been made to fight against corruption and asset recovery. Among others, the Attorney General's Office completed a 2018-22 anti-corruption plan aimed at boosting the prevention and repression of corruption offences as well as enhancing the capability of anti-corruption units and courts. In January 2019, the National Assembly amended the criminal code, which now includes a new chapter on economic and financial crimes with severe penalties for both active and passive corruption. The Attorney General's Office states that it has recovered an estimated USD 7 billion in financial and real assets as of September 2021, with high-ranking officials having been convicted (see IMF, 2021 Angola's Article IV Consultation and Sixth Review Under the Extended Arrangement Under the Extended Fund Facility and Request for a Waiver of Non-observance of a Performance Criterion, January 2022).

Pakistan has taken recent measures to strengthen governance and control corruption (see IMF, IMF-Pakistan MEFP, 29 August 29, 2022). To improve the institutional framework of the anticorruption institution, including, the National Accountability Bureau, Pakistan created a task force with participation and input from reputable independent experts. The task force will suggest structural reforms to improve the independence of institutions devoted to combating corruption, guard against political meddling and persecution, and establish mechanisms for accountability and transparency to guard against abuse. Pakistan also established a digital asset declaration system which will improve public access to annual declarations of elected and unelected federal government cabinet. The country is also working to enhance the use of AML tools to support anti-corruption efforts by helping financial entities to improve monitoring capacities to identify politically exposed persons and apply enhanced due diligence measures. This has been done by increasing the resources of the Financial Monitoring Unit (Pakistan's financial intelligence unit), including, hiring additional analyst positions to cope with the increased number of suspicious transaction reports.

On its turn, Zambia has been trying to implement a zero-

tolerance policy to combat corruption. Among other measures, the government took disciplinary action against officers of the Ministry of Health involved in the deviation of funds intended for the fight against the COVID-19 Pandemic. Additionally, a Comprehensive Governance Assessment is being conducted with the assistance of the IMF which will be used to create an action plan outlining future initiative to improve governance and minimize corruption (see IMF, Zambia-IMF, MEFP, September 2022). Congo enacted a new anti-corruption law in March 2022 aimed to persecute corruption and has worked with the IMF to regulate conflict-of-interest rules and procedures envisaged in the anti-corruption law (see IMF, Republic of Congo: First Review under the Three-year Extended Credit Facility Arrangement. MEFP 18 July 2022).

CONCLUDING REMARKS

There is a need to shift focus before debt accumulation reaches unsustainable levels – and not after. The focus should be driven by the preventative measures discussed in this Guide: proper debt management, transparency, the rule of law and accountability. Although there are many frameworks in place that should help stakeholders manage debt accumulation, it is clear these have not been properly or thoroughly applied given the current excessive debt exposure for many countries. This is a fault of both debtors and creditors.

On the debtors' side, it is straightforward. Sovereign debtors have either not been prioritising debt management or have not been using it efficiently, despite the many benefits that this can bring. Sovereign debtors need to have proper debt management mechanisms in place and understand how internal and external shocks can affect repayment capabilities and roll over capacity. However, the consequences are being learnt in a difficult manner, except for a few cases where the hard work has proved beneficial during the pandemic. Implementing debt management tools and full transparency have no immediate benefits and high costs, both in terms of investment to develop the frameworks and political costs of disclosing the entire debt portfolio. Given the usual short-term vision of some authorities, the answer could simply be the lack of incentives and immediate benefits of applying these tools.

However, creditors could also be to blame for not making proper analyses of the risks of lending to a country that it is highly indebted, and for being tempted by the high interest rates offered by some high-risk countries. Creditors should also perform a dynamic roll over and cost-benefit analysis to assess whether the debt can be considered sustainable in different simulation scenarios, to avoid excessive over lending (see V. Buccola, "An ex-ante approach to Excessive State Debt", Duke Law Journal, November 2014). The shift in the composition of creditors has also played a key role. The usual players, such as the IMF, WB, and Paris Club members, previously had total dominance, but, due to the liberalisation of capital flows and the rapid development of the capital markets since the 1980s, there has been a significant increase in bilateral lending by non-concessional lenders and the private sector. Even so, the multilateral creditors do have responsibilities in this debt accumulation problem.

In terms of transparency, the main problem remains the new forms of bilateral credit arrangements that are often performed via alternative financing methods, such as off-balance lending, execution of swap agreements, or via the participation of SOEs. In most of those cases, it is difficult to obtain a clear picture of the facilities' terms and conditions, given the nature of confidentiality clauses that are usually included, thus affecting transparency. The lack of clear disaggregated and truthful public data and information regarding public debt has been a problem for lenders to assess the actual status of public accounts and repayment schedules. Accurate publication of data has also become difficult due to debt structure being now more complex and diversified in the private sector.

Lack of accurate data about public debt also makes the IMF's Debt Sustainability Analysis difficult and borrowing and investments decisions harder (World Bank, Global Economic Prospects, Flagship Report, January 2021). The application of a centralized information platform regarding the composition of the public debt has also proven problematic for most developing countries. Software such as Meridian has improved the availability of such data, but there is much to be done by key players to support this. Ultimately, the lack of accurate and complete data complicates restructuring procedures.

Transparency and debt management are not magical fixes, but they can contribute significantly to solving the debt problem. Without transparency, there can be no proper debt management strategy (nor accountability), planning, or debt sustainability analysis. All stakeholders—borrowers and lenders—have a role to play to create greater transparency, especially bilateral lenders. Once transparency is achieved, we can focus on debt management, analysing status and planning in the short, medium, and long-term. In all cases, countries need sound macroeconomic policies in place as these tools alone are not enough.

Although it is true that the focus of the debt burden issue is slightly shifting from the ex-post responses of debt restructuring to ex-ante analysis, cooperation by all stakeholders in the debt building process remains critical. Lenders should also provide incentives by including robust loan clauses and covenants such as accurate presentation of financial information, inclusion of certain financial ratios, and even debtors' compliance with some of the guidelines described above so to have more suitable contractual tools. The downside is that sometimes these are difficult to implement as sovereign borrowers feel restrained in their options.

To achieve debt sustainability, good lending practices are equally as important as good borrowing practices. Debt sustainability requires a sense of shared responsibility among all stakeholders. Although it is a long and tedious path, this is the only way to make debt sustainable over the long term. The final building block is that of the rule of law and accountability, i.e., assuming responsibility, which can only be built on the back of a strong rule of law.

Finally, it is important to stress that the onus should be on measures of debt prevention, which are preferable to ex-post debt-restructuring. Otherwise, the problem cannot be prevented and despite how efficient we become at restructuring the debt, crises will continue to occur.

GLOSSARY

Accountability: The obligation of governments or entities to accept responsibility for actions, decisions, and their consequences.

Administrative Auditing Court: A legal entity responsible for overseeing government finances and ensuring adherence to the constitution and budgetary laws.

Anti-Money Laundering (AML) Tools: Measures and procedures, including legislation, aimed at preventing and detecting money laundering activities, often used to support anti-corruption efforts.

Arrears: Unpaid debts or overdue payments.

Bilateral Official Creditors: Sovereigns or sovereign entities providing loans to other countries, categorized as traditional (Paris Club members) or non-traditional (non-Paris Club members, like China, India, and Saudi Arabia).

Bills, Notes, Bonds: Different terms used for negotiable debt instruments based on their maturity date.

Bond Markets: Markets where bonds are bought and sold.

Bondholders: Individuals or entities holding bonds, which can be domestic or foreign currency denominated.

Bonds: Debt instruments issued by a government or entity, usually with a fixed or floating interest rate, and a maturity date when the principal is repaid.

Borrower's Cost: The overall expenses incurred by a borrower (sovereign) when borrowing funds, including servicing costs and associated risks.

Capital Markets: Markets for buying and selling long-term financial instruments like stocks and bonds.

Choice of Jurisdiction: The selection of a place or court where creditors can sue for repayment, influencing the impartiality and commercial considerations.

Clearing Houses: A central body that serves as a third-party intermediary facilitating financial transactions, where a buyer and seller of securities are engaged.

Commercial Creditors: financial institutions and individuals who have granted financing to a sovereign on commercial terms and are entitled to repayment.

Commercial Paper: Short-term, unsecured debt usually issued by corporations.

Communications Advisors: Advisors specialized in media and communication, collaborating with financial and legal advisors, ensuring effective, credible, and transparent communication on a country's debt situation.

Conditionalities/Adjustment Programs: Conditions or policies that a borrower commits to implementing in exchange for financing.

Confidentiality/Non-Disclosure Provisions: Clauses in loan agreements that restrict the disclosure of certain information to third parties.

Cost-Benefit Analysis: A systematic approach to evaluating the potential benefits and costs of a decision or project, often used to assess the sustainability of debt and lending practices.

Covenants: Legal obligations or promises to do or not to do something made in loan agreements.

Credit Ratings Agencies (CRAs): Agencies assigning credit ratings to sovereign bond issuers and specific bond issues.

Creditor: A person or institution to whom money is owed.

Currency Mismatch: A situation where the currency in which debt is repaid differs from the currency in which funds are received.

Customisation: The ability to tailor financial instruments to meet specific requirements.

Debt Crisis: A situation where a country struggles to meet its debt obligations, leading to economic instability and potential financial crises.

Debt Finance: The option for a government to borrow funds from the loan or capital markets.

Debt Management Framework: A set of rules and guidelines assisting government authorities in maintaining sustainable levels of debt. It involves designing and implementing a diversified debt management strategy considering factors like maturity risks, interest rate risks, and exchange risks to prevent issues that could make the debt unsustainable.

Debt Management Strategy: A strategy considering short, medium, and long-term objectives, analysing the needs of each financing agreement, coordinating with other domestic and external borrowings, and aligning with the macroeconomic policies of the country.

Debt Portfolio: A comprehensive collection of a country's debts, comprising several types of creditors, each with distinct legal structures, objectives, and approaches.

Debt Recording: The process of accurately recording and monitoring debt management operations.

Debt Restructuring: The process of reorganizing or modifying the terms of a debtor's outstanding debts, often involving negotiations with creditors to alleviate financial strain and restore economic stability.

Debt Service: The total amount of principal and interest payments required to meet contractual obligations on a debt over a specific period.

Debt Sustainability Analysis (DSA): An assessment to determine whether a country's debt levels are manageable

over the long term, considering economic, fiscal, and financial factors.

Debt Sustainability: The ability of a debtor to meet its debt obligations without jeopardizing its economic stability and growth.

Debt Transparency: The action of making information about a country's debt, including its terms and conditions, publicly available.

Decision-making Process: Transparent procedures for approving debt and guarantees by governmental institutions, involving legislative branch approval through laws and formalities.

Dematerialized Bonds: Bonds held and traded electronically, without physical certificates.

Depository: An institution that holds and safeguards financial assets on behalf of others.

Derivatives Markets: Markets for derivatives, i.e. financial instruments whose value is derived from an underlying asset.

Derivatives: Financial instruments whose value depends on the value of another underlying financial instrument.

Domestic Debt: Debt owed within the country, subject to the laws and jurisdiction of that country.

Domestic Market Development: The process of building and strengthening domestic financial markets to reduce exposure to exchange rate risks and shift capital to domestic developments.

Domestic Securities Market: The marketplace where government securities are bought and sold within a country.

Dynamic Roll Over: A continuous assessment and renewal process of debt, considering changing economic conditions, to ensure it remains sustainable and manageable for the borrower.

Equity: Ownership interest in a company represented by shares.

ESG Bonds (Environmental, Social, Governance Bonds): Bonds issued to raise funds for projects that have positive environmental, social, and governance impacts, with a focus on accountability in using the funds for the intended purpose.

Eurobonds: Bonds issued in a currency other than that of the issuer, often with a maturity of more than 20 years.

Ex-ante and Ex-post: Latin terms meaning "before the event" (ex-ante) and "after the event" (ex-post), used to distinguish actions taken as preventive measures or responses after an event has occurred.

Exchange Rate Risks: Risks associated with changes in currency exchange rates, considered a drawback when taking loans in foreign currency.

External Debt: Debt owed to non-residents of the country, subject to foreign laws and jurisdictions.

Financial Advisors: Professionals with expertise in macroeconomic and financial aspects hired to assist governments in strategic borrowing, risk mitigation, liability management, and market access.

Financial Markets: Different markets or platforms where parties issue or trade financial instruments, including stocks, bonds, commodities, foreign exchange, derivatives, etc.

Fiscal Policy: The use of government revenue and expenditure to influence the economy.

Fragile States (FS): Nations characterized by low levels of administrative capacity and a fragmented rule of law, often leading to challenges in governance and economic stability.

G20 Operational Guidelines for Sustainable Financing (G20 Guidelines): Guidelines issued by the G20 in 2017, including a chapter on transparency and disclosure of information related to lending practices.

Good Faith Negotiation: Negotiations conducted with sincerity, honesty, and a genuine intention to reach a fair and mutually acceptable agreement which, in the context of debt restructuring, requires engaging creditors early in the process.

Good Lending Practices: Ethical and responsible approaches adopted by creditors, including comprehensive risk analyses, to ensure sustainable lending practices and avoid over-lending to high-risk countries.

Governance and Strategy Development: Aimed at coordinating executive and legislative branches of government to promote decision-making processes, accountability, transparency, and proper delegation of debt management responsibilities.

Governance Diagnostic Assessment: An evaluation, often conducted in collaboration with international organizations like the IMF, aimed at assessing a country's governance framework, including the rule of law, to identify strengths and weaknesses.

Governance: The process and structure used to direct and manage an organization or a country.

Governing Law: The legal system under which debt obligations (mostly bonds or loans) are issued, influencing the ability to manage debt in distress scenarios.

Highly Indebted Poor Country (HIPC) Initiative: A program, developed by the World Bank and IMF in the 1990s, aimed at helping economically struggling African countries manage debt through low-interest loans, providing debt relief to alleviate sovereign debt burdens.

IIF Voluntary Principles for Debt Transparency (IIF Transparency Principles): Voluntary principles established by the Institute for International Finance (IIF) in 2019 to enhance transparency in financial transactions involving sovereigns, especially in low-income countries.

IMF Lending Policies: Guidelines and principles set by the International Monetary Fund (IMF) governing the conditions and terms under which it provides financial assistance to member countries facing economic challenges.

Information Asymmetry: A situation where one party in a transaction possesses more or better information than the other, leading to an imbalance in knowledge and potential disadvantages for the less-informed party.

Interest Rate Swap: An agreement where parties exchange interest rate payments to manage exposure to interest rate fluctuations.

Intergenerational Problem: A situation where future generations bear the burden of liabilities incurred by previous generations.

International Financial Institutions (IFIs): Organizations like the IMF and World Bank that benefit from a global membership and offer development loans to countries.

Investor Base: The range of individuals and institutions that invest in financial instruments.

Legal Advisors: Professionals specializing in legal aspects of debt financing, regulatory frameworks, and negotiations, playing a crucial role in debt restructuring and risk assessment.

Lenders: Entities providing funds through loans (or purchasing bonds, although most commonly referred as bondholders), expecting repayment.

Lending into Official Arrears Policy (LIOA): An IMF policy that allows lending to countries in official arrears, particularly when official sector involvement is deemed necessary. LIOA provides a framework for determining whether the Non-Toleration Policy (NTP) should be applied to specific IFIs.

Liquidity: The ease with which an asset can be bought or sold in the market without affecting its price.

Loan Markets: Markets for raising capital through loans, differing from capital markets in the tradability of instruments.

Loans: Borrowed funds that need to be repaid over time, often with interest, negotiated based on the borrower's specific needs and not meant to be traded.

Macroeconomic Indicator: A variable or measure that provides insights into the overall performance of an economy.

Macroeconomic Stability: The overall stability of a country's economy concerning factors like inflation, unemployment, and economic growth.

Master/Global Bond: A single document representing the entirety of a bond issuance.

Medium-Term Debt Management Strategy (MTDS): A strategy created by the World Bank and the IMF, linking borrowing with macroeconomic policy to help countries design a debt portfolio reflecting cost and risk preferences while managing exposure to debt.

Money Markets: Markets for short-term borrowing and lending, dealing with short-term maturity highly liquid assets.

Multilateral Debt Relief Initiative (MDRI): An initiative, complementing HIPC, focused on providing debt relief to heavily indebted poor countries through various means, including low-interest loans.

Multilateral Institutions: Organizations involving multiple countries that collaborate on common objectives, often providing financial assistance and development support. Examples include the IMF, World Bank, and regional development banks (the notion of IFIs is broader as it encompasses multilateral institutions and others).

Multilateral Lending: Financial assistance provided by multilateral institutions, often subject to strict conditions, procedures and policies regarding transparency and accountability as these loans are concessional in nature.

National Development Strategy (NDS): A strategic plan outlining a country's priorities and goals for development.

Negotiability: The quality of being easily traded without encumbrance or conditions.

Non-Toleration Policy (NTP): An IMF policy to restrict certain aspects of debt relief in instances where arrears are owed to IFIs.

Official Sector Involvement (OSI): A component of IMF lending policies involving the participation of official creditors, typically IFIs/multilateral institutions, and bilateral lenders, in the debt restructuring process of a sovereign borrower. This is considered when debt sustainability needs to be restored.

Paris Club: An informal group of creditor countries, established in 1956, that collaborates to address debt-related issues of debtor countries. The Paris Club provides a forum for negotiations on debt restructuring.

Plurilateral Creditors: Emerging international financial institutions with characteristics between multilateral and private commercial creditors. Their treatment during debt restructuring is a complex issue due to their alleged preferred creditor status.

Political Risk Insurance: Coverage protecting investors, including governments or corporations, against financial loss due to political events, such as expropriation, political violence, or changes in government policy.

Primary Market: The market where newly issued securities are sold for the first time.

Private International Law: Legal rules and principles that apply to cases involving parties from different countries.

Private Sector Involvement (PSI): Another facet of IMF lending policies focusing on the engagement of private sector creditors in the debt restructuring efforts. This is applied when the restoration of debt sustainability does not necessitate official sector involvement.

Procurement Practices: Transparent, objective, and competitive procedures for hiring advisors, ensuring fairness and adherence to regulations.

Registered Bonds: Bonds whose ownership is recorded in an official registry.

Repayment: The process of returning borrowed funds, including interest, to the lender.

Rule of Law: A principle that emphasizes the equality of all individuals before the law, requiring that everyone, including government officials, is subject to and governed by impartial courts.

Secondary Market: The market where existing, previously issued securities are bought and sold.

Secured and Unsecured Debt: Debt instruments with or without collateral, impacting credit risk and recovery avenues.

Securities Regulators: Regulatory bodies overseeing the capital markets and securities trading.

Securities: Tradable financial instruments, such as stocks and bonds.

Seigniorage Power: The power of a sovereign to issue currency, allowing it to print money to pay off debts.

Shared Responsibility: A collaborative approach involving all stakeholders, including borrowers and lenders, to collectively address and manage issues such as debt sustainability, governance, and accountability.

SOEs (State-Owned Enterprises): Companies or organizations in which a government owns a sizeable portion of the shares.

Sovereign Debt Management: The process of establishing and executing a strategy for managing a government's debt, aiming to raise required funding, achieve risk and cost objectives, and meet other debt-related goals.

Sovereign Debt: Debt incurred by a government, typically through borrowing from financial markets.

Sovereign Finance: The management of a state's financial resources to provide essential services to its citizens.

Sovereignty: The supreme authority or power of a state or governing body to govern itself.

Special Drawing Rights (SDR): An international monetary reserve asset created by the IMF to supplement its member countries' official reserves.

Stock Markets: Markets where corporate shares (equity) are bought and sold.

Syndicate Lending: A group of banks pooling funds to offer a single lending arrangement to meet borrowers' funding needs and diversify risk.

Transferability: The ease with which a financial instrument can be transferred to another party.

Transparency: Making information publicly available for scrutiny.

World Bank's Debt Management Performance Assessment: A program initiated by the World Bank in 2007 aimed at assisting developing countries in enhancing their debt management abilities.

Yearly Borrowing Plan: A plan developed annually, considering the budget for the fiscal year, and aligning with the objectives of debt management to meet the country's financing needs, reduce funding costs, and ensure compliance with payment obligations.

GOVERNANCE AND TRANSPARENCY DEBT GUIDE

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African Legal Support Facility I Facilité africaine de soutien juridique
Immeuble du Centre de commerce International d'Abidjan CCIA,
Avenue Jean-Paul II, 01 BP 1387 Abidjan 01, Côte d'Ivoire
www.alsf.int

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