ALSF SOVEREIGN DEBT KNOWLEDGE PRODUCT AND CAPACITY BUILDING PROJECT: PRE-CRISIS AND CRISIS MANAGEMENT DEBT GUIDE

CONTRIBUTING AUTHORS

IAN CLARK, MELISSA BUTLER AND DIMITRIOS LYRATZAKIS

at White & Case LLP

Disclaimer

This Debt Guide is the product of its author(s). None of the views expressed in this Debt Guide necessarily represent the views of any of the institutions and organisations (or their respective governors, directors, managers, partners, associates, and/or clients) where each author works. This Debt Guide is intended as an initial guide and does not contain definitive financial or legal advice. Readers considering any of the issues discussed in this Debt Guide should seek advice at an early stage from their respective advisors.

ABOUT THIS GUIDE

The Debt Guide on Pre-Crisis and Crisis Management (the "**Debt Guide**") is divided into four parts.

Part I provides an overview of the sovereign debt landscape, examining both the types of sovereign creditors and the different classes of debt incurred by sovereigns generally, and the evolution of the creditor and financing composition in Africa in particular.

Part II focuses on pre-crisis debt management and outlines how a sovereign can best position itself at the pre-crisis stage to deal with a potential debt crisis. To that end, it highlights considerations in contract design and borrowing structures more broadly, the importance of a sound and transparent debt management framework, and regular liability management tools that can improve the sovereign's debt profile at the pre-crisis stage.

Part III, focuses on the considerations, strategies and techniques for dealing with an impending debt crisis and conducting a pre-emptive or post-default debt restructuring in an orderly manner.

Part IV discusses the effectiveness of the existing framework for crisis management, identifying challenges therein and opportunities ahead.

A few caveats ought to be mentioned. This Debt Guide is not intended as legal advice and does not and cannot account for facts and circumstances of any particular sovereign, as ultimately every country's debt challenges and debt management needs are different. That being said, we believe that this Debt Guide can offer debt managers and policy makers sound guidance on general considerations and best practices relevant to debt crisis management.

TABLE OF CONTENTS

Part I: The Sovereign Debt Landscape

1. The Sovereign Creditor Composition
2. The Sovereign Debt Composition
3. Evolution of debt and creditor composition in Africa

Part II: Pre-Crisis Debt Management

1. Building institutional capacity: importance of debt management and debt management frameworks
2. Thinking ahead: building resilient debt structures and portfolios
3. Planning ahead: managing debt portfolios through liability management transactions

Part III: Crisis Debt Management

1. Causes of debt distress and understanding the type of crisis
2. Sovereign debt restructuring process and timeline at a glance
3. Sovereign default and the importance of early engagement
4. Central role of the International Monetary Fund in crisis resolution
5. Designing the restructuring plan: fundamental considerations
6. Institutional debt relief initiatives
7. Restructuring External Debt: Methods and Considerations
8. Restructuring Domestic Debt: Methods and Considerations

Part IV: Conclusion and Evaluation of Current Debt Resolution Framework

Annex I: A Step-by-Step Approach to Pre-Crisis Debt Management

Annex II: A Step-by-Step Approach to Debt Crisis Management

Annex III: Useful Resources

Annex IV: The IMF Debt Sustainability Frameworks

Annex V: The IMF Arrears Policies

Annex VI: The Comparability of Treatment Principle

Annex VII: Certain Standard Contractual Provisions

Annex VIII: Value Recovery Instruments and SCDIs in Sovereign Debt Restructurings

Annex IX: Key features of Past Sovereign Debt Restructurings

Annex X: Application of Restructuring Techniques in Eurobond Restructurings

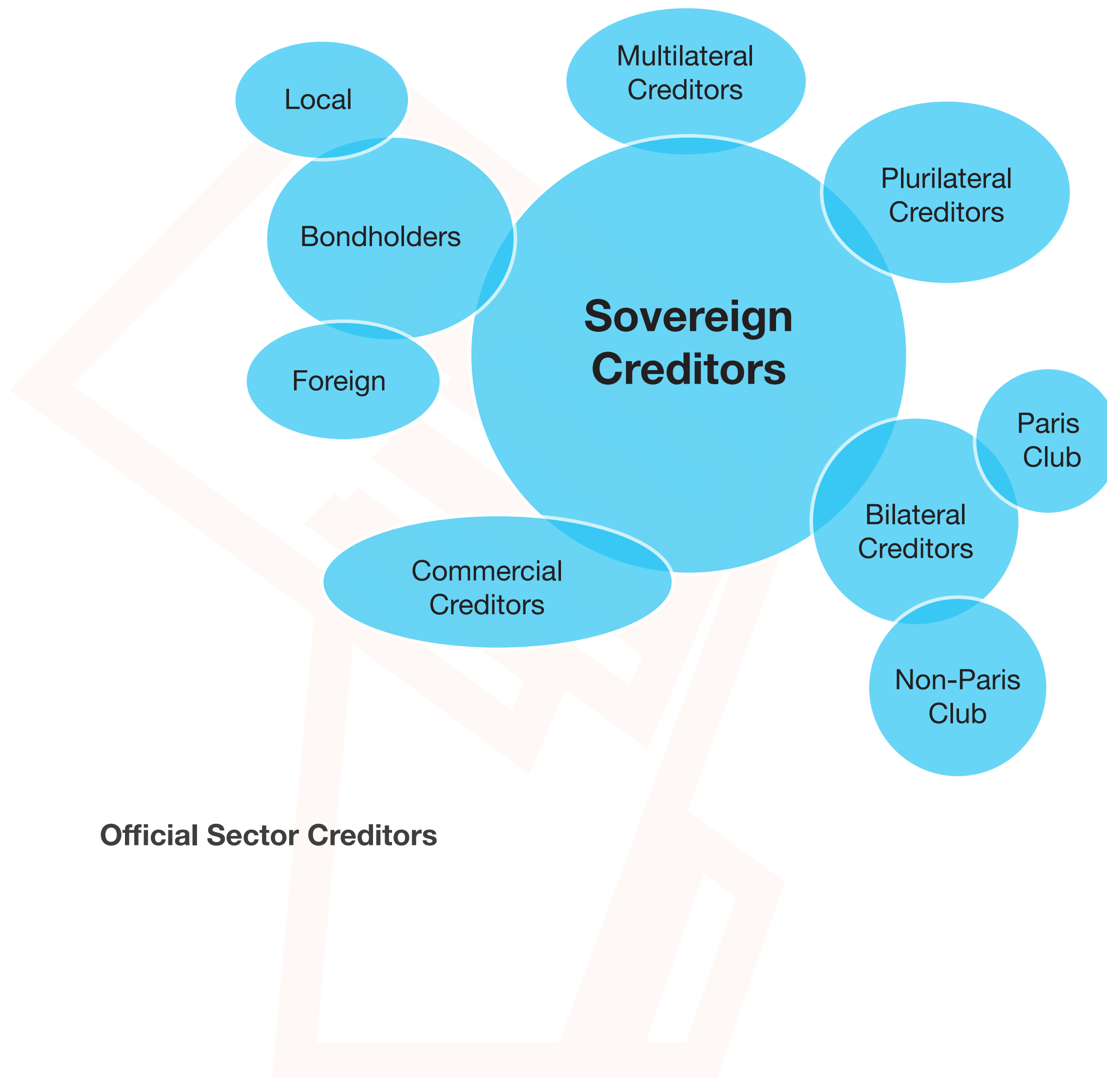
PART I: THE SOVEREIGN DEBT LANDSCAPE

Most countries around the world borrow money from a range of creditors, official and commercial, international and domestic, as part of their regular fiscal policy. The power to incur public debt provides governments with an essential tool for financing budget deficits, investing in long term projects aimed at promoting economic growth and development and smoothing the economic cycle by increasing state expenditure during economic downturns. The underlying logic of public borrowing is that the funds borrowed to finance public expenditure and public investment will ultimately be repaid from future government revenue streams, including revenue streams generated by higher growth rates facilitated by the borrowings themselves.

For lower income countries, public debt serves to support crucial developmental objectives such as investments in education, infrastructure health and power. This section lays out the sources and types of public debt typically incurred by a sovereign. While "public debt" may encompass debt incurred by all public sector entities, "sovereign debt" for the purposes of this Debt Guide shall refer to debt incurred directly by the central government or governmental agencies, or debt of public sector entities guaranteed by the central government.

1. The Sovereign Creditor Composition

Governments borrow from a variety of sources. Sovereign creditors are broadly divided into official sector creditors (comprising multilateral, plurilateral and bilateral lenders) and private sector creditors (comprising bondholders and commercial lenders). In addition, central banks occasionally provide credit to governments.



Official Sector Creditors

Multilateral and Plurilateral Creditors

Multilateral creditors are treaty-based organisations whose memberships comprise sovereign states and whose principal objectives are to promote, finance and support important public policy objectives. Multilateral Development Banks ("**MDBs**"), such as the World Bank and the African Development Bank (the "**AfDB**"), have a mandate to provide financing aimed at reducing poverty and advancing sustainable economic and social development goals.

The International Monetary Fund (the "**IMF**") is a multilateral institution mandated to promote international monetary and financial stability, through monitoring member countries policies, providing financial assistance to address balance of payments problems under adequate safeguards, and providing capacity development assistance to help member countries build better economic institutions and debt management frameworks and practices.

Multilateral creditors are governed by their relevant legal and policy frameworks, and may provide financing either through grants or loans on concessional terms (being loans with financial terms, including maturity and interest rate, which are more favourable than those available from the private markets).

Plurilateral creditors differ to multilaterals primarily in two respects: scope of membership and lending policies. In contrast to multilateral creditors, plurilateral creditors' membership is typically regional rather than global and often includes non-official sector members, such as central banks, government agencies and private shareholders. Most significantly, plurilateral institutions typically lend on terms which are either not as concessional as multilateral lenders or which approximate those available in the commercial market. The kinds of projects in which plurilateral lenders may become involved are also broader than those which multilateral lenders can typically support, and can include general budgetary support as well as project-specific support.

Bilateral Creditors

Bilateral creditors are sovereign governments (or government agencies) which lend to other sovereigns. Bilateral creditors can be broadly categorised as traditional ("**Paris Club**") bilateral creditors and non-traditional ("**non-Paris Club**") bilateral creditors.

Paris Club and Non-Paris Club creditors primarily differ in their financing objectives and the terms and structures used for delivering budgetary support and/or development assistance to other countries.

- Paris Club Bilateral Creditors

The Paris Club is a group of official bilateral creditors that has met regularly in Paris since 1956 and considers the debt of developing and emerging countries. Paris Club bilateral creditors focus on long-term debt sustainability, and can lend on either concessional and non-concessional terms. Paris Club creditors usually make their lending conditional on adoption of initiatives or policies aimed at fostering institution-building and governance.

There are currently 22 permanent members of the Paris Club: Australia, Austria, Belgium, Brazil, Canada, Denmark, Finland, France, Germany, Ireland, Israel, Italy, Japan, South Korea, the Netherlands, Norway, the Russian Federation, Spain, Sweden, Switzerland, the United Kingdom, and the United States of America.

- Non-Paris Club Bilateral Creditors

Emerging, non-Paris Club bilateral creditors are becoming increasingly important as providers of both concessional and non-concessional financing to borrowers on the African continent. These countries may provide financing to developing countries directly, or through government agencies, state-owned banks, and other entities.

In contrast to Paris Club creditors who generally seek to promote or support macro-policy objectives when extending financing, these official creditors tend to focus on micro-sustainability of individual projects. Rather than providing the government with direct budget support, these creditors concentrate on lending to certain sectors of the economy, such as the infrastructure sector. Non-Paris Club creditors usually do not attach any broad conditionality to their lending.

The largest non-Paris Club creditor in Africa is China, while other major creditors include India, South Africa, Brazil and Saudi Arabia.

Please also refer to the **ALSF Debt Guide on Key Considerations for Incurring Non-Traditional Debt.**

Private Sector Creditors

Bondholders

The international and domestic capital markets have emerged as an important source of private sector financing for all sovereigns, leading to the emergence of new classes of creditors holding bonded debt.

Local (resident) bondholders. Where a domestic capital market exists, this is often an attractive source of financing for the sovereign. Domestic banks and other institutional investors (such as pension funds and insurance companies) are typically the largest category of investors in domestic debt, i.e., local treasury bonds and treasury bills.

Foreign (non-resident) holders of local debt. Specialised international institutional investors (e.g., pension funds, hedge funds, and asset managers) looking for exposure to domestic debt (often denominated in local currency)

are increasingly participating in local debt markets. In contrast to local bondholders, foreign investors may be more inclined to sell their investments in anticipation of or during a crisis, which can accentuate liquidity and other problems for a sovereign at a moment of vulnerability.

International bondholders – primary market. Since the 1980s, the bulk of private financing for sovereigns has come through the issuance of international bonds – debt securities directly issued or guaranteed by sovereigns in the international capital markets that are governed by foreign law, typically the laws of New York or England. At the time of issuance, these securities are issued in the "primary market" at a price close to, or at, "par" (i.e., at or close to the bonds face value) to a range of non-resident financial institutions, including pension funds, hedge funds, and asset managers. Primary market participants, who purchase the bonds at or near par value, tend to take a long-term view on their investment and to be repeat purchasers of the government's international bonds. "Index-tracking" funds seek to mimic in their own bond portfolios the composition of leading emerging market bond indices (like the JPMorgan Emerging Market Bond Index), meaning that if a particular sovereign bond issuance meets the criteria for index inclusion, then the index-tracking fund is required to hold such bond in its portfolio.

Institutional bondholders hold the securities in their respective investment portfolios so as to receive periodic payments of principal and interest on the securities. They sometimes sell their bonds in the secondary market based on their portfolio needs or to minimise capital losses (when the security has declined in value) or to crystallise capital gains (when the security has appreciated in value).

International bondholders – secondary market participants. International bonds are typically listed on international securities exchanges and are freely tradable in the "secondary market". Bid and ask prices for these securities are quoted on a variety of platforms and/or by market makers, and ordinary trading of sovereign bonds is facilitated through major international banks and other financial institutions. Many specialized investors who did not purchase bonds in the primary market can thus purchase the bonds at market prices in the secondary market. These secondary-market investors play an important role in providing liquidity to the market. Certain specialized investors only purchase sovereign bonds in the secondary market when the bonds are trading at a significant discount to par, in anticipation of making a return on their investment when the price of the debt security subsequently improves.

The behaviour of international bondholders when a sovereign issuer faces distress can vary depending on the size and structure of their portfolios, their investment objectives, the type of bonds they hold, and the price at which they purchased the bonds. It is therefore critical for sovereign issuers to understand the composition of their bondholders, and appreciate their differing motivations and objectives, particularly in a time of crisis, where secondary market investors – both in domestic and international markets – may behave differently than primary market investors.

Commercial Lenders

Private sector domestic and international financial institutions and other commercial creditors offer an important alternate source of financing to sovereign borrowers. Commercial lending, usually in the form of syndicated or bilateral loans and guarantees, is not concessional or policy-based financing but is offered on market terms agreed by negotiation between the sovereign debtor and commercial creditor. Bank syndicates were the most prominent providers of private sector financing to governments until the late 1980s, when bonds overtook loans as the primary source of private credit in emerging and advanced economies. Banks remain an important source of financing in countries with limited access to international capital markets.

Loans provided by a small group of banks with a longstanding relationship with the sovereign, and an intention to keep the loan on their books to its maturity, are sometimes also called "club loans". In the case of a syndicated loan, one or more banks will act as the arrangers of the financing, bringing other banks into the transaction. Commercial bank financings have been historically described as "London Club" financings.

2. The Sovereign Debt Portfolio

Multilateral Financing

Multilateral loans are typically provided within the context of a development or other policy objective including addressing balance of payment problems. The advantage of such loans is that the financial terms are usually significantly below the market rate that the borrower would receive from commercial lenders, which is known as "concessional" lending.

MDBs typically provide financing in the form of grants or in the form of loans that can be extended on a spectrum of terms from the most concessional to the least concessional. The terms offered to a particular sovereign borrower will typically depend on a range of quantitative and qualitative factors including gross national income and a determination as to whether the borrower is able to access the international capital or financial markets.

Multilateral lenders that provide these policy and development-oriented loans typically regard them as public international law transactions, as opposed to private international law transactions. This is often reflected in the provisions on governing law and jurisdiction, and in the expectation (often not documented) of the lenders to be given priority in repayment over private sector lenders.

The IMF holds a special position amongst multilateral institutions providing financing. The IMF, with a mandate to promote international monetary and financial stability, provides financial assistance to help its member countries address balance of payment problems under adequate safeguards. The IMF's various financing instruments are tailored to address different types of balance of payments problems. Low-income countries ("**LICs**") may borrow on concessional terms through facilities available under the IMF Poverty Reduction and Growth Trust ("**PRGT**"). The Extended Credit Facility ("**ECF**") is the main tool for providing medium-term support to low-income countries facing protracted balance of payments problems, while the Extended Fund Facility ("**EFF**") is the tool to provide financing to IMF members facing serious medium-term balance of payments problems due to structural weaknesses. Standby Arrangements ("**SBAs**") are a source of financing assistance to help members address short-term balance of payments problems. Provision of financing under these facilities and instruments is governed by the IMF's legal framework and relevant policies relating to, e.g., access, conditionality, debt sustainability, and financing assurances, which is further explained in Part III of this Debt Guide.

Plurilateral financing

Plurilateral loans are typically provided on terms that are less concessional (i.e., close to private market financing

terms) than funding provided by multilateral financial institutions. Plurilateral lenders, whose shareholders are often the debtor countries they are lending to, typically have lower credit ratings than multilateral lenders, which means their own cost of funding is significantly higher. Often these loans are provided to sovereign borrowers or their state-owned entities in situations where multilateral and/or bilateral financing is not available, and where private sector financing is not available either because of political risk or other considerations.

Bilateral Financing

Bilateral loans are typically negotiated directly between the debtor country and the official bilateral creditor. This debt can be either (i) deeply concessional, also known as Official Development Assistance ("**ODA**"), or (ii) on less or non-concessional terms, simply known as "non-ODA" debt.

Non-ODA debt is often extended in the form of loans between a government agency or state-owned enterprise ("**SOE**") on the borrower side and, on the creditor side, a commercial entity (often a commercial bank or syndicate of commercial banks) that benefits from a full or partial guarantee from the official creditor's export credit agency ("**ECA**"). Once the guarantee is called, the guaranteed portion of the debt (typically 80%) becomes a claim of the ECA and is treated as direct bilateral, government-to-government debt.

Bilateral financing from Paris Club lenders is typically documented in a relatively straightforward manner, incorporating a limited number of contractual provisions beyond the core commercial terms and "use of proceeds" language. By contrast, the documentation of bilateral loans extended by some non-Paris Club creditors, including China, may include more elaborate repayment safeguards and mechanisms compared to Paris Club loans. These additional provisions can include (i) repayment mechanisms providing the lender security or quasi-security (as discussed in the "Secured and quasi-secured lending" section below), (ii) express terms stipulating that the loan is to be excluded from any debt restructuring of official bilateral claims, (iii) strict confidentiality clauses and (iv) information delivery requirements, such as the requirement to provide to the creditor the same information provided to the IMF. These additional provisions arguably provide a higher degree of contractual protections for such loans over traditional Paris Club loans, and as explained below may complicate the restructuring of the relevant loans.

Commercial Loans

Commercial loans provided by domestic financial institutions are typically governed by the domestic law of the relevant sovereign, while commercial loans, provided by foreign financial institutions, are usually governed by foreign law, typically English or New York. Loans in each case may be denominated in either domestic or foreign currency. The choice of domestic or foreign law can have important legal consequences for both lender and borrower in circumstances where the borrower is facing financial distress, not least because of the theoretical ability of a sovereign government to make changes to domestic law that could affect contractual terms.

Sovereign Bonds

Bonds are debt instruments, constituted by underlying debt contracts, evidencing the payment obligation owed by the sovereign borrower (as the issuer of the bonds) to the bondholders.

Bonds are issued either privately to a group of investors (through a "private placement") or publicly in the international capital markets. When the bonds are issued, they are typically issued in uncertificated "book-entry" form through the international clearing systems, who hold the bonds (directly or through custodians or nominees) for the benefit of the ultimate investors who purchase them. Once the bonds have been issued and allocated to investors, any subsequent trading will take place in the secondary market. Settlement of bond payments and secondary market trading is completed via the international clearing systems.

The large majority of sovereign bonds are structured as "fixed income" instruments. Bond investors provide financing to the issuer for a fixed period of time (until the bond's "maturity"), in an amount equal to the bond's principal amount, and in return typically receive an interest payment, usually calculated by reference to a fixed "coupon" (a specified percentage) of the face value of the bond. Repayment of the principal of the bond occurs either upon maturity in a single ("bullet") payment or pursuant to an agreed amortisation schedule. An advantage of bonds is that the use of proceeds is typically general budgetary purposes, allowing sovereigns to use this financing to fund budget deficits or other government priorities without the requirement that the proceeds be specifically linked to projects (a requirement of most other types of financing).

The sovereign bond markets have evolved to introduce a range of non-fixed income payment structures to cater to the needs of sovereign issuers and the preferences of different investors, and sovereign bonds are nowadays typically rated by one or more credit rating agencies.

- **Domestic bonds**: domestic bonds are bonds governed by the sovereign's own domestic law, and can be denominated in either local currency or foreign currency. They come in the form of treasury bills (short-duration bonds) or treasury bonds (longer duration bonds). Domestic bonds typically have very little, if any, documentation.

- **Foreign bonds**: foreign bonds (or "international bonds" or "Eurobonds") are bonds governed by the law of a foreign jurisdiction, usually New

York or England, and can be denominated in any currency – though the majority of international bonds are denominated in US dollars or Euros.

- **Bond structures**: while traditionally issued in fixed-income form, bond payment structures have continued to evolve to allow issuers to reach an even more diverse investor universe. Among others, such structures include (i) commodity-backed bonds (where payments are derived from the price of a specified commodity), (ii) inflation-linked bonds (where payments are linked to inflation levels to protect investors against unpredicted inflation risks during the life of their investment), (iii) project bonds (whose proceeds are used to finance or refinance a specific infrastructure project and the principal source of repayment is revenues generated by the project), (iv) "green", "blue" and sustainability-linked bonds (which are respectively earmarked for climate/environmental and marine/ocean-based projects or structured to promote social or development goals). Please also refer to the **ALSF Debt Guide on Sustainability Financing.**

Secured and quasi-secured lending

Secured and quasi-secured lending in Africa has increased as a subset of sovereign loan financing, particularly from plurilateral, non-Paris Club official and commercial creditors.

- **Secured lending**

Traditionally, most sovereign lenders extend loans on an unsecured basis, and rely on the government's "full faith and credit" undertaking to repay the relevant obligations.

Secured or collateralized lending is lending where specific assets are pledged as security/collateral for the debt and can be attached by the lender in case the sovereign debtor fails to honour its obligations. There is a wide spectrum of sovereign assets that could theoretically be pledged as collateral, including infrastructure assets, gold reserves, tax revenues, receivables, oil and mining royalties, shares in project companies, and so on.

Secured lending can take many forms and the type of structure often depends on the underlying asset that serves as collateral. Traditional security structures, for example, include mortgages over real estate assets, formal pledges of bank accounts or assignment of receivables. Other arrangements are referred to as "effective" security arrangements, and may include sale and leaseback contracts and forward sale contracts.

"Commodity backed lending" or "resource-backed loans" are a particular type of secured lending most prevalent in commodity-dependent economies whereby the repayment of the loan is either made in kind by natural resources (such as minerals or oil barrels), or from revenues generated by natural resource development and exploitation. These loans are collateralized either by the asset in question or by the revenue streams it generates.

An important distinction is drawn between *limited recourse financing* and *full recourse financing*. When a project is financed with a non-recourse or limited-recourse structure, the loan that is used to finance the acquisition or exploitation of an asset is repaid from the cash flow generated by the asset (e.g., oil revenues). Lenders have a claim against a special-purpose project company, and the claim depends primarily on the financial viability of the project – with no direct recourse to the sovereign if the project fails. In contrast, in a full recourse financing, the lender has a claim against the sovereign – often by way of a guarantee – to backstop the project loan.

While sovereign secured lending can take many forms, the granting of collateral is constrained in practice by the "negative pledge clauses" in debt contracts, including the standard terms of lending of the World Bank. With only limited exceptions, the World Bank Negative Pledge restricts the ability of a sovereign which is in receipt of World Bank loans to grant security over state assets in respect of foreign currency obligations owed to other lenders without providing the same or comparable security to the World Bank. Commercial debt agreements, including international sovereign bonds and loan agreements, also typically contain negative pledge clauses which constrain the ability of sovereign borrowers to grant security in favour of other lenders outside a list of enumerated exceptions.

Collateralized lending raises important issues for the sovereign borrower, which are further discussed in Part III of this Debt Guide.

- **Revenue accounts and quasi-security arrangements**

In recent years some "quasi-security" arrangements have been employed by some bilateral, plurilateral and commercial lenders where the sovereign borrower is required to maintain a designated, funded offshore bank account (typically with a bank that is either chosen by or acceptable to the lender). Per the terms of the relevant loan agreement, the lender is empowered, in certain circumstances, to apply the outstanding balance in such designated bank account to offset the sovereign's debt service obligations. As such, the funds in the offshore account serve effectively as cash collateral for debt repayment without requiring a formal security arrangement. Often, the lender will require that the account always have a minimum balance sufficient to cover certain specified payments (i.e., one year of principal and interest payments).

These quasi-security arrangements may or may not create issues under negative pledge clauses in other sovereign lending contracts depending on how they are drafted, but in any event, they can have significant inter-

creditor implications when the debt obligations of the sovereign need to be restructured in a distress scenario – as discussed further below.

Guaranteed Debt and Contingent Liabilities

Contingent liabilities are potential obligations and claims that only become actual liabilities on the government's balance sheet upon the occurrence of a specified event.

Sovereign contingent liabilities can be defined to include: (1) explicit contingent liabilities arising out of express contractual undertakings such as guarantees and indemnities, (2) implicit contingent liabilities arising in respect of debt obligations of systemically important state-owned entities (e.g., major state owned banks or public utilities) that the government is likely to assume or cover, directly or indirectly, for reasons of political economy, (3) subnational liabilities (such as obligations of provincial or municipal governments), for which the central government may have budgetary responsibility and (4) litigation and arbitration claims which impose financial obligations on the sovereign.

A **guarantee** is the most common example of an express contingent liability, whereby the sovereign, as guarantor, guarantees to fulfil the debt obligations of the primary obligor (perhaps a state agency or state-owned entity) in the event of failure by the primary obligor to perform under the debt agreement. The relevant guarantee agreement will define the scope of the guarantee (i.e., the extent of the guaranteed obligations) and the trigger of the guarantee, which can be automatic or "on-demand", where the relevant creditor has to elect to trigger it.

Guaranteed debt has become a more widely-used sovereign financial tool in recent years because, by its very nature, it supports economic growth and development without directly impacting the sovereign's immediate liquidity or balance sheet. At the same time, however, it can pose unique risks to sovereign debt sustainability to the extent that the contingent liabilities associated with them are not adequately reported and accounted for in the sovereign's debt management framework.

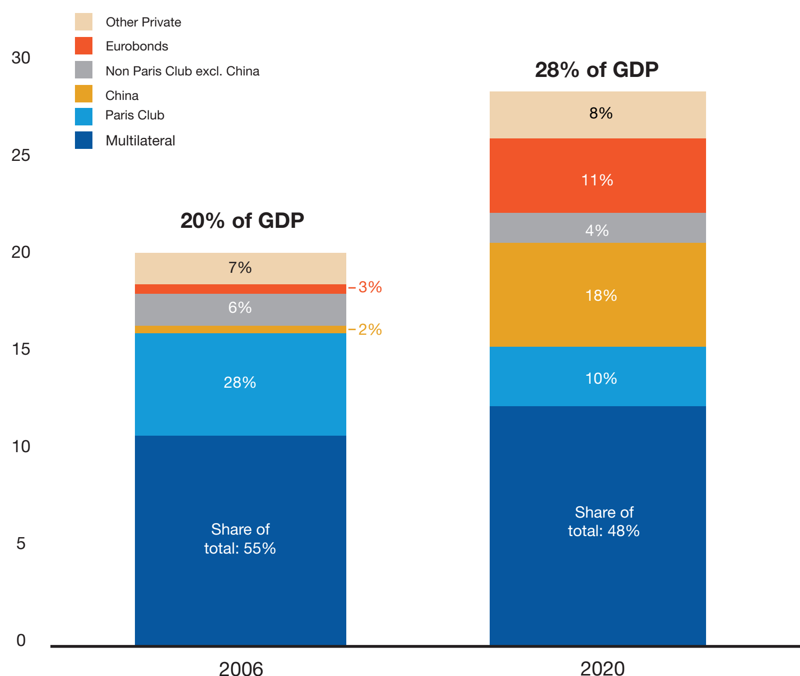
3. Evolution of debt and creditor composition in Africa

Historically, African sovereigns borrowed primarily from multilateral and Paris Club bilateral creditors, who were willing and able to lend at low rates to underdeveloped countries with weak institutional frameworks in an effort to promote sustainable development. More recently, African countries have been availing themselves of new borrowing avenues, especially from the private sector, both because such avenues are becoming increasingly available to African countries as their economies have improved and because traditional sources of official lending have proven insufficient to meet the needs of growing economies.

African sovereign borrowers have found it increasingly difficult in recent years to secure the financing needed to support their key development objectives solely from the "traditional" multilateral and official bilateral lenders. In addition, the strict conditionalities associated with such lending have put constraints on the use of proceeds which have made it difficult for sovereigns to finance all the projects which they consider important. Other sources of financing have had to be found.

Recent years have seen African sovereigns increasingly turn to other sources of financing. These sources include private creditors, through issuances of bonds in both the international and domestic capital markets, as well as non-Paris Club creditors like China and "plurilateral" institutions with a regional lending focus. The range and complexity of financing structures, including ones supported by security and quasi-security, have also increased across the continent.

Evolution of Debt and Creditor Composition, 2006 to 2020, for low-income countries eligible to receive International Development Assistance



Source: International Monetary Fund, Questions and Answers on Debt Restructuring in Low Income Countries (Questions and Answers on Debt Restructuring in Low Income Countries (imf.org))

Private sector – debt capital markets

In the last 20 years, more than 20 African sovereigns have made their debut in the international capital markets with the issuance of international bonds (Eurobonds), in cumulative amounts that exceed $155 billion. The majority of these issuances have come from middle-income or resource-intensive sovereigns such as Nigeria, Egypt, South Africa, Zambia, Angola and Ghana.

African sovereigns increasingly tap the international capital markets as a source of financing. Between 2007 and 2020, 21 African countries issued bonds in the international capital market. However, the largest share of African Eurobond issuers have been the larger, more established economies; capital markets borrowing is not yet a continent-wide phenomenon.

At the same time, the development of domestic financial markets means that many African sovereigns can finance themselves, at least in part, through issuance of domestic debt. For some issuers, domestic debt markets account for nearly half of their public debt, and while domestic markets are still relatively undeveloped across the continent, they are set to play an increasingly large role in public finance.

Non-traditional lenders

Another alternative to traditional multilateral and official bilateral lending is lending from non-Paris Club creditors, in particular, China, India and Saudi Arabia.

The past two decades have seen a sharp rise in lending (both on fully concessional and less concessional terms) to African countries, as well as state-owned banks and government agencies, from non-traditional bilateral creditors, with China being the top lender.

Regional plurilateral creditors, including African Export–Import Bank (Afreximbank) and Trade & Development Bank also play an increasingly important financing role in the region.

Debt dynamics in the region

Over the last 10 years, low-income countries in general have experienced an increase in debt levels and debt service burdens. Certain factors have precipitated the rapid accumulation of debt in the African continent over this period of time, which among others include:

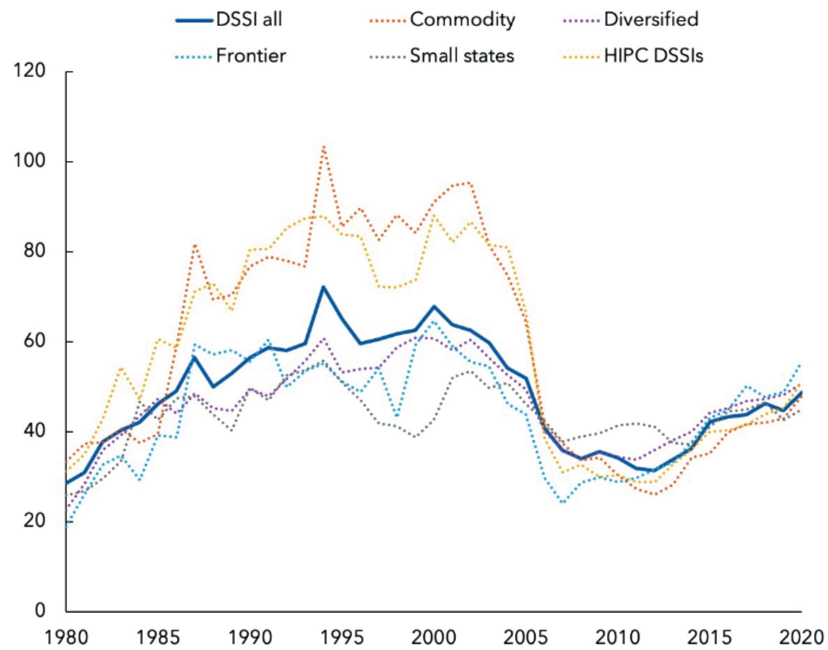
- Commodity exporters have suffered from fluctuations in commodity prices. The collapse of oil prices in 2013 exacerbated fiscal deficits and fuelled the accumulation of debt, while exchange rate depreciation against the US dollar increased the effective burden of debt service on foreign loans.
- Other economies saw increases in debt burdens as a result of increased spending and the financing of fiscal deficits.
- The COVID-19 pandemic fuelled rises in social

spending and exacerbated debt challenges across the region.

- Much of the debt incurred during the last decade was done so at historically low interest rates. As we move into a new era of substantially higher rates, there are worrying concerns about the ability of debtor countries to refinance much of the debt borrowed.

- As a result of the above, debt levels which had previously been reduced as a result of the HIPC initiative (discussed further below) have been on the rise since 2010, as indicated in the chart below.

Evolution of Public Debt to GDP since 1980, for low-income countries eligible for International Development Assistance



Source: International Monetary Fund, Questions and Answers on Debt Restructuring in Low Income Countries (Questions and Answers on Debt Restructuring in Low Income Countries (imf.org))

PART II: PRE-CRISIS DEBT MANAGEMENT

<

Effective Pre-Crisis Debt Management practices

- Building sound institutional capacity to incur, monitor, and manage public debt
- Designing crisis-resilient debt contracts and debt structures
- Managing sovereign debt portfolio through tailored liability management transactions

1. Building institutional capacity: importance of debt management and debt management frameworks

Public debt management is the process of establishing and executing a strategy for managing a government's debt. A comprehensive debt management strategy consistent with international best practices (as illustrated in the *IMF/WB Revised Public Debt Management Guidelines of 2014*) will (i) inform decisions regarding debt incurrence and debt policy design, (ii) establish procedures for sound debt authorization and monitoring, and (iii) establish processes and principles regarding accurate and timely debt reporting, transparency and accountability. For present purposes we focus on the management of central government debt, including both direct and contingent (including guaranteed) obligations.

To effectively implement a debt management strategy, a government should design and adopt a robust legal and regulatory framework, with well-defined and consistent laws and regulations codified in public debt and/or fiscal responsibility laws at the central and local government levels. The framework must provide clear authorization to incur debt, and set forth powers, roles, and responsibilities within the public debt management and borrowing process, with clear delegation of authority.

Armed with a robust and clear framework, a government can execute its debt management strategy, built on the following pillars:

Debt incurrence and medium-term debt management policy

Fundamentally, a debt management strategy will design the optimal debt portfolio that meets macroeconomic needs while limiting macroeconomic risks. In this regard the strategy will determine the desired *borrowing costs and risks of different instruments* in the portfolio, and the associated debt maturity structures, debt currency composition, interest rate structures, amortization profiles and so on.

Strategic decisions with respect to issuance of local debt also directly affect the development of domestic debt markets, defining their liquidity, depth and resilience.

To facilitate effective debt incurrence management, and mitigate against risks, the sovereign should set up procedures (applicable to each agency responsible for borrowing) that:

- ✓ Ensure the consistency of each transaction with the overall debt strategy and macro-framework
- ✓ Enable decision makers to holistically review the legal documentation pertaining to the debt transaction to ensure it complies with both local legislation and with the terms of existing obligations
- ✓ Limit any prospect of self-dealing and corruption

Debt monitoring and risk management

Embedded in the public debt portfolio are oftentimes complex and risky financial structures, generating substantial risk to the government's balance sheet and to the country's financial stability. An appropriate debt management strategy will therefore ensure that the risks associated with the incurred debt structures are properly monitored. The risks to be monitored and managed include:

- Market risk: changes in market conditions (e.g., interest rates or commodity prices) that affect debt servicing costs or conversely, that present opportunities to reduce such costs, either by refinancing the debt cheaply or even buying it back

- Exchange rate risk: changes in foreign currency exchange rates that affect debt servicing costs
- Refinancing risk and market access: when refinancing existing or maturing obligations, there is a risk that market access could be limited or only available at higher rates
- Liquidity risk: it may be difficult to convert illiquid assets to cash to cover government obligations promptly or cost-effectively
- Credit risk: a counterparty might fail to make required payments on time or in full
- Operational risk: poor debt recording and data keeping could result in under- or overpayment of obligations or an inadvertent missed payment

Debt transparency

An important aspect of debt management is the public disclosure of materially important aspects of debt incurrence and debt management operations. As a matter of sound governance, the legislature and the public, as well as all other domestic and external stakeholders, should be informed, through periodic reports, of the context in which debt management operates and the outcomes of the debt management strategy, particularly the outstanding stock and composition of the government's debt liabilities and financial assets, and, where they exist, contingent liabilities.

The quality of a government's debt transparency practices can have important effects on its reputation with key international stakeholders and affect the market's judgment of the government's financial management and competence, and ultimately its credit rating and risks.

Of particular importance is appropriate disclosure of special debt arrangements, such as collateralized debts and contingent liabilities. These types of financing are occasionally underreported, misreported, or unreported, posing serious risks to the sovereign. Misreporting of collateralized or guaranteed debts affects future borrowing and debt sustainability, as future lenders make lending decisions without having a clear understanding of the sovereign's existing debt composition or its ability to make debt payments. Such misreporting – creating effectively a hidden seniority structure – can lead to mispricing, overborrowing and ultimately complications in debt resolution.

Implementation of sound policies on debt transparency can prevent the unexpected emergence of "hidden debts," which greatly erodes perception of the government's debt management capacity and good faith from the perspective of key international stakeholders and market participants. "Hidden debts" can increase the likelihood of debt distress, complicate crisis resolution and cooperation among stakeholders, and jeopardize future borrowing from both private and official lenders.

Debt transparency is particularly important for sovereigns that have issued Eurobonds. Sovereigns that have listed bonds on a European stock exchange or the London Stock Exchange, for example, are subject to the EU Market Abuse Regulation or its UK equivalent, which require the sovereign issuer to ensure that information about it in the public domain is accurate and not misleading, and to disclose certain "inside information" about the sovereign or the Eurobonds that would be likely to have a significant effect on the price of the listed debt.

Investor relations

To enhance transparency with the investor community, debt management offices should establish investor relations capabilities and procedures. Best practices for investor relations include the formation of an investor relations office with a permanent staff, timely dissemination of data and information on economic and financial performance, and establishing regular and formal channels of communication with investors. A sound investor relations strategy paves the way for successful market interactions both at a pre-crisis stage and at a stage of distress. For international best practices in investor relations, see the **Annex III—Useful Resources—International Institute of Finance's Best Practices for Investor Relations**.

2. Thinking ahead: designing resilient debt contracts and debt structures

A sovereign's decision of what kind of debt to incur is usually driven by its immediate financial objectives and the requirements of its short- and medium-term debt management strategy.

An important consideration when deciding to issue debt, however, should be the risks associated with the structure at a time of distress. At the time of debt incurrence, the sovereign has the ability to incorporate legal terms and structures that will mitigate future risks relating to a potential debt restructuring.

A. Considerations in issuing Eurobonds

Sovereign bonds issued in the domestic or international markets are typically constituted by contracts whose terms define the legal relationship between the sovereign debtor and its bondholders.

While the terms of domestic bond contracts often include no more than the payment terms and the governing law (typically local law), the terms of internationally placed Eurobonds are more complex. Such terms have evolved over time to offer the issuer and the holders of the bonds alike certain assurances and protections with respect to performance of the bond contract. Ultimately – in the absence of a sovereign insolvency regime or regulatory mechanism to resolve debt crises – it is the terms of the bond contracts that determine the respective bargaining

power of the sovereign debtor and bondholders in a debt restructuring, and therefore define the contours of the debt crisis resolution.

From the perspective of the bondholder, bond terms should (and have evolved to) mitigate the risk that a sovereign will choose to default on the bondholder's debt when it is otherwise able to pay. To minimize this risk and to increase the marketability of the bonds, bond contracts include clauses that increase the cost of a default. These include: (1) events of default, (2) clauses limiting the sovereign's ability to provide preferential treatment to other creditors, and (3) enforcement clauses.

From the perspective of the sovereign, bond terms should (and have evolved to) mitigate the "renegotiation problem", namely the risk that the sovereign will be unable to renegotiate its debt obligations with its bondholders in situations where it is unable to meet its payment obligations.

The renegotiation problem has two aspects: on the one hand, it is practically difficult to negotiate with dispersed and anonymous bondholders, who may abstain from negotiations due to lack of knowledge or capacity or act in an uncoordinated way. On the other hand, certain bondholders, due to their specific investment objectives, may be inclined to pursue strategies aimed at obtaining repayment in full. Both situations may effectively jeopardize the timely and orderly conclusion of a renegotiation. Bond terms have therefore evolved to mitigate the renegotiation problem – most commonly known as the "collective action" problem – in sovereign bond restructurings. The terms that encourage collective action – and on the flip side limit opportunistic, individualistic action – are discussed further below.

Contract terms that protect creditors and strengthen enforcement

- **Choice of Governing Law and Jurisdiction.** Jurisdiction refers to the location where a sovereign agrees to be sued and governing law refers to the law that governs the contract and will be used to adjudicate any disputes thereunder. While sovereigns would always prefer to be sued in their domestic courts, and under their domestic law, which are typically more convenient, malleable and sympathetic, when targeting international investors, they agree to be sued in foreign jurisdictions with a reputation for objectivity in the enforcement of contractual terms (such as New York or London). They also agree that the bond contracts be governed by the law of the relevant foreign jurisdiction. The incorporation of foreign jurisdiction and foreign governing law offer significant protections to holders vis-à-vis the domestic alternatives, which are potentially vulnerable to change and manipulation at the behest of the sovereign.

- **Waiver of Immunity from suit, attachment and execution.** Under the modern principle of sovereign immunity embedded in public international law, states cannot be sued in court or ordered that their assets be seized to satisfy a private court judgment, subject to limited exceptions. Bond contract terms have evolved over time to include broad waivers of sovereign immunity from suit, attachment and execution, such that – subject to enumerated exceptions – a sovereign and its property are not immune from creditor enforcement actions. Such waiver considerably strengthens enforcement capabilities from the perspective of the holder.

- **Negative Pledge.** This clause included in the terms of sovereign bonds typically prohibits an issuer from providing security (in the form of liens over, or priority access to, state assets) in favour of other categories of creditor without securing the holders of the subject bonds on an equal basis. The scope of the negative pledge clause can vary, and more modern negative pledge clauses limit the application of the clause to foreign creditors/external debt, and sometimes to public bondholders, thereby retaining the right to grant security interests to other categories of creditors. In general, the negative pledge clause will also include a set of enumerated exceptions, that have become standardized, permitting the sovereign to grant certain types of collateral security in relation to specific arrangements.

- **Pari Passu.** The *pari passu* clause is both a representation and an undertaking that holders of the bonds will at all times rank equally with holders of certain other unsecured and unsubordinated debt obligations of the issuer. Originally thought to protect creditors against legal ("*de jure*") subordination, this clause was at the heart of the *NML v. Argentina* litigation before the New York courts, which held that the clause also protected against "*de facto*" subordination and prohibited the sovereign from paying one set of creditors (who agreed to a restructuring) without concurrently paying another (creditors who opposed the restructuring). Following the ruling in that case and to avoid future uncertainty over the meaning of the clause, the International Capital Markets Association ("**ICMA**") has recommended a re-drafting of the clause – which has now become market standard – that specifically excludes the expansive *pari passu* interpretation.

- **Cross-Default and Cross-Acceleration.** Cross-default clauses in sovereign bonds provide that if the sovereign defaults on the payment or other terms of other debt obligations, then such default itself constitutes a default on the subject bonds even though the sovereign may otherwise remain current on and in compliance with the terms of the bonds. Cross-Acceleration clauses are similar, but can only be triggered if the default on other debt is accelerated by the lender. Cross-default provisions operate to drastically increase the cost of default – by

opening the prospect of a generalized acceleration of the sovereign's debt stock in case of a default under a single debt instrument - therefore incentivizing prudent policies that avoid an outright default.

- **Acceleration and Reverse Acceleration**. Acceleration is a declaration by the bondholders to the sovereign that the entirety of the principal amount becomes due and payable at the time of the default, prior to the bond's original maturity. Some bonds – unless issued under a trustee structure – may give individual bondholders the right to accelerate their own bonds upon an event of default. Most commonly, bonds provide that acceleration will occur only after a vote among bondholders—usually 25%.

- **Unconditional right to receive principal and interest**. Most bonds – even those issued under a trustee structure – include an express provision permitting individual holders to sue to recover missed payment amounts, without the need for any collective action or involvement of the trustee.

Contract terms that facilitate a debt restructuring / renegotiation

In cases where a sovereign is unable to meet its payment obligations under international bonds, it will have to renegotiate (or "restructure") those terms in consultation with its bondholders.

While in the case of domestic debt, governed by domestic law, the sovereign may have flexibility to take unilateral legislative action changing certain terms, in foreign law bonds any change to the payment terms has to be with the consent of its holders, and not unilateral.

Bond terms have evolved over time to better calibrate the level of bondholder consent that is needed to amend the terms, aiming to strike a balance between protecting individual creditor rights and providing the sovereign the requisite flexibility to restructure its obligations. For that reason, bond contracts no longer require unanimity to changing bond terms, but instead require the consent of *qualified majorities*. The level of qualified majority differs for amendments to payment terms and non-payment terms that are deemed less material.

- **Modification of non-payment terms ("non-reserve" matters)**. This provision governs the modification of non-reserve matters – that is, terms other than principal, interest, and time of payment and other enumerated terms that are deemed highly material to bondholders. It is normal market practice to allow a simple majority, or at most 66-2/3%, of bondholders to vote to effect changes to non-reserve matters and bind all remaining holders to the revised terms.

- **Collective Action Clauses and modification of payment terms.** Modification of payment terms and other enumerated "reserve matters" are governed by the bonds "collective action clauses" ("**CACs**"). CACs have existed in English-law-governed contracts since the middle of the 19th century. Following the approach that had been accepted in English law-governed bonds, CACs were introduced in New York law governed bonds by Mexico in 2003, and permitted a qualified bondholder supermajority (usually 75% per bond series) to approve modifications to the reserve matters/payment terms of the bonds which would be binding on the entire series. The first formulation of the CAC only applied on an individual series basis, and is referred to as the "series-by-series" CAC.

  CACs reduce the risk that a minority of bondholders seeking a higher value recovery or insisting on repayment in accordance with original contractual terms will be able to hold out from a restructuring. Such behaviour can disrupt a restructuring that has (or would have) otherwise been accepted by a majority of bondholders.

- **Collective Action Aggregation *("aggregated CACs")*.** The series-by-series CAC operates within a single bond issue, and many outstanding bonds issued pre-2013 are likely to contain such formulation. Because the series-by-series CAC does not eliminate the disruptive power of determined holdout creditors (who could amass 25% of a single series and thereby block a restructuring of that series), the design of CACs in sovereign bonds has further evolved over time in response to the evolving strategies and increased financial resources of potential holdout creditors.

  The current best practice in designing sovereign bonds is to include the CACs drafted and endorsed by ICMA in 2014 (the "**ICMA CACs**"), which represent the latest and most widely accepted iteration of the CACs. Most notably, the ICMA CACs permit voting **across different series** of the same issuer, so as to limit the possibility of holdouts in a single series if a supermajority of holders across all series are supportive of restructuring terms.

  ICMA CACs provide three options for modifying the payment and other key terms of sovereign bonds:

  1. a single-series option, which requires 75% supermajority of each relevant series;

  2. a "two-limb" option, which requires a 66 2/3 % supermajority across all series of bonds voting in a designated pool *and* a 50% majority of each bond series within the pool; and

  3. a "single-limb" option, which requires a 75% supermajority across all series of bonds voting in a designated pool as long as all holders are offered the same instrument or a choice from the same menu of instruments.

Aggregated CACs are the most potent weapon of a sovereign in a debt restructuring against opportunistic holdout creditors, and in recent years have served as a catalyst for successful debt restructurings, as further described in **Annex X – Applications of Restructuring Techniques in Eurobond Restructurings**.

Bond contract design considerations

While the above terms are in some form common among international sovereign bonds, we often see significant variations in those terms between different bonds that alter their effectiveness. The precise drafting of these terms can directly affect both the occurrence of a contractual default under Eurobonds as well as the ability of a sovereign to conduct an expeditious and orderly debt restructuring. Debt managers should be aware of the possible contractual formulations, and select those formulations that offer the stronger protections. For instance:

- **cross-default** clauses, **negative pledge** clauses, and **pari passu** clauses can differ in the scope of the sovereign's debt that is covered by the clauses. Clauses drafted in a certain way will trigger the protection of the clause if the sovereign takes certain actions with respect to any of its outstanding indebtedness. Other clauses will limit application of the clause to circumstances where the sovereign takes certain actions with respect to external debt only, and in some cases only with respect to external debt in the form of Eurobonds. From the sovereign's perspective, the narrower the scope, the higher the protection.

- **There is still significant variation in the collective action clauses included in sovereign bonds.** For example, some collective action clauses apply only within a single series, while others apply across different series; some apply across different series insofar as those are issued under the same indenture or fiscal agency agreement, while others apply to all outstanding bonds insofar as they include the similar provisions. Lack of uniformity in the debt stock of many sovereigns can trigger complications in the debt restructuring process.

From a sovereign debt management perspective at the pre-crisis stage, it is imperative to design robust contracts that both protect investors – and therefore allow the bonds to price well in the primary market and trade well in the secondary market – and protect sovereigns by facilitating an orderly restructuring at times of distress.

At the stage of debt issuance, the sovereign should work with its legal advisor to understand the different possible variations and formulations of these important clauses, and design the legal structure of the bonds to maximize its specific objectives.

B. Considerations in incurring secured (collateralized) debt

Incurring secured or quasi-secured debt should be considered carefully by the sovereign debt managers and their advisors.

On the one hand, secured debt is an attractive financing structure – especially for commodity-rich countries – because the security reduces credit risk and thus lowers the borrowing costs. Collateralized borrowing can facilitate access to external financing that would not be available under traditional, unsecured, lending structures.

At the same time, secured borrowing can have serious adverse consequences for a debtor in a time of crisis, as creditors holding secured debt have both (i) a right to liquidate or attach the security granted to them in case of a sovereign default and (ii) correspondingly, *de facto* or *de jure* seniority over unsecured creditors.

The existence of security creates a number of issues for a sovereign in a time of distress.

- First, the assets or revenue streams pledged as collateral – including cash deposited in escrow accounts – undoubtedly become more valuable to the sovereign in a time of distress. Creditor control of valuable assets or cash reduces the flexibility of a cash-strapped government, and may even impact the ability of the sovereign to recover in the medium term.

- Second, the existence of secured debt – with valuable assets pledged as collateral – may impair future financing as it may disincentivize other lenders from providing financing, including emergency financing, on an unsecured basis.

- Third, the threat of creditor attachment may tempt the sovereign to remain current on its obligations to the relevant secured creditors while selectively defaulting on obligations owed to unsecured creditors, or otherwise take steps to give such secured creditors preferential treatment. These actions would violate the implied promise of comparability of treatment between different classes of creditors, and dis-incentivize other creditors from providing debt relief. At the very least, the existence of secured debt can put the sovereign in a weak negotiating position at the outset of the restructuring negotiation.

Before entering into secured debt contracts, therefore, the sovereign should consider the financing purpose and the wider implications of such structures during a time of distress.

Considerations in incurring secured or quasi secured debt

Financing purpose and effect on borrowing costs: at the outset, debt managers should determine whether the incurrence of secured debt will in fact lead to the expected improvement in financing terms (lower borrowing costs vis-à-vis unsecured debt).

Type of collateral and enforceability: the debt managers should carefully consider (1) the type of collateral that is being granted – whether it be formal security or "informal" funding of escrow accounts, (2) the type and significance of assets that are used as collateral, and (3) the enforceability of the collateral, which depends on the type of collateral and the law of the jurisdiction in which it is located. Collateral that is located in the debtor's jurisdiction is harder to enforce, while collateral located in foreign jurisdictions is relatively easier to enforce.

Riskiness of structure for debt sustainability: debt managers also should consider the sustainability of the financing structure and the impact of the structure for the borrower's repayment capacity. Secured transactions that involve collateral related to the assets or revenue streams being financed are generally safer than transactions involving collateral over unrelated assets or revenues. The value of collateral and the significance of the asset are also key considerations, as in a time of distress their free use to the sovereign becomes more valuable.

Impact on debt crisis resolution: debt managers need to assess the impact that incurrence of secured debt may have at a future time of distress. Incurrence of secured debt can complicate debt resolution in two, key, ways:

- *Impair availability of new unsecured emergency financing*: other lenders are likely to be reluctant to provide effectively "junior" or "subordinated" debt in a time of distress, limiting the availability of conventional financing sources, or increasing their cost.

- *Complicate debt restructuring resolution*: the existence of secured debt gives secured lenders more leverage in a debt restructuring vis-à-vis unsecured creditors (including official and private sector creditors). The larger the share of secured debt, the greater the leverage of the secured creditor, and the higher the likelihood that such creditor may require and/or receive preferential treatment. However, any debt relief not provided by secured lenders will have to be provided by the residual unsecured lenders. The unequal burden sharing expected of unsecured creditors decreases their willingness to voluntarily provide necessary debt relief.

Compliance with terms of existing financing arrangements: when deciding whether to enter into a secured financing structure, the sovereign needs to also consider whether the type of security that is being granted is permissible under the terms of existing financing arrangements. In particular, the sovereign needs to assess whether the security to be granted and the type of collateralized loan would violate the World Bank negative pledge clause, as well as the negative pledge clauses contained in commercial contracts (bonds and loans). Incurring secured debt in contravention of contractual terms may lead to events of default and enforcement actions under other financing arrangements.

C. Considerations in issuing sovereign guarantees or debt with credit enhancement features

Sovereigns may issue guarantees of the obligations of state-owned entities or other government instrumentalities for policy or financial reasons. These guarantees constitute contingent rather than direct liabilities of the central government, because they only become direct claims on the central government in predefined circumstances. They can range from a full guarantee of all of the primary obligor's obligations under the primary financing contract, or may be more limited in the amount or circumstances in which they can be called.

The terms and structure of a sovereign guarantee will therefore depend on several factors, including the creditworthiness of the primary obligor and the nature of the risks being covered.

The sovereign guarantor should bear in mind the following considerations to minimize the risks associated with the issuance of guarantees:

- The sovereign guarantor should have a clear understanding of the nature of the primary obligor's obligation to the financial creditor before providing a guarantee. The government should always analyse both the terms of the

guarantee and of the primary financing contract to understand the nature and scope of the contingent liability being created.

- The government should retain the right to be notified of any default of the primary obligor in respect of the guaranteed obligations.
- The government's guarantee should not be capable of being extended to cover liabilities arising under the primary financing contract if the contract is amended or its terms waived without the government's prior consent.
- The government should retain the right to cure any breach/default before such breach/default leads to the termination or acceleration of the primary financing contract (resulting in the calling of the guarantee) as the cost of the cure may be substantially less than any payment required under the guarantee.

Separately from issuing guarantees for sub-sovereign debt, sovereigns oftentimes issue debt that itself benefits from a credit enhancement feature, often in the form of a full or partial third-party guarantee from the official sector (e.g., a AAA-rated multilateral lender such as the World Bank). At times of issuance, such credit enhancement features can help sovereigns lower borrowing costs or access the capital markets at times when they would otherwise be unable to do so. How such instruments are treated at a time of crisis, however, raises its own set of questions and challenges, and market practice varies. Most recently, Ecuador fully excluded a bond that was partially guaranteed by the Inter-American Development bank in its 2020 restructuring. Ghana, on the other hand, has included a bond that benefits from a partial "policy-based" guarantee from the World Bank in its ongoing comprehensive debt restructuring. Debt managers should pay special attention to the terms and legal structure of the credit enhancement instrument before determining its treatment in a comprehensive debt management exercise, to determine whether the instrument should be excluded or included within the restructuring perimeter, and what treatment would be in keeping with the "comparability of treatment" principle.

D. Considerations in sovereign loans

Structuring Loan Facilities

Loans may be structured in a manner that allow sovereign borrowers greater flexibility to access funds over a long period under specified conditions. These more structured products offer not just simple term loans, but a wider and more complex range of "credit facilities".

Facilities can take many forms, most notably (i) revolving facilities that allow a borrower to draw, repay and then redraw again, (ii) term facilities that allow the borrower to borrow specific sums for a specified period of time, or (iii) standby facilities that allow the borrower to draw down funds during the life of the facility upon satisfaction of pre-determined conditions.

Key terms in loan documentation

Loan agreements typically mirror many of the key terms of bonds described above (events of default, repayment and acceleration, sovereign immunity, etc.).

However, syndicated loan agreements (involving more than one bank lender) have traditionally lacked robust majority voting provisions that allow a qualified majority to bind a minority into a restructuring of loan terms. While they contain majority voting provisions for amendments to "non-reserve" matters, they typically lack similar clauses permitting amendments to payment terms, effectively requiring unanimity among lenders prior to any amendment touching on such terms. Historically, banks have taken the position that they lend on a relationship basis and thus the same collective action problems as apply to bondholders do not apply to them. However, the increased volume of trading of loan participations in the secondary market has called into question this assumption, and the absence of majority voting provisions in loan documentation has been identified as a gap in the sovereign debt restructuring architecture.

Most recently, ICMA published model majority voting clauses ("**MVPs**") which are recommended to be incorporated into syndicated loan agreements, to mirror the effect of CACs. To date there has not been widespread adoption of the MVPs in sovereign loan contracts, though the IMF has been supportive of this initiative.

These MVPs operate at a recommended majority voting threshold of 75%, below the current unanimous creditor consent level but above the typical simple majority voting threshold for non-reserve matters.

The model MVPs are annexed in Annex VII—Certain Standard Contractual Provisions of this Debt Guide.

E. Designing Crisis-Resilient Debt Structures

Understanding the meaning, purpose and effect of contract terms in debt agreements is paramount when entering into financing arrangements. As discussed above, thoughtful contract design can both decrease the likelihood of default and, more importantly, improve the outcome of a debt restructuring transaction.

In addition to robust contracting in conventional bond and loan agreements, however, sovereigns can consider issuing debt with structures that are themselves resilient to debt shocks. "State contingent debt instruments" ("**SCDIs**") are debt instruments with variable (or contingent) payment structures that tie payment obligations to a "state variable", i.e., an economic variable that serves as a proxy for the sovereign's capacity to pay.

SCDIs can be issued both at normal times and during debt restructurings. The latter formulation is discussed in Part III of this Debt Guide. The former is the focus of the ALSF Debt Guide on State Contingent Debt Instruments.

The main intent behind issuing SCDIs in normal times is to reduce debt service costs during economic downturns or as a consequence of an extreme event (e.g., after the occurrence of a natural disaster, pandemic or deep recession) and thereby help sovereigns preserve fiscal space and resources for crisis management.

SCDIs can take many forms: debt instruments with continuous (or "indexed") adjustment of debt service payments based on some underlying variable (e.g., a GDP-linked bond, where payments are indexed to nominal GDP), and instruments with discrete adjustment mechanisms (e.g., instruments with natural disaster clauses where debt service relief is triggered by a predefined natural disaster event). By linking debt service payments to a state variable (like GDP) or an exogenous event that proxies or affects the sovereign's capacity to pay, SCDIs seek to stabilize the sovereign's financial position, thereby preserving fiscal space precisely when it is most needed.

When designed appropriately, such instruments can make the sovereign's debt stock more resilient to economic shocks and ultimately reduce the probability of sovereign debt crises.

The introduction of such instruments has been promoted by both the IMF staff and the private sector through the International Capital Markets Association. Most recently, the ICMA published model "climate resilient" debt clauses. Modelled after the natural disaster clauses introduced in Grenada and Barbados (see Box below), the proposed ICMA clauses aim at making debt stocks more resilient to severe climate shocks.

For a complete description of design considerations, benefits and challenges of SCDIs issued in normal times, please refer to the ALSF Debt Guide on State Contingent Debt Instruments.

Examples of resilient SCDI structures in private and official debt

SCDIs in private debt

- **Grenada.** Grenada's first debt restructuring of 2004–06 was triggered by Hurricane Ivan, with a second restructuring following in 2013–15. To strengthen Grenada's financial protection from extreme weather events, existing debt was exchanged in the restructuring for new debt that included a clause allowing a deferral of debt service payments on the restructured debt for up to 12 months in the event of a qualifying hurricane. The chosen trigger for such a natural disaster event was a payout by the Caribbean Catastrophe Risk Insurance Facility (CCRIF) for losses that exceed US$15 million (except for Paris Club debt, whereby creditors opted for a more flexible trigger). Grenada's hurricane provisions allowed the clause to be triggered a maximum of three times. Deferred interest would be capitalized, and deferred principal is paid on top of scheduled payments until final maturity. The hurricane clause would provide significant cash flow relief in case of a natural disaster and improve the risk profile of the debt by reducing the likelihood of a succeeding debt restructuring.

- **Barbados.** In 2018–19, Barbados, a country susceptible to extreme weather events, restructured its public debt for the first time. The government effectively used the debt restructuring to strengthen its financial safeguards against these extreme weather events and earthquakes. The "natural disaster clause" included in most of the debt instruments issued in both the domestic and external debt restructuring allows for capitalization of interest and deferral of scheduled amortization falling due over a two-year period following the occurrence of a defined natural disaster. The trigger for a natural disaster event for the domestic debt instruments is a payout above US$5 million by the CCRIF. Similarly, the external debt instruments also link the threshold for triggering the natural disaster clause to CCRIF payouts. However, for the new external debt instrument, the activation of the clause by Barbados is subject to the consent of holders of at least 50 percent. of the aggregate principal amount of the bonds outstanding at the time.

SCDIs in official debt

- **Agence Française de Développement** (AFD), the development agency of the French government, offers concessional project financing to post-HIPC countries. The instrument consists of a thirty-year loan, a five-year grace period, and a five-year "floating grace period" for principal payments. A borrower has the right to trigger the floating grace period in the event export earnings fall below a predefined threshold. Repayments can be deferred up to five times after the threshold is met. Since 2007, the AFD has offered 16 such loans, amounting to €344mn, to five low-income countries. As of yet, the floating grace periods have not been triggered in any of the loans.

  - **Petrocaribe** lending involves bilateral loans extended by Venezuela to other countries to purchase oil produced by PDVSA (Petroleos de Venezuela, S.A.), Venezuela's state-owned oil company, on predetermined flexible financing terms. The terms of the loan are linked to the prevailing price of oil, potentially providing either the creditor (Venezuela) or the debtor protection in the face of an adverse oil price shock. Payment terms are negotiated bilaterally; debtor countries can also offer goods and services in lieu of currency.

3. Planning ahead: managing debt portfolios through liability management transactions

Purpose of regular liability management

Liability management at a pre-crisis stage falls within the larger institutional framework of debt management and ultimately public policy, and when designed appropriately can help countries improve fiscal sustainability and forestall financial crises.

Liability management exercises helps a sovereign issuer manage the composition of its public debt portfolio to achieve the desired level of risk and debt costs over the short, medium and long term. The core objectives of liability management exercises at the pre-crisis stage are to reduce debt service payments and/or reduce the sovereign's overall refinancing risk by smoothening and ameliorating the country's debt profile.

To improve the sovereign's credit risk profile, liability management exercises can be used to change the debt's maturity structure, interest rate structure, and currency structure, with an aim to minimize rollover, interest rate

or exchange rate risks. Such exercises are also effective in minimizing the risk of sovereign distress and sovereign default.

Liability management tools

The two main liability management tools that can be used to achieve those objectives are debt buybacks and debt exchange transactions. These tools can impact the size of the sovereign's debt service in a given period – by reducing the stock of outstanding sovereign debt and/or the average interest rate on the debt. What distinguishes debt buybacks and debt exchanges at the pre-crisis management stage is that such transactions are purely voluntary. From the creditor's perspective, such transactions do not require the acceptance of a net present value loss.

- **Debt buybacks** are financed either through a drawdown of cash reserves or other liquid assets or through the incurrence of new debt, and have the effect of lowering the debt stock by the face value of the debt repurchased. Buybacks can result in both interest savings on the debt bought back and principal savings when the debt is bought back in the secondary market at a discount to face value.

- **Debt exchanges** can be used both to replace high coupon debt with lower coupon debt through a debt refinancing, and to change other elements of the debt structure to reduce credit risk. In a refinancing swap, the size of the debt stock may remain the same or increase, if the sovereign elects to replace an existing bond issue with a larger issue. Debt swaps are also often used to change the maturity profile (lengthening the average maturity of the debt, or smoothen the repayment profile by incorporating principal amortizations), the interest rate structure (such as swapping floating rate instruments for fixed rate instruments), and the currency structure (such as swapping foreign currency debt for domestic currency debt).

Implementation Considerations

Before initiating a liability management transaction, the debt manager, in consultation with financial and legal advisors, should carefully consider the desired objective and the costs associated with the proposed liability management transaction, including the risks associated with the new structure, the market conditions at the time of execution, as well as any reputational risks. From an implementation perspective, the sovereign will have to choose the appropriate liability management structure and engage in effective investor relations to ensure a successful outcome.

At the same time, the sovereign should carefully consider the implications of such transactions for credit rating agency classifications, as, depending on the specifics of the transaction, such transaction may be classified as "selective default" by one or more agencies.

- **Structuring the transaction**

Liability management transactions can take many forms, and selecting one is often a function of the desired objective, desired timing of completion, and available financing resources, among other things.

A debt buyback transaction can either be completed via open market purchases of outstanding debt, or through public cash tender offers. In an open market purchase, the sovereign is able to repurchase a certain amount of debt in the secondary market at market prices. This option is attractive when the debt is trading at a discount, and the sovereign has considerable flexibility in both the timing of undertaking the transaction and the amount to be repurchased. However, this option is limited by the fact that the sovereign can only purchase a relatively small amount of debt before driving up secondary market prices, thereby reducing the expected savings of the transaction. There are also legal restrictions imposed by the EU Market Abuse Regulations and equivalent legal regimes in other jurisdictions that effectively cap the amount of open market purchases by an issuer without making public disclosure.

Cash tender offers on the other hand are public transactions where the sovereign makes a public offer to purchase some or all of its outstanding debt for cash.

Exchange offers are the most common mechanism to effectuate a debt swap, where the sovereign is inviting holders of its debt securities to exchange existing securities for new securities.

In each case, the sovereign will have to offer investors a premium over market price to induce uptake of the offer, as otherwise holders could simply sell their bonds in the secondary market at the market price. As such, cash tender offers and exchange offers are often structured to be NPV-positive.

In structuring the transactions, a sovereign must ensure that it complies with applicable securities laws and regulations, including the securities laws of the United States.

- **Creditor engagement and investor relations**

A key principle of pre-crisis liability management is that it is a voluntary operation, whereby debt holders voluntarily participate in a carefully designed transaction that achieves the sovereign's debt management objectives.

To successfully consummate a liability management transaction (particularly public transactions such as tender offers), it is imperative that the sovereign has a clear investor relation strategy and provides investors with sufficient information relating to the transaction. Such information should include the macroeconomic

objectives and the expected benefits of the transaction for the sovereign's credit profile. Transparency and communication are imperative to establish the requisite credibility of the transaction.

For more on liability management, please also refer to the **ALSF Debt Guide on Debt Swaps**.

PART III: CRISIS DEBT MANAGEMENT

1. The causes of debt distress and type of debt crisis

The immediate indicator of a sovereign debt crisis is a government's difficulty or inability to make scheduled payments on its debt obligations.

Sovereign debt crises are precipitated by various endogenous and exogenous factors. The following events – individually or together – can precipitate a debt crisis by affecting the government's short- or medium-term capacity to make debt service payments:

- Economic downturns and recessions: lower GDP growth and lower fiscal revenues make it relatively harder to make scheduled debt payments while honouring other government priorities.
- *Terms of trade shocks and falling commodity prices*: for economies that rely on commodity exports as a source of GDP growth, tax revenues and foreign exchange accumulation, commodity price fluctuations can lead to an inability to service debt payments. For economies that rely on imports of key commodities such as oil, a spike in international prices can lead to shortages of foreign exchange available to service external debt.
- *Devaluation or depreciation of local currency*: a devaluation or depreciation of local currency can precipitate a debt crisis to the extent that a large proportion of the debt stock is denominated in foreign currency, as the devaluation or depreciation wWWill make the size of the debt stock larger and the servicing of foreign debt more expensive, in each case as measured in local currency.
- *Exogenous shocks*: exogenous events such as wars, pandemics, natural disasters and other extra-territorial political and economic developments often have profound effects on a government's ability to service its debt, either by decreasing trade flows or GDP or by increasing government expenditures that must be financed through borrowing.
- *Loss of market access or unavailability of affordable financing*: rising interest rates – either as a result of global tightening of monetary policy or as a result of perceived credit risks specific to a sovereign – make it unduly expensive or impossible for sovereigns to finance new borrowings or roll over (refinance) maturing debt obligations.

Warning signs

While the causes and severity of debt distress can vary greatly, there are several "warning signs" that debt managers should monitor in assessing the government's debt trajectory and possibility of distress. These include, among others:

- Declining foreign exchange reserves, which make it harder to service foreign currency debt obligations and vital imports while retaining stability in the foreign exchange market
- Bond prices/yields in the secondary market: falling sovereign bond prices and higher yields can signal a loss of confidence in the economy and be a sign of distress
- Falling demand for government debt and increased sovereign spreads, reflecting a market perception of heightened risk
- Downgrade in sovereign credit rating by international credit rating agencies

The type of debt crisis: crisis of liquidity or solvency

While all debt crises, at their core, imply an inability by the government to make scheduled debt payments, not all crises are of the same severity or necessitate the same treatment. Based on the cause of the government's difficulty in servicing its debt, a crisis is broadly classified as either a liquidity crisis or a solvency crisis.

A liquidity crisis occurs when the sovereign is unable to make scheduled debt payments due to temporary liquidity constraints. Typically, due to sudden economic shocks or the occurrence of a natural disaster, pandemic or other emergency, the sovereign lacks sufficient liquid resources to meet upcoming debt obligations. In that scenario, however, the sovereign's debt is deemed to be sustainable in the longer term, presuming that the

sovereign can implement appropriate policies to deal with the immediate crisis.

A solvency crisis, on the other hand, occurs when it is determined that the sovereign cannot meet the present value of its debt obligations without perpetually accumulating additional debt. In other words, the sovereign is assessed as not being able to meet its existing debt obligations even if it undertakes a strong fiscal adjustment effort and/or receives financial assistance from the IMF or other donors. In such cases, the debt is deemed to be unsustainable.

Understanding debt sustainability frameworks and analyses

The IMF performs debt sustainability analyses in the context of IMF program requests, IMF program reviews, and technical IMF Article IV consultations. The IMF methodology and approach to debt sustainability analysis differentiates between market access countries (MACs) that typically have significant access to international capital markets, and low-income countries (LICs), which typically lack access to international capital markets and instead meet their external financing needs mostly through concessional financing. The debt sustainability assessments are performed through two different frameworks tailored to each set of countries:

- The low-income country debt sustainability framework (the "**LIC DSF**"), jointly developed by the IMF and the World Bank to assess the debt carrying capacity of low-income countries; and

- The sovereign risk and debt sustainability framework for market access countries (the "**MAC SRDSF**"), which is a new framework recently published by the IMF for assessing sovereign risk and debt sustainability of market-access countries.

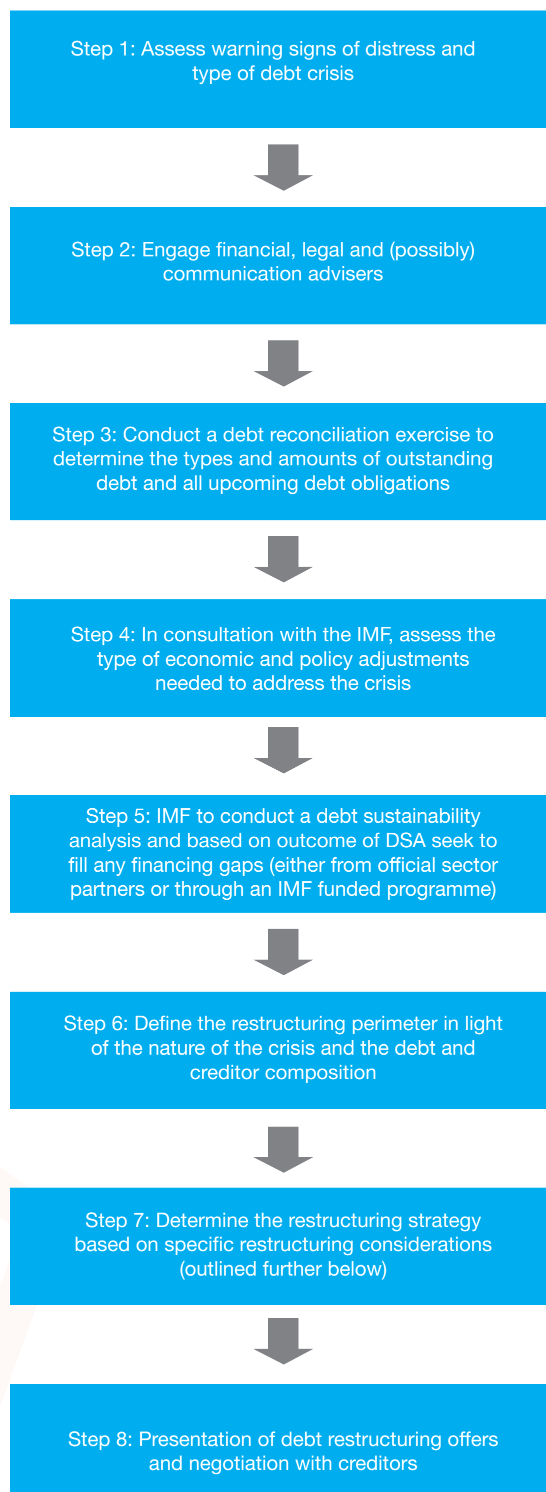
DSAs conducted under the relevant framework aid sovereigns in the borrowing and debt monitoring stage, and are also critical tools in assessing debt sustainability at both the pre-crisis and crisis stage. The IMF, as discussed below, uses the DSA to assess the country's debt sustainability prior to making any lending decisions.

For a summary of each framework, see **Annex IV—IMF Debt Sustainability Frameworks**. For a more comprehensive description of debt sustainability frameworks for low-income countries and market access countries, see the **ALSF Debt Guide on Fiscal Policy and Management.**

2. Sovereign debt restructuring process and timeline at a glance

An orderly sovereign debt restructuring process typically follows the following steps:

Annex II—Step-by-Step Approach to Debt Crisis Management expands on this process.



3. Sovereign default and the importance of early engagement

The unique nature of sovereign defaults

Sovereigns are unique debtors. They differ to corporates and individuals in that there is no bankruptcy code or insolvency regime that applies to a sovereign. This means that a sovereign that defaults on its debt obligations

does not benefit from any insolvency regime protections designed to protect debtors and aid in the orderly resolution of a default. In the absence of insolvency mechanisms that protect the sovereign debtor in the case of a default or bind all creditors into a general workout, the sovereign bears the burden of either avoiding a default entirely or taking concrete measures to remedy the default and resolve its debt crisis through negotiation with its creditors and other key stakeholders. An unresolved default can result in one or more of the consequences for the sovereign discussed further below ("costs and consequences of default").

At the same time, in contrast to a corporate default, a sovereign's creditors have relatively limited means of legal recourse against a sovereign in the event of a default. By their very nature, sovereigns enjoy a certain degree of immunity against creditor enforcement actions. While the legal immunity enjoyed by sovereigns accessing the international financial markets has weakened over the years, primarily as a result of sovereigns electing to participate in the international capital markets and therefore waiving certain aspects of sovereign immunity, key jurisdictions such as the United States and the United Kingdom protect many types of sovereign assets from being attached in creditor enforcement actions. In general, under the legal framework in most OECD countries, property belonging to a sovereign cannot be seized by creditors or applied to satisfy judgment debts unless the property is used for a commercial purpose. As a general rule, most sovereigns – especially those in financial distress - have very limited property outside their own jurisdiction that is used for a commercial purpose. Assets of the central bank (such as foreign exchange reserves) and assets that serve a diplomatic or military purpose enjoy special immunity under the laws of many jurisdictions, and are not typically subject to attachment.

Therefore, although there is no insolvency regime to facilitate an orderly resolution of a sovereign default, the current scope of sovereign immunity and the limited availability of sovereign assets that do not enjoy such immunity *de facto* limits creditor enforcement capabilities. That being said, as explained below, creditors still have enforceable legal rights that pose legal threats and consequences for a sovereign, and the risk of a creditor exercising such rights plays an important role in the dynamic of sovereign debt restructuring.

It is against this unique backdrop that sovereign debt workouts take place, in an attempt to reach a consensual resolution to the crisis that both limits or entirely avoids the consequences of default for the sovereign and permits creditors to recover or collect a reasonable return on their original investment.

Contractual events of default

Both official (multilateral and bilateral) and private debt contracts contain enumerated events of default ("**EoD**"). The occurrence of one or more of such enumerated events, if left un-remedied, would result in the sovereign being in default.

Typical events of default in private debt contracts (particularly Eurobonds) include:

- Payment default: failure to pay principal or interest, or other amounts under the debt contract when due. Private debt contracts typically include a "grace period" during which the sovereign can remedy the payment failure and avoid a default. Typical grace periods range from 10 to 30 days. A payment default is triggered after the expiration of any applicable grace period.

- *Default on other obligations or covenants*: breach of other non-payment obligations under the debt contract (such as information covenants or the negative pledge), subject to a specified grace period. The grace period applicable to non-payment contract breaches is typically longer than the period applicable to payment failures – 45 or 60 days is not unusual.

- *Cross-default or cross-acceleration clauses*: cross-default and cross-acceleration clauses can vary significantly in their formulation but in essence they stipulate that a sovereign shall be deemed to be in default on a debt contract if an event of default has occurred in another debt instrument (and in the case of cross-acceleration, such debt instrument has been accelerated). The clauses are intended to link two or more different debt obligations, such that a default under one triggers a default under the other. The idea is that the creditors benefitting from the cross-default clause should have a voice in the potential resolution of the debt problem notwithstanding that there is no direct event of default.

  Cross-default clauses vary materially in their formulation. A cross-default may be limited by (i) its trigger, whereby it is triggered either by an EoD occurring under another instrument (a "true" cross default) or by another instrument being accelerated following an EoD (a "cross acceleration") and (ii) its scope, whereby only a default (or acceleration) under specified debt that exceeds a certain nominal *de minimis* threshold would be accounted for.

- *Payment moratorium*: an announced moratorium by the sovereign issuer on the payment of specified debts or categories of debt, which can vary in scope.

- *Judgment default*: Legal judgment against the sovereign in respect of other debt for the payment of amounts in excess of a specified *de minimis* threshold.

- *Revocation of authority*: the sovereign's legal authority to perform its debt obligations is revoked or otherwise limited.
- *Debt repudiation or contested validity*: any action by the sovereign to contest the validity or enforceability of the debt obligations.
- *Policy-related events*: these usually include loss of IMF membership or ineligibility to use general resources of the IMF.

Events of default under official debt often include similar terms as private debt, but are structured to reflect the lenders' official status. Particularly with respect to multilateral debt, they also include events of default linked to the sovereign's ability to carry out policy objectives and to use the loan proceeds as permitted by the lender's mandate.

In general, enumerated events of default or breaches of obligations under official/multilateral debt may lead to the suspension or cancellation of the loan, a mandatory repayment of the loan, or an acceleration. Typical events of default in official debt contracts include payment failures, performance failures, fraud, corruption, misrepresentation, unauthorized use or assignment of the loan and withdrawal from membership of the IMF or World Bank.

Rating agency definition of default

Credit rating agencies have their own criteria for determining when a sovereign is in default on its public debt instruments for rating purposes, which are oftentimes broader than the enumerated contractual events of defaults. Understanding these criteria is important, as rating agencies' determination of a default directly informs ratings actions.

For example, Moody's definition of default includes the following:

- Failure to pay principal or interest when due, following expiration of an applicable grace period specified in a debt contract;
- A distressed debt exchange that reduces the sovereign's financial obligation to avoid a payment default. This can sometimes be triggered by an exchange or buyback at below par; or
- Unilateral change in payment terms imposed by the sovereign.

Similarly, Fitch's definition of default events includes the following:

- Missed coupon or principal repayment on a public debt security issued by the sovereign;
- Missed coupon or principal repayment on a public debt security benefiting from an unequivocal, irrevocable and unconditional guarantee provided by the sovereign;
- Failure to pay debt obligations (other than public debt securities) owed to private creditors by the sovereign provided Fitch is satisfied that a default event has occurred;
- Failure to pay debt obligations (other than public debt securities) owed to private creditors by third parties that benefit from an unequivocal, irrevocable and unconditional guarantee from the sovereign, provided Fitch is satisfied a default event has occurred;
- On execution of a distressed debt exchange ("DDE");
- A forced redenomination of sovereign debt into a different currency, unless the old currency ceased to exist; or
- A unilateral or forced change of debt terms initiated by the sovereign on a public debt security that constitutes a material reduction in terms even if a DDE does not occur.

Costs and consequences of default

The costs and consequences of a sovereign default can be grouped into five categories: increased borrowing costs and market exclusion, reputational costs, domestic financial costs, political costs and legal costs.

Increased borrowing costs and market exclusion

A direct consequence of a sovereign debt default is the threat of a prolonged exclusion of the sovereign from the international capital markets. While permanent exclusion from the capital markets has never been observed, prolonged periods of market exclusion often follow a sovereign default. Similarly, sovereign borrowing costs tend to increase following a default and restructuring. Rating downgrades following events of default and restructuring episodes almost inevitably increase borrowing costs and may contribute to the risk of temporary market exclusion. For middle-income sovereigns that rely on access to the international capital markets for their financing needs – or for low-income sovereigns that increasingly aim to rely on private credit – a potential loss of market access may be a significant cost and consideration.

Collateral impact on the domestic financial system

A sovereign default can have significant spillover effects on banks and domestic financial institutions to the extent that such institutions hold sovereign debt. Where their holdings of sovereign debt are substantial, a default on or restructuring of such debt can damage the balance sheets and capital adequacy ratios of domestic financial institutions, potentially requiring such institutions

to be recapitalized and/or to reduce their lending to the real economy. Banking crises occasioned by an accompanying sovereign debt crises can have a severe negative signalling effects regarding the overall state of the economy, leading to decreased investment, spending and economic growth and an increase in capital flight.

Political costs

Defaults can have serious political consequences for the government of the day. First and foremost, to the extent that the default has a financial impact on domestic holders directly or indirectly (particularly to the extent that it affects domestic financial institutions), it can lead to a loss of political support for the government. At the same time, the default can expose economic fragility and/or poor debt management practices that contribute to reducing confidence in the government. Ultimately, the economic and fiscal adjustments needed to reverse the economic path and cure the default is likely to adversely affect the local population, say through a series of tax increases, spending cuts, or both.

Legal consequences

At its core, a sovereign default is a breach of a contractual obligation. Following the breach, the relevant lender has the ability to exercise certain rights under the debt agreement.

While multilateral and bilateral lenders usually do not take enforcement actions against a sovereign in the case of a default under their facilities, they may restrict further extensions of credit, cancel or suspend disbursements under existing facilities or take other actions in response to a default as permitted by their respective financing arrangements. The IMF in particular has policies for dealing with member states in arrears to the Fund (i.e., IMF policies on “overdue financing obligations”). By contrast, private lenders, both commercial banks and bondholders, may and occasionally do take enforcement action against the sovereign following the occurrence of a default. Enforcement actions can be grouped into three categories: (i) acceleration of the debt, (ii) suit for overdue payments under the contract, and (iii) enforcement of a court judgment or arbitral award.

➢ Acceleration

Upon an enumerated event of default arising under a loan agreement or bond, the lenders/bondholders generally have the ability to “accelerate” repayment, meaning that they may demand the full amount of the loan or the principal amount of the bond be immediately repaid.

Each debt contract will specify any conditions that have to be met – in addition to an event of default having occurred and continuing – before debt holders can accelerate the maturity of the debt. In the case of bonds, the process of acceleration depends on whether the bonds were issued under a trust structure or under a fiscal agency structure. Under a trust structure, acceleration requires the consent of 25% of holders of the affected bond. Under a fiscal agency structure, individual holders may sometimes accelerate their debt without any reference to other holders, although most modern fiscal agency agreements contain clauses that permit acceleration only with the consent of 25% of the holders.

Acceleration in itself, however, is nothing more than a declaration from the lenders to the sovereign that the full amount of the debt has become due and is payable prior to its stated maturity. It is a contractual step, not a judicial process.

➢ Suits for missed or accelerated payments

A distinct legal remedy available to lenders following an event of default and specifically a payment default is the right to sue for overdue payments under the debt contract. In the case where a loan or bond has been properly accelerated, the suit may include a claim for accelerated amounts as well.

In the case of bonds, the ability of individual holders to sue to recover missed payments or accelerated payments will again depend on the legal structure of the bonds and whether they are issued under a trust structure or fiscal agency structure. Under a NY law governed trust structure, individual holders typically have the unconditional right to sue to recover missed principal and interest when such amounts have become due – but those amounts typically exclude any accelerated principal. Suits for accelerated principal under a trust structure are centralized in the hands of the trustee, and individual holders have direct rights only in a limited set of circumstances where the trustee has failed to sue, after directed to do so, on behalf of all bondholders. Under a fiscal agency structure, however, individual holders have a right to sue for missed payments as well as for their pro rata share of accelerated amounts, to the extent that the principal amount has been properly accelerated.

A suit for missed payments is effectively a suit for breach of contract. As such, a court’s assessment as to whether a breach has occurred is often straightforward and binary: either a payment has been made, and there is no breach, or a payment has not been made and the lenders are entitled to a judgment in their favour for the missed payment amounts. It is important to note that – contrary to claims in arbitration that are based on bilateral investment treaties – claims for a breach of contract are as a rule governed by the four corners of the contract. Unless specified in the contract, the sovereign rarely has any substantive defences against a lawsuit for missed

payment amounts and a creditor can expect, in time, to receive a court judgment in its favour.

- Enforcement of a judgment

Enforcement of a judgment against a sovereign state – as discussed previously – is subject to the general laws governing sovereign immunity in the jurisdiction of the court adjudicating the dispute. The application of such laws may be impacted by the inclusion in the relevant debt contract of an explicit waiver of sovereign immunity. While sovereigns no longer enjoy absolute immunity as they once did, both debt contracts and the laws of major adjudicating jurisdictions such as the United States and the United Kingdom restrict the types of sovereign property and sovereign assets that are available to satisfy a judgment. While the risks posed by judicial actions seeking asset attachment ultimately must be assessed on a case-by-case basis, and some sovereigns will be more at risk of such actions than others, in general efforts to attach sovereign assets rarely lead to full debt recovery from a creditor's perspective.

Notwithstanding this reality, judgment creditors can be particularly costly for a sovereign. While a sovereign debt restructuring process is ongoing, judgment creditors may hinder the prospects of an orderly and successful debt restructuring to the extent that they demand outsized returns compared to other creditors and "hold out" from the restructuring process. After the completion of a sovereign debt restructuring, to the extent the claims of judgment creditors remain unresolved, the presence of and threat posed by judgment creditors can adversely impact future debt issuances and disrupt flows of foreign direct investment.

Importance of early engagement

Historically, sovereigns experiencing debt distress have been understandably reluctant to initiate debt restructuring processes. While this is not surprising given the potential political and financial fallout of a default and restructuring, delaying a restructuring when the signs of distress are clear generally only accentuates the underlying financial or economic problems while making completion of an orderly restructuring more difficult.

Delaying taking necessary steps in response to a debt crisis and implementing a well-considered debt restructuring plan can have significant adverse effects for the sovereign, including:

i. using up scarce foreign exchange in a vain effort to stay current on external debt to the detriment of financial stability and ensuring the continued flow of essential imports;

ii. borrowing to finance unsustainable debt service payments may increase the amount of debt that will ultimately need to be restructured;

iii. a delay in restructuring may increase the size of the economic adjustment that will need to be undertaken domestically in order to restore fiscal stability and return the debt to sustainable levels;

iv. in the absence of international capital market access or the availability of official financing, the increased borrowing to fill any financing gaps may have to come from local banks and financial institutions, which will increase the risk that a domestic debt restructuring may ultimately be needed;

v. delaying the inevitable restructuring diminishes the policy credibility of the government in the eyes of creditors and increases the likelihood that the government will have to conduct debt restructuring negotiations while in default.

A timely and well-executed pre-emptive restructuring, however, can have several distinct advantages:

i. Avoid an outright default and the costs associated with it;

ii. Facilitate creditor engagement and creditor coordination, as it reduces the risk that certain creditors will seek legal remedies that delay and complicate the restructuring process;

iii. Pre-emptive restructurings are typically completed in a shorter period of time than post-default restructurings; and

iv. Reputational effects of a responsible, proactive and market-friendly debtor, that can expedite resumption of access to the international capital markets.

4. The central role of the IMF in crisis resolution

As the global institution for monetary cooperation, the IMF plays a critical role in managing and resolving sovereign debt crises. The institution offers valuable resources in a pre-crisis setting, such as its analytical capabilities to help identify and manage early sovereign debt risks and provide appropriate policy advice and technical competencies in devising long-term debt management strategies. Additionally, the IMF debt crisis resolution framework can catalyse the country's effort to manage an impending crisis and, if necessary, help the country implement a viable debt restructuring programme.

When a country begins to lose market access and is unable to refinance its debt, it often approaches the IMF for the financing needed to fill the financing gap and avoid a default.

Under its Articles of Agreement, the IMF may only provide financing assistance to members to resolve their balance of payments issues under policies that establish adequate safeguards for the temporary use of the IMF resources. The IMF can lend only if it has determined that its resources will be used to support policies that will resolve a country's balance of payments problems, and always subject to such adequate safeguards.

The IMF policies on debt sustainability, market access, financing assurances and arrears all help the Fund achieve its financing mandate, and prior to providing financing the IMF seeks to ensure that the requirements under each of these policies have been met. In other words, these policies, which are further described below, seek to ensure both that the financing will help a member resolve its balance of payments problems and restore the external viability of the sovereign's balance of payments and that the sovereign will be capable of repaying the IMF.

Debt sustainability policy

Upon receiving the request of a country for financing, the IMF has two options: (i) provide financing in support of an economic adjustment program that catalyses return to market access and enables the country to continue to service original debt obligations (often referred to as a "catalytic" program), or (ii) approve a program on the condition that the sovereign takes steps to restore debt sustainability, that may include a debt restructuring.

The choice effectively depends on the sovereign's debt sustainability because the IMF is precluded from providing financing unless it has assurances that debt sustainability will be restored. A country's debt is deemed sustainable when the IMF assesses that the country is capable of supporting a program that enables the government to keep servicing its debts while restoring confidence in the market. Debt is unsustainable if debt levels are so high that the country cannot service it over the medium term, even taking into account IMF financing and a strong adjustment program. In other words, in an unsustainable debt scenario, there are no feasible economic policies or levels of financing that can prevent debt levels from rising without some form of debt relief.

Sustainable debt

If the IMF determines that a country's debt is sustainable, then the Fund will consider an adjustment or "catalytic" programme that enables the country to meet its debt obligations without a formal restructuring plan. Instead, the Fund primarily provides financing to support a government in its continued efforts to finance its external debt through economic adjustments. The general aim of such adjustment measures is to slow down capital outflows and facilitate the country's efforts to regain access to private capital markets. The expectation is that the economic adjustment program supported by the IMF financing will revive market confidence and catalyse funding from other sources that will further assist a nation out of debt distress.

This kind of catalytic financing nonetheless often requires the IMF to lend beyond the normal access limits. In order to benefit from such financing, a country will also have to meet the criteria under the IMF's "exceptional access" policy. Under this policy, on top of assessing debt sustainability (where debt needs to be sustainable with high probability), the member also needs to meet the criteria of having good prospects of regaining access to private capital markets and a sound adjustment plan with a reasonably strong prospect of success. If the IMF determines that the country meets the criteria for exceptional access it will work with the country to devise a catalytic programme.

Unsustainable debt

When a country's debt is assessed as unsustainable, the IMF's legal framework precludes it from providing financial support unless the country is taking credible steps to restore debt sustainability, including a debt restructuring.

Lending into an unsustainable debt often exacerbates the problems and further deteriorates the country's return to debt sustainability and market access over the medium term. It also means that the country may be unable to repay the IMF. This would run counter to the IMF's lending mandate of helping countries address balance of payments programs under adequate safeguards.

It is therefore critical for the IMF to determine the country's debt sustainability before making a lending decision. In each and every case, the Fund's assessment of debt sustainability is based on its own DSA. The IMF's DSA is forward looking in that it takes into account the actions being taken by the government to restore sustainability in the medium term and includes an assessment of various alternative scenarios and stress tests.

Should the IMF determine that the debt is unsustainable,

the DSA will prescribe the “adjustment effort” needed to make it sustainable. In particular, the DSA will determine the level of economic adjustment that is required and is to be realized through government efforts, as well as the size of the “restructuring envelope”, i.e., the residual adjustment effort to be borne by creditors in the form of debt relief needed to return the debt to sustainable levels. In the case of the required debt relief effort, the IMF will only prescribe the aggregate amount of debt relief that is required. How that necessary quantum of debt relief is apportioned between the different classes of creditors is solely within the purview of the government and is not mandated by the IMF.

While legacy creditors of a sovereign in debt distress often seek to provide input on the design of the DSA, and share with the IMF their views on economic assumptions and projections that will underpin the DSA outputs, ultimately the DSA and the determination of the requisite balance between debt relief and economic adjustment falls solely within the purview of the IMF.

Financing Assurances Policy

Once it is determined that a country’s debt is unsustainable and some form of debt relief is required to restore debt sustainability, the Fund requires assurances that debt sustainability will be restored and the program will be fully financed before providing financing to a member that is not yet in arrears. Under the Fund’s financing assurances policy, in a pre-default case (i.e., the sovereign has not yet defaulted on any of its debt), the program financing must be adequate to fill financing gaps – which requires that the IMF supported program is fully financed within the program period and the member is in a position to repay the Fund during the post-program period. If a debt restructuring is needed, this policy requires the restructuring of creditors’ claims on terms consistent with program parameters.

Under the IMF policy, the form of financing assurances differs between official bilateral and private creditors. For official bilateral creditors, financing assurances are provided (i) by the Paris Club in the form of a preliminary indication that a restructuring will occur in line with the parameters of the Fund supported program in anticipation of the conclusion of “Agreed Minutes”, or (ii) by non-Paris Club bilateral creditors in the form of “specific and credible” assurances of debt relief and/or financing. Such specific and credible assurances typically take the form of a written communication by an official authorized under domestic law of the affected creditor expressing an understanding of the debtor’s situation and committing to take needed actions to restore debt sustainability in line with the parameters of an IMF supported program.

In the case of financing assurances from private creditors, such assurances are derived from the Fund’s judgment that a “credible process” of debt restructuring is underway and such restructuring will likely deliver an outcome in line with program parameters. Among others, the engagement by the debtor of financial and legal advisors and the launching of an engagement process with creditors are signals that a sovereign intends to embark on constructive negotiations with private creditors that can deliver sufficient debt relief.

The financing assurances policy aims one the one hand to facilitate timely provision of emergency financial assistance by the IMF to avoid a crisis becoming even worse, while on the other hand to ensure the Fund receives adequate comfort that (i) debt sustainability will ultimately be restored through a combination of new concessional financing and debt relief and (ii) the debtor will be in a position to repay the Fund.

Lending into arrears policies

In situations where it is determined that the debt is unsustainable and the sovereign is in default (i.e., arrears) to its official and/or private creditors, the requirements of the Fund’s policies on arrears must be met before approving financing to a country.

Historically, the Fund had a policy of “non-toleration of arrears” (the “**NTP**”) with respect to both official bilateral and private claims before extending financing. More recently, the NTP has been relaxed to facilitate program financing in situations where arrears accumulate to creditors who are unwilling to contribute to the program.

The Fund’s lending into arrears policies permit the sovereign to partially fill any financing gap through accumulation of arrears, so long as the sovereign is making good faith efforts to resolve the arrears with the respective creditors on terms consistent with the parameters of an IMF supported program with the ultimate aim of restoring medium term external viability.

Importantly, since the criteria under the lending into arrears policies are designed to restore debt sustainability, the IMF may proceed (on a case-by-case basis) with providing financing to the sovereign in the absence of financing assurances from all creditors if those criteria are met. In other words, there is no need to apply financing assurance policy in such cases. This reduces the risk that certain creditors unwilling to provide financing assurances can jeopardize the entirety of the IMF supported program and, correspondingly, reduces the leverage of such potential “holdout” creditors in their negotiations with the sovereign.

The arrears policies differ for private, bilateral, and multilateral creditors. Please see **Annex V—the IMF’s Arrears Policies** for a full description of the policy as it applies to each class of creditors.

5. Designing the restructuring plan:

fundamental considerations

A successful debt restructuring strategy will be tailored to a sovereign's specific debt situation, on the basis of the following broad principles and considerations:

A. What is the nature of distress

First and foremost, a debt restructuring strategy and solution will have to be tailored to the nature of distress the sovereign is facing, namely whether the crisis is one of liquidity or solvency. A solution to a liquidity crisis is often found in a mix of debt service deferrals (maturity profile extensions) and/or temporary or short-term coupon adjustments. A solvency crisis, on the other hand, typically requires more severe restructuring of the relevant debt, including principal write-offs/haircuts and deeper or permanent coupon reductions.

It is important for the sovereign to correctly assess the nature of the crisis – in consultation with its advisers and the IMF – because attempting to apply the incorrect restructuring measure may prove costly to the sovereign. On one hand, adopting short term, liquidity related solutions to a solvency crisis will not provide the sovereign with sufficient debt relief to restore debt sustainability. At the same time, attempting to apply harsher, deeper restructuring measures on creditors in a case of a liquidity crisis is unlikely to garner sufficient creditor support, thereby delaying the restructuring outcome and worsening the debt crisis.

B. Creditor composition

Once sovereign debt distress is ascertained, the sovereign, together with its advisers, should conduct a debt assessment and reconciliation exercise, to better understand the universe of outstanding debt claims that are contributing to the crisis and that may be part of a future restructuring solution. In particular, the sovereign will need to understand:

- the quantum of different debt claims and the relevant contribution of each to the total outstanding debt stock and upcoming debt service obligations;
- the legal and contractual terms of the relevant debt claims;
- the nature and number of different creditors that the sovereign will have to negotiate with; and
- the degree of homogeneity or heterogeneity within each debt class: this assessment is particularly important because the development of borrowing structures often leads to different sub-structures within a debt class. For example, private debt may consist of loans and bonds, and each of these classes may further consist of secured debt, debt issued with materially different financial or legal terms, and so on.

Understanding the complete picture of the sovereign's debt and creditor composition will in turn enable the determination of an effective restructuring strategy, including decisions relating to the design of the restructuring perimeter (i.e., which debts are to be restructured), engagement strategies with different classes of creditors, and assessment of idiosyncratic risks applicable to each class. Ultimately this will allow a fair and equitable treatment of all affected creditors and satisfaction of the "comparability of treatment" principle (further described in section F below).

C. Who will bear the burden of adjustment: define the restructuring perimeter and excluded claims

Once the nature of distress (and the corresponding solution) is ascertained and the amounts and types of outstanding debt have been assessed and reconciled, the sovereign will have to consider the apportionment of the burden of adjustment necessary to restore the sovereign's financial position.

Apportioning the burden of adjustment is a zero-sum game on two different levels. First, it is a zero-sum game between the sovereign and the creditors. In the context of a solvency crisis, for instance, where a debt restructuring is needed to restore debt sustainability, the burden of adjustment will be split between the economic adjustment efforts undertaken by the sovereign (in the form of reduced government expenditures and increased government revenues), on the one hand, and the creditors, in the form of debt relief and/or new concessional financing provided, on the other. The DSA of the IMF will prescribe the level of debt relief that is required to restore debt sustainability.

Once the quantum of debt relief is established, the sovereign will need to assess how to apportion the burden among its creditors. As the amount of needed debt relief is fixed, apportioning debt relief between creditors is a zero-sum game, where an unwillingness or inability to request debt relief from one class of creditors necessarily increases the amount of relief that must be requested from the remaining classes.

The design of the restructuring perimeter is subject to various sensitivities that historically have led to certain classes of debt being excluded from the perimeter.

- Multilateral debt, as discussed further below, is typically afforded preferred treatment and is excluded from the perimeter.
- Trade credits are usually excluded because they are necessary for continuous trade financing.
- Domestic debt was traditionally excluded from the perimeter because (i) such debt is typically denominated in local currency and therefore does

not affect the external balance of payments and (ii) restructuring domestic debt was considered destabilizing to the local financial markets. However, as domestic debt has become an increasingly important part of the debt portfolio of developing countries, the restructuring of domestic debt claims has, on a case by case basis, become increasingly common.

A broad and well-considered debt perimeter is imperative in implementing a restructuring that is considered by creditors as fair and thus has higher chances of success.

D. Strategy of engagement with creditors and stakeholders

Having assessed its debt and creditor composition and carefully designed the restructuring perimeter, the sovereign will then need to consider the appropriate engagement strategy with its (affected) creditors.

A carefully designed engagement strategy is important for two reasons. First, it minimizes information asymmetries between the sovereign debtor and the creditors that exist at the beginning of any restructuring process. On the one hand, the creditors do not know the overall level of debt relief that the sovereign needs and the rationale therefor, and on the flip side, the sovereign do not know the level of debt relief that the creditors may be prepared to provide. Additionally, proactive engagement with creditors can help build a good faith relationship that facilitates a successful restructuring outcome.

Two preliminary engagement considerations relate to (1) the method of engagement and the organization of creditor committees and (2) the sharing of information. While in most recent cases bondholders have been quick to organize in representative committees, the sovereign can invite the creation of committees among official bilateral creditors as well, while in certain instances where the majority of outstanding debt is highly concentrated in the hands of a few large creditors, the sovereign can opt to engage bilaterally with such creditors in the hopes of an efficient resolution. In cases, however, where the debt and creditor composition is fragmented, creditor committees can facilitate both communication between the sovereign and each class of creditor and communications between creditors themselves. This increases the flow of information and coordination among different stakeholders.

The second important consideration, not least to ensure compliance with the IMF's criteria for good faith engagement with creditors, is the level of transparency and information sharing between the sovereign and its creditors. Transparency and flow of information builds trust, cures information discrepancies, and allows creditors to make informed decisions. However, the sovereign will have to carefully assess the type of information it is allowed to share with creditors, as for example information about certain debt facilities may be subject to confidentiality provisions. The format and timing of sharing information must also be considered, since public bondholders (for example) are restricted from trading while in possession of material non-public information. This means that material information shared with bondholders in the course of negotiations must ultimately be made public, notwithstanding the sensitivity of such information. The same considerations do not necessarily apply in the context of discussions with official bilateral creditors.

The sovereign, together with its financial and legal advisers, will have to carefully assess the level of information it wishes to put in the public domain or share with creditors bilaterally (including under non-disclosure agreements), with a view to creating fertile grounds for constructive restructuring negotiations.

E. What are the implementation risks, legal risks and collateral effects?

In designing an effective restructuring strategy, a sovereign must carefully evaluate implementation or execution risks, including potential collateral effects. In other words, the sovereign and its advisors will need to consider the chances of success and possible unintended consequences.

As a sovereign debt restructuring is not subject to any formal insolvency regime that can compel creditor participation, the resolution of a debt crisis is ultimately a matter of negotiation between a sovereign and each affected creditor/class of creditors. Creditors may be inclined to not participate in the restructuring process (i.e., "holdout"), in the hopes that if a substantial majority of other creditors participate, the sovereign will be restored to financial health and will be in a position to honour its legacy contractual obligations (or may be prepared to negotiate a more favourable restructuring solution with the holdout creditor).

Holders of debt instruments that do not provide for majority voting through "collective action clauses", or holders of debt instruments that benefit from security or quasi-security arrangements, may decide to engage in holdout behaviour which has the effect of destabilizing an otherwise orderly restructuring process. For this reason, the sovereign and its advisors will have to carefully examine the legal structure and provisions of the debt agreements within the restructuring perimeter to ascertain a creditor's bargaining power and the likelihood of holdout behaviour. Restructurings can and should be designed to incentivize high levels of participation and disincentivize potential holdouts.

There is always the possibility that holdout creditors – private creditors in particular – may initiate lawsuits to recover overdue payments and initiate enforcement proceedings to find and attach sovereign assets to satisfy a judgment. While the scope of sovereign immunity generally provides protection for a range of state assets that are located abroad, commercial assets

are usually subject to attachment, and certain private creditors (with the assistance of asset tracing specialists) have on occasion gone to considerable lengths to find available assets to attach. For that reason, part of the risk assessment advisable in the context of a sovereign debt restructuring process is an evaluation of sovereign assets that are located abroad and could potentially be subject to attachment. With the support of its legal advisors, there are steps a sovereign can take to shield assets from attachment prior to any creditor enforcement actions.

Aside implementation and legal risks, a sovereign will also have to carefully evaluate any collateral effects the restructuring may have on the domestic economy, and, if necessary, take actions to mitigate those effects. Restructuring of international sovereign bonds can often spillover into the domestic banking system to the extent that domestic banks and financial institutions are substantial holders of sovereign bonds. The risk is particularly acute when a sovereign has to conduct a restructuring of its domestic debt – governed by local law and often denominated in local currency – to restore sustainability. Restructuring domestic liabilities such as treasury bills ("**T-bills**") and treasury bonds ("**T-bonds**") that may be held by a large variety of domestic institutions, such as banks, the central bank, pension funds, and retail investors, may have direct effects on the financial condition and viability of the holders of such instruments. As such, a debt restructuring would need to be structured so as to mitigate these effects and preserve the viability of the domestic financial system to the largest extent possible.

F. Comparability of treatment

In the absence of an insolvency regime to prescribe the sovereign debt restructuring process, market participants and policy makers have long stipulated informal principles for the fair and orderly resolution of a debt crisis.

A core debt restructuring principle is that of comparability of treatment, which has been an integral part of the Paris Club restructuring process, forms an integral part of the Common Framework, and has been espoused and promulgated by private creditors and other stakeholders through the Institute for International Finance's Principles for Stable Capital Flows and Fair Debt Restructuring. See *Appendix IV—Comparability of Treatment* for a more detailed description of the Paris Club, Common Framework and IIF application of the principle.

As such, an implicit – and often explicit – condition of participating creditors in a debt restructuring is that the sovereign will seek comparable treatment from its other creditors. The core idea is that no creditor should benefit from a more favourable treatment than another, and that the burden of restructuring should be fairly spread across creditors.

However, comparability of treatment does not have a single universal definition and there is no universally accepted mechanism to test it.

Historically, the anchor for comparability of treatment was set by the Paris Club, which was often the largest creditor and typically moved first to agree to provide debt relief to a distressed sovereign. Paris Club agreements contain a specific clause whereby "a debtor country that signs an agreement with its Paris Club creditors should not accept from its non-Paris Club commercial and bilateral creditors terms of treatment of its debt less favourable to the debtor than those agreed with the Paris Club."

The Paris Club's assessment of a sovereign's compliance with the clause relied on a case-by-case assessment of multiple factors, including the net present value ("**NPV**") reduction of the claims (calculated on a non-fixed "appropriate market" discount rate), their average maturity, and their contribution to filling the financing gap (i.e., contribution to debt relief) during an IMF programme period. This multi-factor assessment provided the Paris Club a degree of flexibility in the application of the comparability of treatment principle, ensuring that such application took into account the unique characteristics of each sovereign's situation.

In the context of the Highly Indebted Poor Countries ("**HIPC**") initiative (described in Part III.6 below), a rare example of where multilateral creditors agreed to provide debt relief, comparability of treatment was assessed based on NPV reduction of all claims, where a "common reduction factor" was applied to all claims (bilateral and multilateral), with a single discount rate and a single reference date for the calculation of NPV reduction.

In today's sovereign debt restructurings, assessing comparability of treatment on NPV terms is ever more challenging, predominantly due to the presence of a larger and more diverse group of creditors all holding different types of claims.

In the current creditor landscape, assessing comparability of treatment based on the value of the claims post-restructuring raises the difficult question of what discount rate to use to discount the cash flows of differently situated creditors who lend at different rates. If each class of creditors calculates its net-present-value contribution to a restructuring using a different discount rate, it becomes difficult to ascertain comparability based on NPV terms alone, unless all creditors agree on an appropriate discount rate. At present there is no consensus between official and private creditors on the appropriate discount rate to apply, with official creditors typically applying a substantially lower rate (typically 5%) for these purposes than private creditors, who apply market rates.

In the absence of a universally accepted methodology, sovereigns, together with their advisors, will have to consider how comparability of treatment can be best achieved in a particular case – taking into account, among other factors, the debt and creditor composition and the contribution of each claim to the restructuring effort.

This can be very challenging, but is critical to ensuring that different categories of creditors each believe that they are bearing an appropriate share of the burden of restructuring.

6. Institutional debt relief initiatives

Even though there is no international insolvency regime for resolving sovereign debt crises, the international financial community, and in particular the official sector, has from time to time introduced debt relief initiatives aimed at alleviating the debt burdens of low-income countries.

Highly Indebted Poor Countries (HIPC) Initiative

The World Bank and IMF launched the HIPC Initiative in 1996 to create a framework in which all creditors, including multilateral creditors, can provide debt relief to the world's poorest and most heavily indebted countries to ensure debt sustainability, reducing the constraints on economic growth and poverty reduction in these countries imposed by the unsustainable debt burdens. To date, 38 HIPC-eligible countries have reached "Decision Point" (i.e., adopted poverty reduction policies deemed sufficient to qualify them for debt relief), of which 36 have reached "Completion Point" (continued sound policy implementation and received full debt relief).

Created in 2005, the aim of the Multilateral Debt Relief Initiative (the "MDRI") was to further reduce the debt of eligible low-income countries and provide additional resources to help them reach their development objectives. Under the MDRI, three multilateral institutions—the World Bank's IDA, the IMF and the African Development Fund—provide 100 percent debt relief on eligible debts to qualifying countries, at the time they reach the HIPC Initiative Completion Point.

The aims of the HIPC and MDRI initiatives are now nearly completed, with HIPC closed to new entrants in 2011 and MDRI was terminated in 2015.

The DSSI

More recent institutional debt relief initiatives emerged at the outset of the COVID-19 pandemic in 2020. With the stated aim of helping low-income countries (eligible for International Development Assistance) deal with the immediate consequences of COVID-19 and excessive debt service burdens, the G20 introduced the Debt Service Suspension Initiative (DSSI), which allowed 73 eligible low-income countries (the "DSSI-eligible countries") to request a deferral of debt service payments due to official creditors through the end of 2021. While the DSSI did not require the participation of private creditors, it successfully delivered $6 billion of official sector debt relief during 2020 and a further $7 billion in 2021 for the 48 countries which signed up.

The Common Framework

To address certain of the limitations of the DSSI, namely the fact that the DSSI was designed to address short-term liquidity challenges rather than more severe debt sustainability concerns and only relied on voluntary participation of private creditors, the G20 reached agreement in November 2020 on a "Common Framework for Debt Treatment Beyond the DSSI" (the "CF"), which would continue to apply to DSSI-eligible countries. The CF intended to go beyond the DSSI in bringing the newer official non-Paris Club creditors (including China, India and Saudi Arabia) into a process that was akin to that used to restructure traditional bilateral, Paris Club debt. Unlike the DSSI, the CF also specifically mandates private debt treatment, requiring that private creditors provide comparable debt relief to that agreed by official sector creditors.

The progress of the CF since its launch, however, has been disappointing to many – only four countries have applied for debt relief under the CF (Chad, Ethiopia, Ghana and Zambia), and of those only Chad has completed its debt restructuring as of the date of this Debt Guide's publication. The initiative, so far, has been criticized for the slow pace of implementation, in large measure due to problems in coordination amongst official creditors and continuing disagreements over application of the comparability of treatment principle across creditor classes.

7. Restructuring External Debt: Methods and Considerations

In the absence of an internationally recognized bankruptcy regime for sovereigns – and in situations where the institutional debt relief initiatives are not available or are not considered effective – a distressed sovereign debtor can only restructure its debts through negotiation with its creditors. This process requires good faith and realism on both sides.

After defining the external debt restructuring "perimeter" (i.e., the external debt claims that will be treated), the sovereign must take into account specific considerations applicable to each class of creditors and follow tailored approaches and strategies to effectuate a successful restructuring.

In this section we address debt restructuring considerations and strategies as they apply to external debt, i.e., debt governed by foreign law, owned to both official and private creditors.

The seniority of sovereign debt and preferred creditor treatment

As described earlier, a key consideration at the outset of a debt restructuring is the establishment of the restructuring perimeter; that is, the scope of the sovereign debt that will be subject to restructuring.

While there is no legal or contractual basis for establishing

different levels of seniority or otherwise differentiating between sovereign debt obligations, sovereigns have long been guided by conventions and market practice in designing the restructuring perimeter and giving preferential treatment to certain claims.

At the top of the *de facto* seniority structure is the IMF and other multilateral development banks – such as the World Bank Group and other international financial institutions with global membership– that offer policy-based financing and emergency financing at concessional rates. Such institutions provide an important public good in the form of maintaining financial stability and offering developmental assistance.

As such, multilateral official creditors claim to enjoy "preferred creditor status" ("**PCS**") and their claims are typically excluded from a debt restructuring and paid in full. This seniority is not codified or prescribed in articles of association of the relevant institutions; instead, it is conferred by market practice. Such preferred creditor status and treatment originated in the context of debt restructuring by the Paris Club, where official bilateral creditors have historically been willing to exclude the IMF from the restructuring process in recognition of its role in the international financial system as lender of last resort.

In practice, in the absence of endorsement of a creditor's preferred status by the Paris Club (or the official sector more broadly), a creditor is usually deemed to lack such standing in the context of sovereign debt restructurings.

Official bilateral creditors are next in the pecking order of effective seniority.

- The Paris Club's comparability of treatment principle states clearly that non-Paris Club official creditors and private creditors should receive a treatment on comparable terms to those granted by the Paris Club. In other words, other creditors cannot receive more favourable treatment. The Paris Club has rejected the concept of "reverse comparability of treatment", meaning that the sovereign is free to offer other creditors worse terms than those offered to the Paris Club without requiring that the Paris Club also accept such worse terms.

- Certain non-Paris Club official creditors include specific clauses in their debt agreements which provide that the claims are to be excluded from any restructuring of official claims. Such provisions however have not been honoured or enforced in practice. In addition, certain of such creditors have extended financing through elaborate collateralized structures in an attempt to gain *de facto* priority in payment.

The treatment of private debt claims – and the decision to confer preferential treatment – is assessed on a case-by-case basis and is guided by the collateral effects of restructuring (or not restructuring) such debts. As a result, short term private trade credits are usually excluded from the restructuring perimeter as they are fundamental to ongoing trade financing for the sovereign in distress.

The treatment of all remaining private debt claims – domestic and international bonds, bank loans and other credits – is guided by the comparability of treatment principle and the relative bargaining power of each class of creditors in the restructuring process.

A. Restructuring multilateral and plurilateral debt

Claims of multilateral creditors are typically excluded from a debt restructuring treatment (and to the extent arrears are owed to such creditors, those have to be resolved before the IMF will extend financing) by virtue of such creditors enjoying a *de facto* preferred creditor status.

Such claims have traditionally included only claims by the World Bank Group, the IMF, and other international financial institutions with global membership (i.e., MDBs), that provide policy-driven lending at concessional rates, and have enjoyed preferred treatment by consensus of the Paris Club.

However, an increasing share of lending to emerging and developing countries is currently being done at near-market rates by regional banks and institutions with more limited memberships that comprise both official institutions and private institutions.

Such "plurilateral" creditors support projects and fill financing gaps that traditional multilateral or bilateral creditors cannot fill. For many countries, particularly in Africa, plurilateral institutions are long-term financing partners – even though they are rarely providing funding on the concessional terms offered by MDBs. Due to that relationship, plurilateral creditors have in a number of cases claimed to enjoy PCS and have stipulated they are unwilling to restructure their debts alongside other bilateral and private creditors.

A sovereign facing resistance from plurilateral creditors who claim to have PCS should assess in good faith the merits of awarding such creditors preferred treatment, based on the following considerations:

- Has such creditor traditionally been regarded as enjoying PCS in the view of the Paris Club (or the official sector more broadly)? If yes, then the sovereign can treat the creditor preferentially.

- If past practice does not confer the creditor PCS, then the sovereign needs to assess the benefits and costs of doing so.

- The most significant challenge and risk to conferring PCS to a creditor that has not previously enjoyed such status among the official

sector is that it may violate the comparability of treatment principle.

- A unilateral decision to confer PCS to a creditor in a comprehensive debt restructuring involving official sector claims may be seen by Paris Club creditors (or official bilateral creditors more broadly) who provide debt relief and by multilateral creditors who may be providing additional emergency financing as breaching a fundamental tenant of equal burden sharing. This may jeopardize the conclusion of restructuring agreements with official creditors and/or the provision of new financing (including as a result of a breach of the IMF's arrears policy with respect to such creditor).

B. Restructuring Paris Club debt

The sovereign may decide to approach the Paris Club to seek rescheduling of its government-to government debt to Paris Club creditors. The precondition for a Paris Club rescheduling is that the country must have an IMF-supported programme in place. The Paris Club has established a set of operating principles and a menu of options for sovereign debtors in debt distress, referred to as the "Paris Club Principles" and the different Paris Club "treatments".

The principles include: (i) solidarity, where all Paris Club members agree to act as a group, (ii) consensus, where debt relief decisions are taken by consensus, (iii) information sharing, where members share data and information on their claims and the situation of the sovereign debtor, (iv) case by case approach, where debt relief is tailored to the particular debtor case, (v) conditionality, where the debtor country commits to implement economic reforms to restore their financial position, and (vi) comparability of treatment, where a debtor country commits not to accept from other bilateral and commercial creditors any less favourable terms than those agreed with the Paris Club.

The "treatment" options include rescheduling, which is debt relief by postponement of maturities or, in the case of concessional rescheduling, reduction in debt service obligations during a defined period (flow treatment) or as of a set date (stock treatment). The modality of debt treatment, cut-off date, and consolidation period depend on the financing gap identified in the IMF DSA. In deciding on the appropriate debt treatment, the Paris Club takes into account the country's track record in implementing necessary reforms and servicing its debt and the expected contribution from other external creditors.

The agreement reached between the sovereign and the Paris Club is documented through Agreed Minutes. The terms of the Agreed Minutes, which effectively constitute an agreement in principle, are subsequently implemented by the sovereign through the execution of bilateral agreements with each Paris Club creditor country.

The Agreed Minutes importantly include a standard and broadly construed comparability of treatment clause, providing that the terms of the other agreements entered into by the sovereign cannot be less favourable to the sovereign than the terms of the Agreed Minutes. However, historically, the Paris Club has never "enforced" comparability of treatment by withdrawing or amending an agreed debt treatment following an assessment that other creditors have received more favourable treatment.

C. Restructuring non-Paris Club official debt

In contrast to Paris Club debt restructuring – which follows a set of established principles and effectively involves negotiation with a unified creditor body – non-Paris Club restructuring takes the form of independent, bilateral negotiations with each non-Paris Club official creditor.

Case-by-case approach. The negotiation dynamics will necessarily be driven by the relationship of the sovereign debtor with each creditor, and will be a function of political, diplomatic, financial and legal considerations.

Assessing creditor leverage. As in every bilateral negotiation, the outcome will partly be driven by the relevant leverage between the debtor and the creditor. Non-Paris Club creditors can exert leverage in different forms:

- **IMF financing assurances**: in the context of an IMF supported programme, financing assurances from non-Paris Club creditors may be required before the programme is approved by the IMF Executive Board. The leverage of the bilateral creditor is highest in situations where financing assurances are required, as withholding such assurances effectively jeopardizes the approval of IMF financing.

- **Lending structures**: the government, in consultation with its legal and financial advisors, should review carefully the applicable financing structure and documentation. In many cases, non-Paris Club financing is extended via lending structures that confer on the lenders rights to collateral or quasi-collateral in the case of non-payment (see prior discussion on Secured and Quasi-Secured Lending). Lenders who benefit from such structures can threaten to attach the collateral and thereby gain priority over other creditors. Depending on the magnitude of the preferential treatment that may be gained in this way, this may impact the negotiations with other

creditors and/or with the IMF.

- **Threat of non-participation**: in the absence of an insolvency regime, official bilateral creditors are not bound by a decision of other creditors to provide debt relief. Ultimately, provision of debt relief is a voluntary decision. Mere threat of non-participation in a restructuring may therefore serve as leverage in and of itself, because the presence of unrestructured debt – even if the debtor undertakes not to make payments on such debt in the absence of an acceptable restructuring – can threaten the longer term stability and sustainability of the country's debt position.

Mitigating leverage and obtaining debt relief. Each of the above elements of creditor leverage can complicate restructuring negotiations. While there are no "one size fits all" solutions, sovereigns can take steps to mitigate each such element.

- **Comply with IMF Lending into Official Arrears policies and good faith engagement**: in the case where an official bilateral creditor's unwillingness to participate in debt restructuring may jeopardize the approval of IMF financing, the IMF can choose to utilize its LIOA policy with respect to such creditor insofar as the sovereign is in default to such creditor. In order for the LIOA policy to apply, the IMF needs to make sure that the relevant conditions (set out in **Annex V**) are met, including that the sovereign is engaging in good faith with the official bilateral creditor towards a resolution of its claims. Application of the LIOA policy will enable the IMF to disburse funds in the presence of a non-participating creditor, and permit the programme to be partly "financed" through arrears.

- **Mitigate risks of preferential payments**. In the case where the lender benefits from security or access to sovereign funds deposited in quasi-security accounts, the sovereign can either take steps to protect its assets (i.e., terminating funding of accounts, resisting attachment of domestic assets, etc.) or it can account for any assets or funds that have been so attached in the sovereign's restructuring proposal. In other words, if a creditor takes steps to enforce against collateral, then any payments or other assets preferentially obtained in that way will be proportionately reflected in the overall debt relief effort the creditor will subsequently be asked to provide in order to ensure comparable treatment.

- **Tailored restructuring proposals and incentives**. To incentivize the participation of a creditor in the restructuring process, the sovereign can tailor the proposal to the creditor's specific preferences insofar as the overall offer (and the creditor effort required) is comparable to that requested of other official creditors and consistent with IMF program parameters. For example, the offer may provide for a combination of maturity extensions, coupon adjustments, and/or principal reductions to accommodate the preferences of the creditor, and may even involve contingent or value-recovery elements to minimize the losses in defined upside scenarios.

D. Restructuring sovereign bonds

Important Considerations

Since the 1980s, sovereign bonds placed in the international capital markets have emerged, as the leading form of private sovereign financing. For middle-income countries with market access, bonds make up an increasingly large percentage of the country's outstanding debt stock, while low-income countries in recent years have also been able to tap the international bond markets because of the historically low interest rate environment. As the source of private credit has shifted from bank loans to Eurobonds, the composition of sovereign private creditors has also shifted from a relatively small group of international banks towards anonymous and dispersed holders of interests in global bonds lodged in the international clearing systems.

From the sovereign's perspective, a dispersed and heterogenous private creditor base makes a potential debt restructuring operation more complicated. Not only is it harder to identify and engage with the largest bondholders, but the sovereign also has to cater to the reality that bondholders have a range of different business models and economic preferences, and therefore, respond to different incentives. Specialist distressed debt investors behave differently than "real money" institutional investors, retail investors behave differently than local banks, and so on.

In the absence of a sovereign debt restructuring regime, a sovereign cannot bind bondholders as a class into a restructuring. However, the contract terms of international sovereign bonds have evolved to facilitate collective action. Today, most new issues of sovereign bonds include collective action clauses that permit a defined majority of bondholders – either within a series or across different series – to bind the remaining minority into a restructuring. That being said, because the evolution of CACs has been gradual, different bonds issued at different times by a sovereign can include different clauses and voting mechanisms.

For example, (i) bonds issued prior to 2004 (especially under NY law) may not include collective action clauses at all, (ii) bonds issued between 2004 and 2007 may include "series-by-series" CACs (that apply within a single series only), (iii) bonds issued between 2008 and 2014 may include CACs that permit voting within series and limited voting across series, and (ii) bonds issued after 2014

may include the modern, aggregated CACs promulgated by ICMA that provide for a menu of voting options and permit aggregated voting across all bond series.

The key preliminary considerations in re-structuring sovereign bonds are:

i. What is the composition of the bondholder class?

ii. What is the scope of the collective action clauses included in the sovereign bonds?

iii. In the absence of robust collective action clauses, what other contract terms can facilitate a restructuring?

The absence of uniformity of contract terms and sufficiently robust collective action clauses throughout the entirety of the class of sovereign bonds creates opportunities for individualistic, holdout behaviour that can debilitate or at least delay a restructuring process.

In cases where all or some of the outstanding sovereign bonds do not include CACs, the sovereign will have to resort to other techniques to incentivize creditor participation and minimize the number of holdout creditors, as discussed further below.

See **Annex IX—Key features of Past Sovereign Debt Restructurings** for an overview and comparison of key features of previous sovereign debt restructurings.

Creditor Engagement

The establishment of representative bondholder committees often provides an answer to the creditor coordination problem. Bondholder committees facilitate information flow between the debtor and the bondholders, reduce information asymmetry, and facilitate constructive dialogue between the parties, particularly in cases where the creditor landscape is fragmented and debt is not concentrated in the hands of a few large institutions.

The composition of the bondholder committee can be critical, and it is to the benefit of both the sovereign and bondholders that any committee that is established encompasses a diverse set of creditors that is broadly representative of the bondholder base. A well-structured committee that is perceived to represent the interests of the broad class of bondholders gives credibility to the negotiating process and facilitates relatively quick resolutions. Not least, a representative committee that can command the support of the broad bondholder class is often catalytic in leveraging the benefits of collective action clauses.

Transaction structures and techniques

The implementation of a bond restructuring relies on the voluntary participation of a large number of bondholders. To implement a debt restructuring, the sovereign either (i) launches an exchange offer, where the sovereign invites bondholders to exchange their existing bonds for new bonds with different payment terms, (ii) launches a consent solicitation, seeking the consent of bondholders to amendments to the payment terms of the bonds, or (iii) launches a combination of a consent solicitation and exchange offer, where the sovereign invites bondholders to exchange their existing bonds for new bonds and in the process also amends the terms of the existing bonds.

In the absence of collective action clauses that can make amendments to the existing bond terms binding on all holders if they are accepted by a qualified majority, sovereigns must rely exclusively on voluntary exchange offers. In these transactions, the sovereign invites holders to exchange their existing bonds for new bonds with reduced payment terms that include lower principal (i.e., a principal “haircut”), lower coupons, an extension of maturities, or all three.

In order to maximize voluntary participation and minimize the number of non-participating bondholders, a use of specific incentives and disincentives typically accompanies each offer.

The traditional toolkit of incentives and disincentives include the following “carrots” and “sticks”:

Incentives / "carrots"	Disincentives / "Sticks"
➢ Cash or cash equivalents and consent fees Cash, consent fees (payable only to participating holders) or cash equivalents (including a portion of past-due interest paid in cash) are used to compensate participating holders and incentivize participation. Such cash payments, although sometimes modest, nonetheless increase creditor recovery. ➢ *Value recovery instruments* ("VRIs") VRIs are "upside" contingent instruments that have been issued to participating creditors to compensate for losses incurred in the restructuring, most commonly as a result of principal haircuts. The premise of a VRI is that if the country does better than anticipated economically following a restructuring – as measured against baseline scenarios normally established by the IMF DSA – then the participating creditors in the restructuring are able to recoup some or all of their principal losses via the VRI. ➢ Contractual improvements aimed at strengthening creditor protections Sometimes the new bonds issued in a restructuring include improved contractual terms that the market perceive as more valuable, and therefore enhance the tradability and value of the new debt in the secondary market. ➢ Most favoured creditor clauses / Rights Upon Future Offers clauses Such clauses, which can take a number of forms, provide assurances to participating bondholders that any non-participating holders will not in future receive a better restructuring offer from the sovereign without the participating creditors having the right to receive the same advantageous terms. The inclusion of these clauses is intended to convince potential holdout creditors that they will gain nothing from following such a strategy.	➢ Threats of non-payment and legislative actions A threat of non-payment to holders who choose not to participate is implicit or explicit in every debt restructuring. Given the voluntary nature of debt restructurings, few if any bondholders would elect to participate if they thought that they would otherwise receive full payment on their existing instruments when due. ➢ Application of collective action clauses In bonds that contain collective action clauses, whether or not CACs serve as a strong disincentive depends on how the sovereign elects to use them. In many cases, the sovereign will use the CACs to bind non-participating creditors into the same deal accepted by the holders who voluntarily participated. Most recently – and as discussed further below – CACs have also been used in conjunction with "exit consents" to give holdout creditors worse terms than the ones accepted by the participating creditor majority. ➢ Use of "exit consents" "Exit consents" is a technique that applies in the context of a concurrent exchange offer and consent solicitation, whereby a sovereign invites holders to exchange their bonds and in the process use their voting power to amend certain terms of their existing bonds, so that any non-exchanging holders who retain the existing bonds end up holding bonds with impaired terms. As discussed below, exit consents had traditionally been used to alter non-payment terms, whose amendment requires a lower voting threshold than that for payment terms, but recently have also been used in conjunction with CACs to amend the payment terms of non-participating bonds and give non-participating holders worse economic terms than those accepted by the relevant bondholder majorities. The aggressive use of exit consents is potentially subject to legal challenge, but may be a useful tool when dealing with particularly intransigent holdout creditors.

Annex X—Application of Techniques in Eurobond Restructuring describes in more detail the application of certain incentives and disincentives to implement certain selected Eurobond restructurings over the last 20 years.

E. Restructuring sovereign loans

The considerations and the methods of restructuring sovereign loans are generally similar to those for restructuring sovereign bonds, with a key exception: in contrast to bonds, and in the absence of wide adoption of the novel majoritarian voting provisions, syndicated bank loans require consent of all members of the syndicate to amend payment terms. This in theory heightens the risk of holdout action by one or more lenders, although in practice banks have not tended to follow holdout strategies in sovereign debt restructurings.

Obtaining unanimous consent is further complicated by the fact that bank lenders may either transfer their interest in the bank loan to a secondary buyer or sell a participation in the loan to another creditor. As such, the creditor class is expanded to include creditors with different preferences, fiduciary concerns or risk tolerance.

While most syndicated loans still lack majority clauses to amend payment terms, they contain amendment provisions for non-payment terms that, coupled with the legal technique of exit consents, can facilitate high participation by rendering the old debt difficult to enforce. However, loan terms are often not standardized and can vary greatly: loans will differ on the majorities needed for amendment and what terms may be amended with agreement from less than all creditors.

F. Restructuring guaranteed commercial debt

State guaranteed debt – obligations owed by state entities other than the central government whose performance is guaranteed by the central government – is an increasingly prominent feature of the sovereign finance landscape. Accordingly in the context of a sovereign debt restructuring, the question arises whether such instruments, before they are called and thereby become a direct sovereign obligation, should be included in the debt restructuring perimeter. From the sovereign perspective, excluding guaranteed debt from the perimeter means that the sovereign has a contingent liability that at any time might be called upon to satisfy, which could disrupt financing plans and/or jeopardize the restoration of debt sustainability. From the perspective of other sovereign creditors within the restructuring perimeter, basic questions of burden sharing and comparability of treatment will arise if the obligations covered by the sovereign guarantee are not restructured.

Historically, state guaranteed obligations typically formed only a small part of the outstanding debt portfolio and were therefore excluded from the restructuring perimeter. At most, guarantees were included in the perimeter only if and when the beneficiary of the guarantee called on it prior to the conclusion of the restructuring. However this practice is now changing, and it is increasingly common to see guaranteed obligations included in the perimeter even though the underlying obligor has remained current on debt service payments.

Including guaranteed obligations in the restructuring perimeter creates some unique challenges for the sovereign debtor, including creditor coordination (since the holders of the guaranteed obligation may not be capable of being bound through a collective action mechanism and may indeed be reluctant to participate so long as the underlying obligor is remaining current) and fairness (since the holders of the guaranteed obligation are in a stronger position than other sovereign creditors to the extent they continue to retain a direct claim on a solvent underlying obligor).

Restructuring guaranteed obligations is typically effectuated in one of the following ways:

- **Voluntary offers**: a sovereign can attempt to restructure its guaranteed debt in a voluntary exchange offer, whereby holders of the guaranteed debt are either (1) invited to exchange their claims for new direct obligations of the sovereign (taking into account the additional value of the claim on the underlying obligor) or (2) invited to exchange their guaranteed debt for new debt of the same structure but amended payment terms.

- **Involuntary offers**: as an alternative to a purely voluntary offers, a sovereign can attempt to implement a restructuring of the guaranteed debt by application of collective action clauses, to the extent present either in the guarantee or the underlying obligation. Guarantees governed by foreign law rarely have collective action clauses embedded in them, but guarantees governed by local law leave room for retroactive application of collective action clauses by domestic legislation. More often, collective action clauses are included in the underlying obligation, where holders of the underlying instrument have the ability to change the terms of both the underlying obligation and the guarantee.

To facilitate the application of collective action clauses in restructuring guaranteed debt, it is possible to draft the collective action clauses included in both the sovereign bonds and the guaranteed bonds to provide for aggregated voting between holders of direct and guaranteed sovereign obligations. The inclusion of such drafting can reduce the holdout risk when restructuring guaranteed obligations.

G. State Contingent Debt Instruments in Debt Restructuring

Debt restructurings of private sector debt have often included the exchange of existing debt instruments for new, fixed income instruments with reduced present value and with payment terms calibrated to help the sovereign restore debt sustainability. In the context of an IMF-supported programme, the new payment terms would be designed to comply with the IMF's debt targets under the baseline macro-fiscal trajectory for the

sovereign underpinning the programme. In the absence of an IMF programme, the agreed terms of the restructured debt would be designed to fit into the expected macroeconomic trajectory of the sovereign as agreed between the sovereign and its respective creditors, such that they provide an amount of debt relief all parties consider appropriate.

SCDIs in this context are instruments whose payment terms depend on the value of a state variable, which is linked to – and functions as a proxy for – the sovereign's debt service capacity. SCDIs embed contingent features, where payouts under the instrument depend on the value of an observed variable. For a detailed description of SCDIs issued at the pre-crisis stage, see the **ALSF Debt Guide on State-Contingent Debt Instruments.**

Role of SCDIs in debt restructurings

Instruments whose payouts are contingent on future outcomes can prove particularly useful in the context of a sovereign debt restructuring. The terms of a debt restructuring are necessarily based on a forward-looking assessment of the sovereign's economic condition and debt sustainability in the short, medium and long-term. Forward-looking assessments carry, by their nature, a significant level of uncertainty, and are often subject to significant disagreement among the participants in the restructuring process.

By tying the debt service payments of restructured debt contracts to future outcomes, SCDIs may help bridge the gap in economic expectations between debtors and creditors, minimize lengthy disputes about the sovereign's future debt payment capacity, and expedite agreements between sovereigns and their creditors. SCDIs can facilitate quicker debt crisis resolution while achieving the right balance between the level of debt relief provided to the sovereign and the losses incurred by creditors over the medium term.

Types of SCDIs in debt restructurings

In a sovereign debt restructuring context, two types of SCDIs are most prominent: (1) VRIs (discussed above) and (2) symmetric instruments with automatic adjustments ("**symmetric SCDIs**").

Value Recovery Instruments

Value recovery instruments are typically structured as derivative instruments or warrants that are tied to a state variable (such as nominal GDP growth or exports), which serves as a proxy for the sovereign's debt payment capacity. They have been historically issued in situations where debtors and creditors disagree about the economy's future outlook, but the core debt restructuring terms are based on conservative economic assumptions. In such cases, VRI payouts can supplement those under the fixed income debt instruments issued in the debt exchange and provide creditors with an enhanced return (or "upside") if the selected variable outperforms the original expectations. The most commonly used form of a VRI is a GDP-warrant, which provides creditors with additional payouts if the country's nominal GDP growth over a defined period exceeds baseline assumptions (usually embedded in the IMF programme).

While VRIs can be useful to bridge gaps in expectations between a sovereign and its creditors, and to ensure that creditors who provide sufficient debt relief may recoup some or all of their losses in cases of improved economic performance, VRIs have certain shortcomings that limit their attractiveness to market participants. These broadly include (1) design and data credibility issues, (2) investor appetite for non-fixed income instruments, and (3) valuation issues that impact liquidity.

First and foremost, for a VRI to be effective, the proxy variable that determines payouts has to be independently verifiable and outside the control of the government. If investors perceive that the proxy variable may fall within the direct or indirect control of the government, this will negatively impact valuation of the instrument. At the same time, certain investors, predominantly "real money" institutional investors, may prefer fixed-income instruments in lieu of more exotic, derivative instruments. That is more evidently the case in situations where such instruments are hard to price, due to the bespoke nature of the contingent payment mechanisms and the underlying uncertainty about future payouts. These same considerations mean that VRIs are generally not eligible to be included in emerging market bond indices, which further reduces the attractiveness of these instruments to large institutional holders whose portfolios track the relative weighting of different sovereigns in the indices. These and other challenges narrow the spectrum of secondary market investors who are interested to hold and trade these instruments, further impacting pricing and liquidity. For a summary of the use of VRIs in debt restructurings, please see **Annex VIII—Value Recovery Instruments and SCDIs in Sovereign Debt Restructurings.**

Symmetric SCDIs

Symmetric SCDIs differ from VRIs in that they provide for symmetric payouts (adjusted upwards and downwards) as opposed to only upside payouts. While VRIs are typically issued alongside and separate from fixed income instruments in a debt restructuring, symmetric SCDIs can be issued based on a more favourable baseline scenario of expected future outlook, and include "automatic adjusters" that periodically adjust payouts under the instrument based on the actual reported economic performance of the sovereign at certain observation periods.

This structure can in theory facilitate expedited restructuring agreements by aligning the debt relief requested by the sovereign with the debt relief that creditors are willing to provide, while offering downside protection to the sovereign if certain economic risks

materialize and the economy performs worse than expected over a period of time. In other words, symmetric SCDIs at the time of issuance can increase creditor returns without increasing the risk of default, as payments under the instrument would automatically adjust downwards in a time of distress.

The symmetric SCDI can be structured such that all payment terms, including the coupon, the principal amount, and the duration are adjusted upon occurrence of certain pre-determined events. For example, in the case that real GDP falls below a certain threshold, the coupon or principal may be reduced or the maturity extended to reduce the sovereign's payment pressures and automatically provide debt relief when needed.

SCDI design considerations

A robust design of an SCDI will increase the desirability of the instrument from a creditor perspective. Some of the features that can enhance the attractiveness, and hence value, of SCDIs include the following:

- Choice of state variables and triggers

The state variable that will trigger payouts or adjustments under the SCDI should be independently observable and verifiable, outside the control of the government, which can serve as a proxy for the government's debt repayment capacity. Careful selection of both the variable to be used in the SCDI and the trigger point for payouts or adjustment will be important to ensure the SCDI is a credible and attractive instrument to investors while also ensuring the sovereign will benefit from adequate debt relief in adverse scenarios.

- Design of payout formulas

The payout formulas have to be designed to ensure appropriate sharing of risk between the sovereign and the SCDI holders. Structures without a cap on payouts are risky, because they can lead to over-allocation of government revenues to SCDI-holders and create a perception of unfairness. At the same time, structures where the payouts are excessively constrained or are perceived as too contingent, will be unlikely to hold much value for investors in a restructuring negotiation. In any event, the payout structure should be robust to avoid moral hazard on the part of the sovereign and temptation to manipulate the payments.

- Enhancing liquidity and tradability

After choosing a credible state variable, the sovereign should design the SCDI in a way that maximizes its tradability and liquidity. Instruments that have simple payout formulas are usually easier to price than more complex instruments. In the case of a VRI, the instrument should be detached from the fixed income instrument such that it can be traded independently from the time of issuance. In the case of a symmetric SCDI, the sovereign should design the instrument – if possible – with an eye to ensuring that it will be capable of inclusion in leading emerging market bond indices, thereby increasing its appeal to the large institutional holders of sovereign debt instruments. An SCDI that is likely to trade and price well will inevitably hold more value in a restructuring negotiation than one that does not.

H. Debt-for-Nature Swaps

In situations of sovereign distress, where market debt trades at steep discounts and a sovereign faces sustainability pressures, debt for nature swaps can be designed to alleviate part of the public debt burden while preserving ecological resources and enhancing long-term sustainable development. However, the execution of a debt for nature swap can be complex and time consuming, and while in some cases the inclusion of such a feature can be an incentive for restructuring participation, it is not in itself a catalyst for restoring debt sustainability. While such swaps can be effective tools at the margins of large-scale debt restructurings, they remain a niche tool for sovereign debt management.

Restructuring of sovereign debt has in certain cases been facilitated by the introduction of climate-related elements in the form of debt-for-nature swaps ("**DFNs**"). Debt-for-nature swaps are described in detail in the **ALSF Debt Guide on Debt Swaps**, and this section only briefly describes the rationale, mechanics and effectiveness of a debt-for-nature swap in a restructuring context.

Rationale: The international community and participants in international financial markets are increasingly focusing on undertaking sustainable investments that mitigate the threats from climate change and biodiversity loss, fostering environmental conservation and green spending. This high level of vulnerability underlines a pressing need for conservation and green spending, but the pandemic has submerged this need in favour of public health spending on the immediate crisis. In other words, increased health and social spending as a result of the pandemic have exacerbated the already large financing gap for the urgently needed measures related to climate and nature.

Debt-for-climate/nature swaps are one way to foster environmental conservation policies while at the same time addressing a debt crisis. With creditors providing debt relief that will be used by low or middle-income countries to finance local conservation efforts.

Operation and Mechanics: The basic structure of a debt-for-nature swap involves the provision of partial debt relief with respect to a country's sovereign debt obligations in exchange for conservation commitments by the sovereign debtor, and can be applied to both official bilateral and private commercial debt.

Under bilateral debt swaps, bilateral creditors agree to provide debt relief (debt write offs) in exchange for the sovereign committing to use all or some of the freed-up cash resources to finance agreed environmental projects. As such, the original debt service owed to official bilateral creditors is redirected to the financing of mutually agreed projects in areas such as nature conservation and climate.

In the context of commercial debt transactions, most debt-for-nature swaps are a tripartite transaction. Tripartite swaps involve buybacks of privately held debt financed by donors and/or new lenders, usually intermediated by an international nongovernmental organization (NGO), conditional on nature- or climate-related policy actions and/or investments.

In a typical operation, the NGO lends new money to the sovereign debtor at below-market interest rates, on the condition that (1) the debtor uses the funds to buyback commercial debt at a discount, and (2) a portion of the resulting debt relief (the difference between the cost of the retired commercial debt and the new debt owed to the NGO) is used to fund climate-related actions or investments.

Challenges: while debt-for-nature swaps have been effective in complementing a debt restructuring transaction and providing debt relief in certain instances, most recently in Belize in 2021, they remain a niche tool utilized only on a case-by-case basis. Challenges in implementation and design largely prevent the tool from having wider application and catalysing debt restructuring operations.

- **Availability of financing and investor appetite.** First and foremost, only a small number of investors in private sovereign debt have a focused climate agenda and would be interested in debt-for-nature swaps that affect the value of their claim in a sovereign debt restructuring context. In the private debt context, the execution of the swap also depends on the availability of below-market financing by a viable source – and such funding must of course fit within the debt parameters of the IMF programme.

- **High transaction costs and timing considerations.** DFN swaps have to be targeted to specific nature conservation projects, that require identification, structuring and monitoring. Identifying viable projects and structuring a tripartite transaction can take a long time – often between 12 months and 4 years. As timing is a critical element of a sovereign debt restructuring and there is already concern that the architecture for resolving such situations is not delivering timely outcomes, the extended time horizon for execution of DFN swap transactions currently makes it an unattractive option to most debtors in distress.

- **Moral hazard and monitoring costs.** Accepting debt relief in exchange for a commitment to future natural conservation actions creates moral hazard risks on the part of the debtor – who may renege on commitments post-restructuring. Minimizing moral hazard risks requires consistent and careful monitoring of project implementation and adherence to specified performance measures, all of which are debtor-specific and project-specific. As such, compliance monitoring creates additional costs and administrative challenges that can complicate execution and implementation.

8. Restructuring Domestic Debt: Methods and Considerations

Domestic debt is debt issued by a sovereign under its domestic law and subject to the exclusive jurisdiction of its domestic courts. 'Domestic' does not necessarily relate to currency denomination or debtholders' residency, though there is often an overlap, with most domestic law debt also being denominated in local currency. In principle, all domestic debt could be part of a domestic debt restructuring ("**DDR**").

DDRs are becoming more frequent, and this trend is expected to continue. This comes as a result of the rapid recent development of domestic financial markets as an important source of budget funding for many sovereigns in the emerging markets, and the corresponding increase of the volume of domestic debt in the sovereign's debt portfolio (and share of domestic debt service in the overall mix). Common features among economies electing DDRs include a high share of domestic debt to total public debt, the relatively high cost of domestic debt as compared to external debt, and a relatively small share of privately held external public debt. More generally, sovereigns typically elect DDRs when it is unavoidable or obligatory (e.g., a pre-condition to IMF relief) and where a DDR's likely domestic collateral effects and impact is manageable. There are still many sovereign debt restructurings that are undertaken without the inclusion of a DDR.

DDRs offer the sovereign certain flexibility as compared to external debt restructurings. Firstly, a sovereign can amend its domestic law in a way which makes the restructuring easier to implement. This may include introducing or amending legislation either prospectively or retroactively to facilitate its desired DDR without creditors' consent (e.g., overcoming holdout creditors by varying the required statutory majority mechanism), or unilaterally imposing financial terms on creditors via executive decrees. However, these are controversial tactics that must be approached cautiously, given the legal risks and potentially significant adverse consequences to the sovereign's reputation. Secondly, domestic debt is typically adjudicated in the sovereign's jurisdiction, leaving litigation in domestic courts as the only recourse available. This can, as a practical matter, reduce the prospects of a successful holdout strategy. Finally,

because a substantial proportion of the creditors are usually domestic, the adverse impact of the restructuring on such holders can in theory be managed or mitigated through domestic public policy – including changes to tax, accounting and regulatory supervision practices.

At the same time, a sovereign considering a DDR must recognize and evaluate the specific risks that such operations can pose to domestic financial stability and investment in the real economy. Potential political and reputation effects of a DDR must also be considered in view of local conditions.

Specifically, sovereigns must consider the impact a DDR would have on its domestic financial institutions and financial system more broadly. Economic costs typically include more constrained credit conditions impacting financing of the real economy (potentially leading to lower economic growth) and the potential cost of recapitalizing financial institutions whose balance sheets are materially adversely affected by the DDR. When planning a DDR, the sovereign may consider it appropriate to include mechanisms to compensate or insulate some systemically important domestic creditors (e.g., its central bank, state pension fund and key domestic financial institutions), to safeguard financial stability.

Practical, legal, and procedural issues to be addressed in the context of a domestic debt restructuring

After considering the debt restructuring perimeter for the DDR in light of its own specific circumstances, and developing a credible and sustainable macroeconomic and monetary policy framework to underpin the DDR, the sovereign then has to choose the appropriate design and implementation strategy.

Ahead of the DDR, sovereigns should ensure that the DDR will fit within a robust legal and regulatory framework for public debt management. This includes taking steps to ensure due authorisation, as well as accurate recording and reporting, of its domestic debt. Without a clear idea of the extent of the sovereign's debt distress, the DDR may not be well targeted and, as a result, not achieve its debt relief objectives. Experienced external advisors can help the sovereign ascertain the identity of the domestic creditors and liaise with them in the hope of constructive negotiations.

PART IV: CONCLUSION AND EVALUATION OF CURRENT DEBT RESOLUTION FRAMEWORK

The framework of sovereign debt restructuring has evolved over the last 20 years to adapt to the evolving nature of the sovereign debt landscape. Most notably, the framework has adapted well to the increasing prominence of private creditors and the challenges posed in the restructuring of private debt, with the application of collective action clauses and other restructuring techniques greatly facilitating bond restructurings in Ukraine, Mozambique, and most recently Argentina and Ecuador.

However, more recently, the existing framework has not led to the expeditious and equitable resolution many stakeholders have hoped for.

International stakeholders (in the multilateral and official sectors), sovereign debt managers and their advisors going forward will have to address the question of how to design sovereign debt restructurings against the backdrop of an increasingly heterogenous and diverse group of creditors and an ever more complex sovereign debt stock. The evolving creditor and debt composition – particularly in lower income countries – poses a set of unique challenges for sovereign debt managers:

- **Collective action and creditor coordination**. The large number of creditors, as well as the number and complexity of claims, that fall within the restructuring perimeter pose inherent difficulties in collective action. While in the case of bond debt, contractual clauses can promote collective action, there is currently no mechanism, contractual or otherwise, that promotes collective action among heterogenous creditors with different interests. The challenge is acute both within creditor classes (i.e., within the bilateral official creditor class, where Paris Club and non-Paris Club creditors do not always act in coordinated ways) and across classes, where private creditors often view with suspicion the actions of official sector creditors.

- **Creditor seniority and preferred treatment have become more contentious**. The emergence of new official creditors and the changing dynamics amongst participants in the sovereign debt landscape increasingly calls into question the traditional, custom-based practices of preferred creditor treatment. For instance, plurilateral creditors increasingly claim preferred creditor status notwithstanding concerns expressed by MDBs, and non-Paris Club bilateral creditors call for increased participation of multilateral creditors in the debt resolution process – principally through increased lending. The established roles and boundaries of different participants in the sovereign debt restructuring process are undergoing a rapid transition.

- **Comparability of treatment has become harder to ascertain**. The diversity of creditors and claims directly increases the complexity of assessing comparability of treatment and ensuring fairness in the sharing of the restructuring burden. Plainly, the different costs of funding among creditors make it difficult to agree on a formula or objective mechanism for calculating "comparable" treatment. Absent an objective mechanism, assessment of comparability of treatment becomes a contentious subject among different creditors, that causes delays in restructuring implementation.

Despite such structural challenges, sovereigns can take the steps outlined in this guide both at the stage of debt incurrence and at the stage of debt resolution to improve the likelihood of success of a comprehensive debt treatment. Most importantly:

- Careful planning when incurring sovereign debt, whether direct, guaranteed or collateralized, can help mitigate risks inherent in different

instruments and structures *at the pre-crisis stage* and contribute to improved sovereign debt management.

- Acknowledging a debt crisis early and taking decisive, strategic, and thoughtful action improves the likelihood of a successful outcome.

ANNEX I

A Step-by Step Approach to Pre-Crisis Debt Management

1. The below is offered as a quick guide to the typical and recommended steps of pre-crisis debt management.

2. Government to design, implement and maintain a robust legal and regulatory framework for debt management, consistent with public debt and fiscal responsibility laws.

3. Government (through the debt management office) to implement a medium term debt management strategy, including policies and procedures with respect to debt incurrence.

4. Procedures to be set up applicable to each governmental agency responsible for borrowing to ensure (1) each transactions is consistent with debt strategy, (2) proper and timely review of legal documentation to ensure consistency with legal framework and ensure understanding of legal risks.

5. At the time of debt incurrence, careful consideration to be given to the legal structure of proposed debt obligations and an assessment to be undertaken of the risks such structures would pose at a time of distress.

6. Procedures to be set up to ensure debt transparency, both internally and externally towards the market and sovereign stakeholders, including appropriate recording of debt obligations and disclosure of material events and information to domestic and international stakeholders.

7. Ministry of Finance/DMO to establish investor relations program to facilitate regular communication of macroeconomic and other data to market participants, and to obtain feedback from key domestic and international creditors.

8. Ministry of Finance/DMO to monitor primary and secondary market dynamics (ie pricing and liquidity) to assess market risk, exchange rate risk, refinancing risks and liquidity risks.

9. Ministry of Finance/DMO to conduct regular audits of domestic and external debt portfolio, including analysis of both legal and commercial terms in light of market dynamics.

10. If market conditions permit or dictate, Ministry of Finance and DMO to conduct analysis of liability management options, often in consultation with financial advisors, legal advisors, and/or banks (dealer managers).

11. Structure of liability management operation to be considered in light of market sentiment, potential effect on credit ratings, and effect on the sovereign’s medium term debt portfolio.

ANNEX II

A Step-by Step Approach to Pre-Crisis Debt Management The below is offered as a quick guide to the typical and recommended steps of pre-crisis debt management.

1. Government to design, implement and maintain a robust legal and regulatory framework for debt management, consistent with public debt and fiscal responsibility laws.
2. Government (through the debt management office) to implement a medium term debt management strategy, including policies and procedures with respect to debt incurrence.
3. Procedures to be set up applicable to each governmental agency responsible for borrowing to ensure (1) each transactions is consistent with debt strategy, (2) proper and timely review of legal documentation to ensure consistency with legal framework and ensure understanding of legal risks.
4. At the time of debt incurrence, careful consideration to be given to the legal structure of proposed debt obligations and an assessment to be undertaken of the risks such structures would pose at a time of distress.
5. Procedures to be set up to ensure debt transparency, both internally and externally towards the market and sovereign stakeholders, including appropriate recording of debt obligations and disclosure of material events and information to domestic and international stakeholders.
6. Ministry of Finance/DMO to establish investor relations program to facilitate regular communication of macroeconomic and other data to market participants, and to obtain feedback from key domestic and international creditors.
7. Ministry of Finance/DMO to monitor primary and secondary market dynamics (ie pricing and liquidity) to assess market risk, exchange rate risk, refinancing risks and liquidity risks.
8. Ministry of Finance/DMO to conduct regular audits of domestic and external debt portfolio, including analysis of both legal and commercial terms in light of market dynamics.
9. If market conditions permit or dictate, Ministry of Finance and DMO to conduct analysis of liability management options, often in consultation with financial advisors, legal advisors, and/or banks (dealer managers).
10. Structure of liability management operation to be considered in light of market sentiment, potential effect on credit ratings, and effect on the sovereign's medium term debt portfolio.

ANNEX III

Useful Resources

IMF Guidelines for Public Debt Management	Revised Guidelines for Public Debt Management (imf.org)
IMF Debt Sustainability Framework for Market Access Countries	Review of The Debt Sustainability Framework For Market Access Countries (imf.org)
IMF Debt Sustainability Framework for Low Income Countries	Debt Sustainability Analysis -- Low-Income Countries (imf.org)
IMF Arrears Policies	Reviews of the Fund's Sovereign ARREARS Policies and Perimeter (imf.org)
IMF – Questions and Answers on debt restructuring in LICs	Questions and Answers on Debt Restructuring in Low Income Countries (imf.org)
The G-20 Common Framework (text)	Microsoft Word - Annex Common Framework for Debt Treatments beyond the DSSI.DOCX (clubdeparis.org)
IIF – Principles of Stable Capital Flows and Fair Debt Restructuring	The Principles for Stable Capital Flows and Fair Debt Restructuring, April 2022 Update > The Institute of International Finance (iif.com)

ANNEX IV

IMF Debt Sustainability Frameworks

The IMF and the World Bank have jointly developed a debt sustainability framework to assess the debt carrying capacity of low-income countries ("LIC DSF"). In addition, the IMF has recently published a new framework for assessing sovereign risk and debt sustainability for so-called market access countries ("MAC SRDSF"). Debt sustainability analyses carried out within those frameworks play a pivotal role in assessing a country's debt condition and eligibility to borrow from the IMF at a time of crisis.

LIC DSF

A primary aim of the LIC DSF in a pre-crisis environment is to guide borrowing decisions of low and middle income countries to balance their debt financing needs with their current and prospective ability to repay the debt, based on specific circumstances. The forward-looking nature of the LIC DSF allows it to serve as an "early warning system" of the potential risks of debt distress so that appropriate borrowing decisions can be made and preventive action can be taken in time.

According to the IMF, DSAs conducted under the LIC DSF are designed to include:

An assessment of the country's debt-carrying capacity as "strong", "medium" or "weak" drawing on a set of country-specific and global factors;

scrutiny of the "realism" of baseline projections;

a standardized forward-looking analysis of the debt and debt service dynamics over the next 10 years under a baseline scenario and in the face of plausible shocks specific to the country;

tailored stress tests to better evaluate country-specific risks stemming from contingent liabilities (consistent with the coverage of public sector debt), natural disasters, volatile commodity prices, and market-financing shocks; and

modules that provide a richer characterization of debt vulnerabilities

The LIC DSF focuses on the present value of debt, generating results for debt-service dynamics under the baseline scenario, and under standardized alternative scenarios and stress tests. The template is flexible enough that it can be adapted to country-specific circumstances.

MAC SRDSF

The MAC SRDSF is used to assess debt sustainability of countries that have market access, playing a key role in the IMF's core functions of surveillance and lending to these countries. In surveillance, this framework helps identify such a country's vulnerability to sovereign stress and steer the country away from such stress. In IMF-supported programs, which often take place after the stress has already developed, the MAC SRDSF helps determine if sovereign stress can be resolved via a combination of IMF financing and economic reforms, or if measures such as sovereign debt restructuring are needed to deliver medium-term debt sustainability. The MAC SRDSF framework is also used in developing IMF conditionality and informing the need for debt relief in debt restructuring operations undertaken in the context of IMF-supported programs.

The MAC SRDSF is based on several tools that analyze debt risks at various time horizons. A core subset of the framework is applicable to all countries and informs the assessments undertaken at the near- and medium-term horizons. Additional specialized analyses help gauge broader risks at the medium and long- term horizons.

The IMF provides the following near-term, medium-term, and long-term risk analysis in the MAC SRDSF:

- Near-term: This takes the form of an Early Warning System that predicts sovereign stress events over short (1-2 year) horizons using reported data outturns on indicators of country's quality of institutions and stress history, cyclical position, debt burden and buffers, and global conditions.
- Medium-term: This combines the results of two modules that capture solvency and liquidity risks implied by the medium-term projections, respectively. The Debt Fanchart Module focuses on solvency risks stemming from a country's debt burden over the next 5 years. Liquidity risks and a country's ability to meet its gross financing needs over the medium term are handled by the Gross Financing Needs (GFN) Module.
- Long-term: For some countries, additional stress tests could be triggered to assess a specific vulnerability. The tools for assessing some longer-term risks, which may not be applicable for all countries, include (i) climate change; (ii) long-run fiscal costs due to demographics; (iii) large debt amortizations; and (iv) the development or exhaustion of natural resources.

The new framework helps to signal sovereign stress more accurately and better assess debt sustainability in market access countries, which is a prerequisite for most international financial institution lending. Compared to its predecessor, the MAC SRDSF provides more comprehensive and consistent debt coverage, enhanced debt transparency, clearer signals of sovereign debt risks based on improved analytical methods, and new risk assessments at three different horizons (i.e., short, medium and long term). After a pilot phase, the MAC SRDSF roll-out started in September 2022 for all program countries. All market access countries have been implementing the new framework since December 2022

ANNEX V

IMF Arrears Policies

The IMF arrears policies are different for private creditors, official bilateral creditors, and multilateral creditors. The below offers a summary of certain aspects of the policies as they apply to each creditor class.

For more detailed information, see International Monetary Fund, Reviews of the Fund's Sovereign ARREARS Policies and Perimeter, May 2022.

Private creditors

The lending into arrears policy for private creditors ("LIA") provides that the Fund may approve a financing programme despite of arrears to private creditors on a case by case basis, where (1) prompt financial support is considered essential for the implementation of the sovereign's adjustment programme and (2) the sovereign is pursuing appropriate policies and is making a good faith effort to reach a constructive agreement with its private creditors to resolve the arrears. A determination of "good faith" is based on a set of principles guiding engagement, including whether a sovereign has: (i) engaged with its creditors early and throughout the process, (ii) been sharing relevant information on a timely basis in relation to the proposed debt treatment, (iii) provided creditors with an early opportunity to share views and input on the design of a restructuring strategy and/or specific instruments, and

(iv) offered terms consistently with the parameters of the IMF supported programme.

Official bilateral creditors

The lending into arrears to official bilateral creditors policy ("LIOA") was introduced in 2015 to ensure that, in situations where a restructuring of official bilateral claims is necessary, an IMF programme can be approved notwithstanding the unwillingness of certain holdout official creditors to "join an effort that is supported by an adequately representative group of creditors".

The LIOA policy applies in specific circumstances and depends on (i) the nature of the claim and (ii) whether the official bilateral creditor is expected to contribute to the Fund-supported programme, by providing financing and/or debt relief. Despite the many forms of bilateral lending, only "Direct Bilateral Claims" benefit from the preferential treatment under the LIOA, while all other official bilateral claims (for example, credits extended by many state-owned banks) are subject to the LIA policy. Direct Bilateral Claims are claims that arise

from direct financing or guaranteed financing by a government or an agency acting on behalf of the government to the sovereign recipient.

The treatment of such direct bilateral claims further depends on whether additional contributions from the official sector to fill the financing gap ("OSI") are required. If no contribution to the IMF supported programme is required from the official sector, then the claim falls under the Fund's Non-Toleration Policy ("NTP"), and the Fund may only provide financing if the creditor (through its Executive Director at the Fund) acquiesces (or does not object) to the Fund approving financing despite the arrears.

In cases where OSI is required, the LIOA applies (i.e. the Fund can approve a programme despite the existence of arrears) where:

1. There is an "adequately representative" agreement, where adequately representative means that the agreement provides a majority of the total financing contributions (comprising but not limited to debt relief and new financing) required from official bilateral creditors over the programme period, or

2. the official bilateral creditor has provided its consent, or

in the absence of (1) or (2), the Fund determines that (i) prompt financial support is required and the sovereign is pursuing appropriate policies, (ii) the sovereign is making good faith efforts to reach agreement with the creditor on a contribution consistent with the parameters of an IMF supported programme, and (iii) the decision to provide financing despite arrears would not have an undue negative effect on the Fund's future ability to mobilize official financing packages.

Official multilateral creditors

The treatment of multilateral or, more broadly, international financial institution ("IFI") creditors in the IMF's lending into arrears policies also depends on the type of the institution.

The treatment of claims of IFI creditors, as with direct bilateral claims, depends on whether OSI is required.

If a contribution from the official sector is not required to restore debt sustainability, then the claim falls under the NTP, and the Fund may only provide financing if the member requesting financial support from the Fund has a credible plan in place to resolve the arrears during the programme period.

In cases where OSI is required, the Fund should judge whether a credible plan to resolve such arrears is required as a condition for lending. The factors informing the Fund's judgement in this regard were extended following the Fund's Executive Board's comprehensive review of the Fund's lending into arrears policies, completed on 4 May 2022. The factors include the following: whether the IFI creditor has global, rather than regional, membership; the IFI creditor's treatment by the Paris Club; the IFI creditor's participation in the Heavily Indebted Poor Countries initiative; the IFI creditor's mandate and role in the global financial safety net (in particular, whether the IFI creditor is a regional financing arrangement); and the IFI creditor's treatment by a creditor committee based on a representative standing forum recognised under the LIOA in the case at hand (which is currently only the Paris Club).

In cases where OSI is required, but the arrears on the claims of IFI creditors are not covered by the NTP (i.e. the arrears owed to an IFI creditor do not fall under the previous paragraph above), the LOIA applies where the following conditions are met:

1. the IFI creditor has provided its consent to Fund financing notwithstanding the arrears owed to it, or

the Fund determines that (i) prompt financial support is required and the sovereign is pursuing appropriate policies, (ii) the sovereign is making good faith efforts to reach agreement with the creditor on a contribution consistent with the parameters of an IMF supported programme, and

(iii) the decision to provide financing despite arrears would not have an undue negative effect on the Fund's future ability to mobilize official financing packages.

ANNEX VI COMPARABILITY OF TREATMENT PRINCIPLE

The Comparability of Treatment ("CoT") principle is a fundamental tenant of sovereign debt restructurings. In the absence of a sovereign insolvency regime, the principle seeks to ensures that all creditors of a distressed sovereign nation are treated fairly and equitably during the debt restructuring process. The CoT clause set forth in an agreement between a debtor and its respective creditor – which can have different formulations – typically requires the debtor to commit to seek from other creditors within the restructuring perimeter a debt treatment on terms at least as favourable as those offered by the respective creditor, and to commit not to provide other creditors within the restructuring perimeter with debt treatments that are assessed to be more favourable to other creditors than those provided to the respective creditor.

The CoT principle has been an integral part of the Paris Club restructuring process, forms an integral part of the Common Framework, and has been espoused and promulgated by private creditors and other stakeholders through the Institute for International Finance's Principles for Stable Capital Flows and Fair Debt Restructuring.

Official Sector Perspective Paris Club and Common Framework

The Paris Club Agreed Minutes CoT clause typically states:

"A debtor country that signs an agreement with its Paris Club creditors should not accept from its non-Paris Club commercial and bilateral creditors terms of treatment of its debt less favorable to the debtor than those agreed with the Paris Club."

The Paris Club has traditionally not expected or required the debtor's agreements with other creditors to exactly match its own terms, given the diversity of the creditor landscape. Instead, it requires require the debtor to seek "comparable" terms and to keep the Paris Club appraised of the results of the negotiations with the other creditors. The Paris Factors considered for comparability include changes in debt service, net present value, and duration of the restructured debt for each type of creditor.

The Paris Club takes a broad-based approach in their assessment of whether CoT has been achieved. The assessment of a sovereign's compliance with the clause relied on a case-by- case assessment of multiple factors, including the net present value ("NPV") reduction of the claims (calculated on a non-fixed "appropriate market" discount rate), their average maturity, and their contribution to filling the financing gap (i.e. contribution to debt relief) during an IMF programme period. Assessment of CoT compliance can also account for mitigating factors in relation to specific creditors or debt instruments.

This multi-factor assessment has historically provided the Paris Club a degree of flexibility in the application of the comparability of treatment principle, ensuring that such application took into account the unique characteristics of each sovereign's situation.

The Common Framework relies on the Paris Club definition, providing that:

"A debtor country that signs an MoU with participating creditors will be required to seek from all its other official bilateral creditors and private creditors a treatment at least as favourable as the one agreed in the MoU. … Assessment of comparable efforts will be based on changes in nominal debt service, debt stock in net present value terms and duration of the treated claims."

Application of the Common Framework CoT has yet to be tested, and there remains substantial disagreement among stakeholders as to how the application should be assessed, particularly in light of the diversity of creditors and claims that often form the debt landscape of countries eligible for the Common Framework.

The Agreed Minites or the MoU will include provisions relating to consequences of a breach of the CoT principle. In instances where the CoT principle is assessed to be breached, the terms of the Agreed Minutes or the MoU can become null and void, effectively leading to the reinstatement of claims held by the official sector prior to agreement. In many cases, in instances of breach the sovereign is given a period of time to apply corrective measures to remedy the breach before the reinstatement clauses apply.

Private Sector Perspective – Institute of International Finance

The IIF's "The Principles for Stable Capital Flows and Fair Debt Restructuring" document outlines the IIF's perspective on comparability of treatment in sovereign debt restructuring, which relies on the following principles:

- Fair Treatment: Sovereign debtors should strive for fair and comparable treatment of creditors, acknowledging that variations in treatment may be warranted for different creditor classes. This approach extends to official bilateral creditors, promoting fairness for all parties involved. By ensuring fair burden sharing, it encourages voluntary creditor participation in debt resolution and maintains investor demand for sovereign debt.
- Inclusivity: It is imperative that no creditor, creditor group, or financial instrument is precluded from participating in debt restructuring. Decisions regarding their involvement should be made on a case-by-case basis, in coordination with relevant stakeholders, to facilitate broad creditor participation. This approach is essential for assessing the impact of new financial assistance and determining the appropriate ranking of creditor claims.
- Preferred Creditor Status: The document recognizes the de facto Preferred Creditor Status of institutions such as the IMF and major multilateral development banks in debt restructurings. Their role involves providing new lending and policy advice to support debtor adjustment programs, which aim to restore medium-term external viability. Transparency in claims subject to restructuring and additional financing from development finance institutions is essential to engage all stakeholders and secure private sector capital inflows.
- Valuation Methodology: Private creditors assess the impact of proposed restructuring terms using a net present value methodology. This approach involves discounting new payment flows with a rate comprising a risk-free rate and a sovereign risk spread. Such assessments can vary by creditor. Official sector methodologies, including the Paris Club, may use different criteria that do not include a sovereign risk component. It is the position of the private sector that comparability assessments should consider these differences.
- Fairness of Voting: For a fair and unbiased voting process in debt restructuring, bonds, loans, and financial instruments controlled by the sovereign debtor should not have the power to influence the outcome of creditor votes.

ANNEX VII

Certain standard clauses relevant to sovereign debt restructurings

Type of clause	Extract
ICMA bond clauses	
Single Series Reserve Matter Modifications	"Any Modification constituting or including a Reserve Matter Modification to the terms and conditions of the Bonds of a single series, or to the Governing Instrument insofar as it affects the Bonds of a single series, may be made, and future compliance therewith may be waived, with the written consent of the Issuer and the affirmative vote or consent of holders of more than 75% of the aggregate principal amount of the outstanding Bonds of that series."1
Cross-Series Modifications with Single Aggregated Voting	"Any Cross-Series Modification constituting or including a Reserve Matter Modification that is Uniformly Applicable to the terms and conditions of the Bonds of two or more series, or to the Governing Instrument insofar as it affects the Bonds of two or more series, may be made, and future compliance therewith may be waived, with the written consent of the Issuer and the affirmative vote or consent of holders of more than 75% of the aggregate principal amount of the outstanding Bonds of all the series affected by the proposed Modification (taken in the aggregate)."1
Cross-Series Modifications with Two-Tier Voting	"Any Cross-Series Modification constituting or including a Reserve Matter Modification to the terms and conditions of the Bonds of two or more series may be made, and future compliance therewith may be waived, with the written consent of the Issuer and: i. the affirmative vote or consent of holders of more than 662/3% of the aggregate principal amount of the outstanding Bonds of all the series affected by that proposed Modification (taken in the aggregate), and ii. the affirmative vote or consent of holders of more than 50% % of the aggregate principal amount of the outstanding Bonds of each series affected by that proposed Modification (taken individually). It is understood that a Cross-Series Modification constituting or including a Reserve Matter Modification to the terms and conditions of the affected Bonds that is not Uniformly Applicable must be effected pursuant to this subsection (f); such a Cross-Series Modification that is Uniformly Applicable may be effected pursuant to subsection (e) or (f), at the Issuer's option."1

Definitions relevant for Modification	“Cross-Series Modification” means a Modification constituting a Reserve Matter affecting two or more series of Bonds. “Cross-Series Modification with Single Aggregated Voting” means a Modification of the kind described in subsection (e) above. “Cross-Series Modification with Two-Tier Voting” means a Modification of the kind described in subsection (f) above. “Governing Instrument” means [the trust indenture, trust deed, fiscal agency agreement or other instrument pursuant to which Bonds of a particular series are issued]. “Modification” means any modification, amendment, supplement or waiver affecting one or more series of Bonds, including those effected by way of exchange or conversion. “Modification Method” has the meaning given to that term in subsection (c) above. “outstanding”, in the context of the principal amount of Bonds, shall be determined in accordance with subsection (k) below (Outstanding Bonds). “Reserve Matter” has the meaning given to that term in subsection (c) above. “Reserve Matter Modification” has the meaning given to that term in subsection (c) above. “series” means Bonds having the same terms and conditions and issued on the original issue date therefor, together with any further issuances of Bonds that, in relation to each other and to the original issuance, are (i) identical in all respects except for their issue date, issue price and the first payment date and (ii) expressed to be consolidated and form a single series, if any. “Single Series Reserve Matter Modification” means a Modification of the kind described in subsection (d) above. “Uniformly Applicable”, in the context of a proposed Cross-Series Modification, means a Modification by which holders of Bonds of all series affected by that Modification are invited to exchange, convert or substitute their Bonds on the same terms for (x) the same new instruments or other consideration or (y) new instruments or other consideration from an identical menu of instruments or other consideration. It is understood that a Modification will not be considered to be Uniformly Applicable if each exchanging, converting or substituting holder of Bonds of any series affected by that Modification is not offered the same amount of consideration per amount of principal, the same amount of consideration per amount of interest accrued but unpaid and the same amount of consideration per amount of past due interest, respectively, as that offered to each other exchanging, converting or substituting holder of Bonds of any series affected by that Modification (or, where a menu of instruments or other consideration is offered, each exchanging, converting or substituting holder of Bonds of any series affected by that Modification is not offered the same amount of consideration per amount of principal, the same amount of consideration per amount of interest accrued but unpaid and the same amount of consideration per amount of past due interest, respectively, as that offered to each other exchanging, converting or substituting holder of Bonds of any series affected by that Modification electing the same option under such menu of instruments).”[1]

Remedies following an Event of Default	"(a) Declaration of Acceleration If any of the following events (each an "Event of Default") occurs and is continuing: [Insert Events of Default] then the holders of at least 25 per cent. in aggregate principal amount of the outstanding Notes may, by notice in writing to the Issuer (with a copy to the [Fiscal Agent/Trustee/other bondholder representative]), declare all the Notes to be immediately due and payable, whereupon they shall become immediately due and payable at their principal amount together with accrued interest without further action or formality. Notice of any such declaration shall promptly be given to all other Noteholders by the Issuer. (b) Withdrawal of Declaration of Acceleration If the Issuer receives notice in writing from holders of at least 50 per cent. in aggregate principal amount of the outstanding Notes to the effect that the Event of Default or Events of Default giving rise to any above mentioned declaration of acceleration is or are cured following any such declaration and that such holders wish the relevant declaration to be withdrawn, the Issuer shall, give notice thereof to the Noteholders (with a copy to the [Fiscal Agent/Trustee/other bondholder representative]), whereupon the relevant declaration shall be withdrawn and shall have no further effect but without prejudice to any rights or obligations which may have arisen before the Issuer gives such notice (whether pursuant to these Conditions or otherwise). No such withdrawal shall affect any other or any subsequent Event of Default or any right of any Noteholder in relation thereto."1
Standard "Pari Passu" Provision for the Terms and Conditions of Sovereign Notes	"The Bonds constitute and will constitute direct, general, unconditional and unsubordinated External Indebtedness of the Issuer for which the full faith and credit of the Issuer is pledged. The Bonds rank and will rank without any preference among themselves and equally with all other unsubordinated External Indebtedness of the Issuer. It is understood that this provision shall not be construed so as to require the Issuer to make payments under the Bonds ratably with payments being made under any other External Indebtedness"[1]

"Majoritarian voting provisions" (based on standard LSTA documentation where removed language is stricken through and new language in blackline)	"9.02 (b) Amendments, Etc. Except as otherwise expressly set forth in this Agreement (including Section 2.11(e) and Section 2.24), no amendment or waiver of any provision of this Agreement or any other Loan Document, and no consent to any departure by the Borrower therefrom, shall be effective unless in writing executed by the Borrower and the Required Lenders, and acknowledged by the Administrative Agent, or by the Borrower and the Administrative Agent with the consent of the Required Lenders, and each such waiver or consent shall be effective only in the specific instance and for the specific purpose for which given; provided that no such amendment, waiver or consent shall: i. extend or increase any Commitment of any Lender without the written consent of such Lender (it being understood that a waiver of any condition precedent set forth in Article IV or the waiver of any Default shall not constitute an extension or increase of any Commitment of any Lender); ii. reduce the principal of, or rate of interest specified herein on, any Loan, or any fees or other amounts payable hereunder or under any other Loan Document, without the written consent of each Lender directly and adversely affected thereby the Specified Required Lenders (provided that only the consent of the Required Lenders shall be necessary (x) to amend the definition of "Default Rate" or to waive the obligation of the Borrower to pay interest at the Default Rate or (y) to amend any financial covenant (or any defined term directly or indirectly used therein), even if the effect of such amendment would be to reduce the rate of interest on any Loan or other Obligation or to reduce any fee payable hereunder); iii. postpone any date scheduled for any payment of principal of, or interest on, any Loan, or any fees or other amounts payable hereunder or under any other Loan Document, or reduce the amount of, waive or excuse any such payment, without the written consent of each Lender directly and adversely affected thereby the Specified Required Lenders; iv. change Section (b) or Section 2.15 in a manner that would alter the pro rata sharing of payments required thereby or change Section 7.02, in each case, without the written consent of each Lender directly and adversely affected thereby; v. waive any condition set forth in Section 4.01 without the written consent of each Lender; vi. change Section 2.05(d) in a manner that would permit the expiration date of any Letter of Credit to occur after the Commitment Termination Date without the written consent of each Lender; or vii. change any provision of this Section or the percentage in the definition of "Required Lenders" or "Specified Required Lenders" or any other provision hereof specifying the number or percentage of Lenders required to amend, waive or otherwise modify any rights hereunder or make any determination or grant any consent hereunder, without the written consent of each Lender; provided, further, (1) the Loans and Commitments of all Lenders hereunder shall be divisible and unitized for voting purposes in accordance with the final paragraph below entitled "Unitized Voting" and (2) subject to [the last paragraph of Section 9.02(b)] no such amendment, waiver or consent shall amend, modify or otherwise affect the rights or duties hereunder or under any other Loan Document of the Administrative Agent, unless

	in writing executed by the Administrative Agent, unless in writing executed by the Borrower and the Lenders required above. Notwithstanding anything herein to the contrary, no Defaulting Lender shall have any right to approve or disapprove any amendment, waiver or consent hereunder (and any amendment, waiver or consent that by its terms requires the consent of all the Lenders or each affected Lender may be effected with the consent of the applicable Lenders other than Defaulting Lenders), except that (x) the Commitment of any Defaulting Lender may not be increased or extended, or the maturity of any of its Loans may not be extended, the rate of interest on any of its Loans may not be reduced and the principal amount of any of its Loans may not be forgiven, in each case without the consent of such Defaulting Lender and (y) any amendment, waiver or consent requiring the consent of all the Lenders or each affected Lender that by its terms affects any Defaulting Lender more adversely than the other affected Lenders shall require the consent of such Defaulting Lender. [In addition, notwithstanding anything in this Section to the contrary, if the Administrative Agent and the Borrower shall have jointly identified an obvious error or any error or omission of a technical nature, in each case, in any provision of the Loan Documents, then the Administrative Agent and the Borrower shall be permitted to amend such provision, and, in each case, such amendment shall become effective without any further action or consent of any other party to any Loan Document if the same is not objected to in writing by the Required Lenders to the Administrative Agent within ten Business Days following receipt of notice thereof.] In addition, for the avoidance of doubt and notwithstanding anything in this Section to the contrary, (i) any amendment or waiver referred to in this Section may be effected by way of an exchange, conversion or other substitution of all or part of one or more Loans through an Exchange Offer; and (ii) where the Specified Required Lenders have chosen to participate in any such Exchange Offer, any Loans (or portions thereof) which were not the subject of consents in respect of that Exchange Offer shall be amended so that their payment terms equate with those available under the Exchange Offer on the basis described in Section 9.02 (c)(iii). (c).Exchange Offers. For the avoidance of doubt, where a sovereign obligor invites or offers the Lenders pursuant to an Exchange Offer to exchange, convert or otherwise substitute any Loan or Loans for (or into) other obligations of, or securities issued by, the [Borrower or Guarantor] (such other obligations or securities being "New Sovereign Instruments"): i. nothing in Section 9.02(b) shall be construed so as to limit or restrict the terms of any New Sovereign Instrument; ii. where the Specified Required Lenders consent to any such exchange, conversion or other substitution into New Sovereign Instruments, those consents (an "Approval to Exchange Loans") shall be sufficient for all purposes of this Agreement and under applicable New York law and so shall be binding on all Parties notwithstanding that the New Sovereign Instruments may contain provisions which differ from the corresponding provisions of this Agreement and nothing in Section 9.02(b) shall limit or restrict any such exchange, conversion or other substitution;

	iii. where there is an Approval to Exchange Loans, the payment obligations owed by the Borrower under any Loan (or portions thereof) which were not the subject of consents for that Approval to Exchange Loans (together the "Minority Portions") shall be amended on and from the closing date of the applicable Exchange Offer so that, in relation to each Minority Portion, the payment obligations of the Borrower are in the same amount as those of the obligor under the applicable Qualifying New Sovereign Instruments which would have arisen if such Minority Portion had been exchanged, converted or otherwise substituted for those Qualifying New Sovereign Instruments under that Exchange Offer. For these purposes "Qualifying New Sovereign Instruments" means: A. New Sovereign Instruments denominated in the same currency as such Loan (or portions thereof) which do not require such Lender to make any further lending; and B. (in circumstances where the Lenders are able to choose more than one type of New Sovereign Instrument as part of the Exchange Offer), those New Sovereign Instruments which meet the requirements of paragraph (A) of this definition into which the greatest proportion of the principal amount of the Loans are selected to be exchanged, converted or otherwise substituted under the Exchange Offer by those Lenders consenting to the Approval to Exchange Loans; and iv. the consent of any Lender to an Exchange Offer in respect of all or any portion of any Loan may be signified by that Lender submitting all or such portions of such Loan for exchange, conversion or substitution in accordance with the terms of that Exchange Offer and notifying the Administrative Agent accordingly. New definitions and revision to existing definitions: "Required Lenders" means, at any time, Lenders having Total Credit Exposures representing more than [50]% of the Total Credit Exposures of all Lenders. The Total Credit Exposure of any Defaulting Lender shall be disregarded in determining Required Lenders at any time.26 "Specified Required Lenders" means, at any time, Lenders having Total Credit Exposures representing more than [75]% of the Total Credit Exposures of all Lenders. The Total Credit Exposure of any Defaulting Lender shall be disregarded in determining Specified Required Lenders at any time. For voting purposes only, any Total Credit Exposure of a Lender which is an agency or [Affiliate] of the [Borrower][sovereign obligor] or otherwise controlled by the [Borrower][sovereign obligor] or any agency or [Affiliate] thereof shall be deemed to be zero"[2]

World Bank "Negative pledge clause"	"(a) It is the policy of the Bank, in making loans to, or with the guarantee of its member countries not to seek, in normal circumstances, special security from the member country concerned but to ensure that no other Covered Debt shall have priority over its loans in the allocation, realization or distribution of foreign exchange held under the control or for the benefit of such member country. To that end, if any Lien is created on any Public Assets as security for any Covered Debt, which will or might result in a priority for the benefit of the creditor of such Covered Debt in the allocation, realization or distribution of foreign exchange, such Lien shall, unless the Bank shall otherwise agree, ipso facto and at no cost to the Bank, equally and ratably secure all Loan Payments, and the Member Country, in creating or permitting the creation of such Lien, shall make express provision to that effect; provided, however, that if for any constitutional or other legal reason such provision cannot be made with respect to any Lien created on assets of any of its political or administrative subdivisions, the Member Country shall promptly and at no cost to the Bank secure all Loan Payments by an equivalent Lien on other Public Assets satisfactory to the Bank. (b). The Borrower, which is not the Member Country undertakes that, except as the Bank shall otherwise agree: i. if it creates any Lien on any of its assets as security for any debt, such Lien will equally and ratably secure the payment of all Loan Payments and in the creation of any such Lien express provision will be made to that effect, at no cost to the Bank; and ii. if any statutory Lien is created on any of its assets as security for any debt, it shall grant at no cost to the Bank, an equivalent Lien satisfactory to the Bank to secure the payment of all Loan Payments. (c). The provisions of paragraphs (a) and (b) of this Section shall not apply to: (i) any Lien created on property, at the time of purchase of such property, solely as security for the payment of the purchase price of such property or as security for the payment of debt incurred for the purpose of financing the purchase of such property; or (ii) any Lien arising in the ordinary course of banking transactions and securing a debt maturing not more than one year after the date on which it is originally incurred. (d). The Member Country represents, as at the date of the Loan Agreement, that no Liens exist on any Public Assets, as security for any Covered Debt, except those listed in a notification from the Member Country to the Bank and those excluded pursuant to paragraph (c) of this Section 6.02."[3]

ANNEX VIII

Value Recovery Instruments

Below is a high level summary of the key terms of VRIs that have been used in sovereign debt restructurings.

With the exception of the Greek VRI, issuance of each such instrument in the cases below has been considered instrumental in increasing creditor participation at the time of implementation.

Argentina (2005)

In 2001, Argentina defaulted on approximately USD$81.8 billion of its bonds (the "defaulted bonds") due to the recession the country faced between 1998 and 2002. This led to a debt restructuring process which in 2005 culminated in an Exchange Offer which was accepted by c. 76% of bondholders, allowing Argentina to resume payment to this subset of its foreign holders. As part of the debt restructuring exchange, Argentina issued VRIs in the form of GDP-linked warrants. The GDP-linked warrants were attached to each Argentine restructured bond and its payments were linked to the growth of the economy. Pursuant to the terms of the GDP-linked warrants, payments would be made to investors if the following three conditions are met simultaneously in any particular year between 2006 and 2035:

i. a level condition: the actual real GDP must exceed the baseline real GDP (the base case GDP, measured in 1993 pesos)

ii. a growth condition: the growth in actual real GDP must exceed the growth in baseline real GDP; and

iii. a cap: the cumulative amount of past payments should not exceed 0.48 cents per unit of currency of the warrant.

When the three conditions are met, the Argentine government will pay five per cent. of the difference between the actual growth of GDP and the base case growth of GDP during the relevant year.

Given the lags in publishing GDP data, the payments relating to GDP performance in a given year is not actually paid until 15 December of the following year. If the conditions are not satisfied in a given year but are then met in the next year, the missed payments can be recovered. Argentina's GDP-linked warrants are detachable from the underlying bonds and have been traded separately since November 2005. However, Argentina's GDP-linked warrants are not callable.

Argentina's GDP warrants denominated in euros (and governed by English law) and US dollars (and governed by New York) are each the subject of ongoing litigation, which ensued following Argentina's rebasing of GDP in 2013, following which time Argentina seized making payments under the warrants, claiming that the payment conditions had not been met.

Greece (2012)

As part of its 2011-12 large scale debt reduction and restructuring, Greece issued GDP-linked warrants. Similar to the Argentine warrants, these were also characterised by three conditions:

i. a level condition: the nominal GDP must exceed a base case nominal GDP specified to be a certain value from 2014 to 2020, then equal to the 2020 value;

ii. a growth condition: the real GDP growth rate must exceed the baseline growth rate; and

iii. a cap: each annual payment will not exceed one per cent. of the nominal value of the bonds.

When the three conditions are meant, the Greek government will pay an amount equal to the nominal value of the GDP-linked warrants multiplied by 1.5 times the difference between the real growth rate

in that year and a baseline growth rate. Unlike the Argentine GDP-linked warrants, missed payments in one year are not recovered in the next year.

Ukraine (2015)

As part of its 2015 debt restructuring, Ukraine issued GDP-linked warrants to creditors who wrote down 20 per cent. of the bonds' original value. Below are three key terms of the Ukraine warrants at the time of issuance:

i. a level condition: the nominal GDP must reach USD$125.4 billion (calculated using the average hryvnia/dollar rate), compared to about USD$82 billion at the time of issuance;

ii. a growth condition: the real GDP growth rate must exceed three per cent.; and

iii. a cap: each annual payment will not exceed one per cent. of GDP between 2021 and 2025.

The insrtruments provided that upon the three conditions being met meant, the Ukrainian government will pay 15

per cent. of nominal GDP multiplied by the excess real GDP growth exceeding three per cent. However, if the real GDP growth rate exceeds four per cent. the government will pay 40 per cent of nominal GDP multiplied by the excess real GDP growth above four per cent.

Ukraine's GDP-linked warrants also have a put option which allows the holders of the warrants to ask Ukraine to repurchase the warrants at their notional price if Ukraine fails to meet certain conditions, including non-payment or moratorium on debt. However, the put option expired in December 2018 although the warrants do not expire until May 31, 2040.

Suriname (2023)

Suriname is the latest case to successfully include VRIs as part of its restructuring offer, leading to a high level of participation. The VRI would be issued in a notional amount that would compensate the bondholders in full for a 25% haircut on their claims as well as for the risk that payments under the VRI may never materialize.

In contrast to the GDP Warrants that had been issued in Argentina, Greece and Ukraine, Suriname's VRI was anchored to the generation of certain oil revenues from Suriname's Block 58, making it the first VRI to be tied to a variable other than GDP.

In particular, Suriname's VRI contains the following terms and features:

i. Applicable revenue base: Republic of Suriname government oil royalties from Block 58 offshore Suriname, from the date of first production through the Oil-linked Securities expiration date

ii. Payment mechanism: After the applicable revenue "one-off" floor is reached, the Republic will allocate 30 per cent. of its annual royalty income from Block 58 to make payments under the Oil-linked Securities on a quarterly basis, subject to (a) the maximum amount outstanding on each quarterly payment date and (b) a cumulative payment cap. Payments under the VRI would be made through deposits of royalty revenues into an offshore account.

iii. The "one-off" floor was set as the first U.S.$100 million of oil royalties, which would belong exclusively to Suriname

iv. Ability to prepay the VRI: Suriname retains the ability to prepay the VRI in full at any time and using any resources (including beyond royalty revenues) without penalty or premium.

v. Put Right: the holders of the VRI have the right to request Suriname to repay the VRI in full (including accruals thereunder at a rate of 9%) upon the occurrence of certain enumerated "put events".

vi. Springing lien: Suriname granted holders of the instrument a "springing lien" over the offshore account containing royalty revenues. The springing lien would only come into existence upon the valid exercise of the holders of their Put Right.

Annex IX

Key features of past Eurobond restructurings

The below table includes a comparison of key features of both pre-emptive and post-default Eurobond Restructurings. The table is replicated from International Monetary Fund, Reviews of the Fund's Sovereign ARREARS Policies and Perimeter, Annex II, May 2022.

	Time between announcement of restructuring and start of dialogue	Did the debtor share non-confidential relevant information with creditors? 1/	Did the debtor provide creditors with early opportunity to give input on the design of the restructuring'	Type of creditor dialogue: Creditor Committee (CC), London Club (LC). B laterally (BiL)	If creditor committee formed, share of claims represented	Debt treated (US$bn)	Participation rate 3/	Time from announcement to completion of restructuring
Pre-default restructuring								
Belize 2007 (Ext Bonds/ Loans)	2m	Yes	Yes	CC	>51%	0.5	980%	7m
Belize 2013 (Ext Bonds)	2m	Yes	Yes	CC	37%	0.5	100.0%	6m
Belize 2017 (Ext Bonds)	2m	Yes	Yes. (after initial consent solicitation)	CC	60%	0.5	100.0%	4m
Chad 2015 (Ext Loans)	<7m	No info.	Yes	Bil.	n/a	1.5	100.0%	15m
Chad 2018 (Ext Loans)	<5m	Yes	Yes	BiL	n/a	1.2	100.0%	17m
Cyprus 2013 (Dom/Ext Bonds)	d m	No info.	No info	Bil.	n/a	1.2	100.0%	1 m
Dominican Republic 2005 (Ext Bon ds)	9 m	Yes	Yes	Bil.	n/a	1.1	97.0%	14m,
Ecuador 2020 (Ext Bonds)	2m	Yes	Yes	CC (3 committees)	53%	174	100.0%	5m
Greece 2012 (Dom/Ext Bonds)	<1 m	No info.	No info	CC	30-40%	2734	969%	9 m
Grenada 2005(Dom/ ExtBonds/loans)	2 m	No info.	Yes	CC	>70%	0.3	933%	14 m
Jamaica 2010 (Dorn Bonds)	<1m	Yes	No info	Bil.	n/a	7.9	992%	1 m
Jamaica 2013 (Dom Bonds)	*1 m	Yes	No info	Bil.	n/a	9.1	990%	1 m
Molodva 2002 (Ext Bonds)	<1 m	No info.	Yes	Bil.	n/a	0.0	100.0%	5m

	Time between announcement of restructuring and start of dialogue	Did the debtor share non-confidential relevant information with creditors? 1/	Did the debtor provide creditors with early opportunity to give input on the design of the restructuring'	Type of creditor dialogue: Creditor Committee (CC), London Club (LC). B laterally (BiL)	If creditor committee formed, share of claims represented	Debt treated (US$bn)	Participation rate 3/	Time from announcement to completion of restructuring
Mongolia 2017 (Ext Bonds)	*1 m	Yes	No (but reprofiling only)	Informal; Bil	n/a	0.6	w%	<1 m
Mozambique 2016 (Ext bond)	<1 m	No	No (but reprofiling only)	CC	n/a	0.7	850%	10m
Nicaragua 2003 (Dorn bonds)	*1 m	No info.	No info	Bil.	n/a	0.3	100.0%	1 m
Nicaragua 2008 (Dorn bonds)	« 2 m	No info.	No info	Bil.	n/a	0.3	100.0%	2m
Ukraine 2015 (Bonds/Loans)	2 m	Yes	Yes	CC Bil for SOE debt	44%	18.0	100.0%	10m
Uruguay 2003 (Ext Bonds)	<1 m	Yes	Yes	Bil.. Roadshows (2)	n/a	54	91.5%	3 m
Average/Share	2m	Mostly yes	Mostly yes	8/19 had CC	43%	1.1	100%	5 m
Post-default								
Argentina 2005 (Dom/Ext Bonds)	dm	Yes	No	CC	>50%	79.7	803%	42m
Argentina 2020 (Dom/Ext Bonds)	4 m	Yes	Yes	CC (3 committees)	40-45%	655	990%	9m
Barbados 2019 (Dom/Ext Bend-/Loans)	dm	Yes	Yes	CC	>50%	0.B	100.0%	19m
Cote d'Ivoire 2010 (Ext Bonds)	<1 m	Yes	No info	LC	100%	0.1	100.0%	21m
Congo.	>6m	Yes	Yes	Bil.	n/a	n/a	n/a	ongoing
Dominica 2006 (Bonds/ Loans)	7 m	Yes	Yes	BiL. Roadshow	n/a	0.1	72%	36 m
Dominican Republic 2005 (Ext Loans)	4 m	No info	No info	LC	n/a	0.2	N/A	118 m
Grenada 2015 (Bonds/Loans)	12m	Yes	Yes	CC	>50%	0.2	100.0%	32 m
Iraq 2006 (Bank/Comm. Loans)	> 7 m	No info	No info	CC, Bil.	n/a	17.7	96.0%	20 m
Mozambique 2019 (Ext bond)	17m	Yes	Yes	CC	68%	0.7	99.5%	35 m
Serbia-Montenegro 2005 (Loans)	10 m	No info	No info	LC, Bil.	n/a	2.7	n/a	44 m

	Time between announcement of restructuring and start of dialogue	Did the debtor share non-confidential relevant information with creditors? 1/	Did the debtor provide creditors with early opportunity to give input on the design of the restructuring'	Type of creditor dialogue: Creditor Committee (CC), London Club (LC). B laterally (BiL)	If creditor committee formed, share of claims represented	Debt treated (US$bn)	Participation rate 3/	Time from announcement to completion of restructuring
Seychelles 2010 (Ext Bonds/ Loans)	< 1 m	Yes	No info	Bil., Roadshow	n/a	0.3	100.0%	19 m
St. Kitts & Nevis 2012 (Bonds/ Loans)	3 m	Yes	Yes	CC and Bil.,/Roadshow	n/a	0.1	100.0%	10m
Suriname ongoing (Ext Bonds/ Loans)	<1m	Yes	Yes	CC	n/a	n/a	n/a	ongoing
Average/Share	5m	Mostly yes	Mostly don't know	11/14 CCs find. LC)	50%	0.5	100%	20.5m

Sources: International Monetary Fund, Reviews of the Fund's Sovereign Arrears Policies and Perimeter, Annex II, May 2022, IMF Staff reports and media reports; Asonuma, Niepelt and Ranciere (2019), Asonuma and Trebesch (2016), Cruces and Trebesch (2014), Das, Papaioannou and Trebesch (2012), Park and Samples (2021).

1/ According to the LIA policy this would normally include information on the assessed economic situation/financial circumstances, outline of a viable program, and a comprehensive picture of the proposed treatment of claims.

2/ Anthony, Impavido and van Selm (2020) for Barbados domestic debt episode. Staff calculations for Argentina and Ecuador (both 2020). Crusces and Trebesch (2013) for cases prior to 2014, Asonuma, Niepelt and Ranciere (2018) updated dataset for all remaining episodes. Weighted average (respect to debt outstanding) of instrument-specific NPV and market haircuts. NPV and market haircuts correspond to 1 - (PV of new bonds/PV of old bonds), and 1 - (PV of new bonds/Face value of old bonds), respectively.

3/ Based on Staff Reports, media reporting, and Park and Samples (2021). After application of CACs, where relevant.

4/ 83 percent participation rate of existing holders, or over 90 percent excluding US-based investors who could not participate for legal reasons.

Annex X

Application of Restructuring Techniques in Selected Eurobond Restructurings

In the absence of an international sovereign bankruptcy regime, use of contractual techniques – such as application of collective action clauses and exit consents as well as the use of additional "incentives" and "disincentives" – is the only way to effectuate the restructuring of Eurobonds. The application of techniques and the contractual architecture itself has evolved over time to facilitate Eurobond restructurings, and subject to few exceptions, has generally been successful in facilitating and effectuating the restructuring of Eurobonds.

Ecuador in 2000

Ecuador was the first sovereign to use an "exit consent" technique to restructure its debt, relying on voting provisions that required a simple majority to amend various non-payment terms of each bond series. Ecuador, therefore, invited bondholders to exchange their bonds and, in the process, amend various non- payment terms of their existing bonds to make them less attractive to holdout creditors. The proposed modified terms removed the cross-default clause, the negative pledge clause, and the requirement to list the bonds in the Luxembourg Stock Exchange.

Uruguay in 2003

Uruguay also utilized an exit consent technique to restructure its New York-law governed bonds, albeit narrower than Ecuador's. There the proposed modification narrowed the sovereign immunity waiver and was intended to limit the ability of holdouts to attach payments made by the sovereign to service the new bonds offered in the exchange. The exit consent was supplemented by an explicit threat that Uruguay would prefer the servicing of exchanged debt over non-exchanged debt.

Argentina 2001-2014

While the use of exit consents and other restructuring mechanisms worked well in these early cases of Ecuador and Uruguay, leading to bondholder participation in excess of 90%, the shortcoming of these techniques in remedying the collective action problem were revealed in Argentina's 2001-2014 restructuring saga. At that time, similarly to Ecuador and Uruguay, Argentina's outstanding bonds did not include collective action clauses that would allow payment terms to be amended with supermajority support. An exit consent strategy was also not an option because creditors had allegedly amassed more than 50% in some individual series. in the absence of better options, Argentina's strategy relied on the use of "value recovery instruments" (in particular GDP-linked warrants that would provide creditors who participated in the restructuring additional value to compensate for their losses if Argentina's GDP exceeded certain targets) and the explicit threat of non-payment of non-exchanged debt. The threat of non-payment was carried through via the introduction of the Lock Law in 2005, which made it illegal, as a matter of Argentine law, for the sovereign to service defaulted debt or settle with holdout creditors. Notwithstanding those elements, Argentina's exchange offer was only accepted by around 75% of its creditors, and was followed by years of litigation from holdout creditors who eventually were granted a judgment based on a novel reading of the "pari passu" provision, which the court read as prohibiting Argentina from paying participating creditors while leaving holdouts in default.

Recent application of enhanced contractual mechanism

The evolution of sovereign debt terms and the inclusion of collective action clauses has made the implementation of debt restructurings evidently more effective.

The Covid-era Latin America restructurings provided the first occasion for the new aggregated ICMA CACs to be tested in practice, even though on several occasions the debt to be restructured included older- issued debt that did not include the aggregated CACs or included CACs with different, usually higher, voting thresholds.

Notwithstanding such heterogeneity, the CACs operated to facilitate consensual restructuring outcomes for Argentina, Ecuador and a number of Argentine provinces in 2020/2021. While each debtor tailored its restructuring proposal to its particular characteristics, the availability of CACs coupled with the endorsement of large creditors and well-organized creditor committees, ultimately catalyzed a holistic restructuring for these debtors.

Ecuador in 2020

was the first sovereign to consummate a restructuring transaction in September 2020. In July 2020, after constructive consultation with its largest creditor group, Ecuador launched a consent solicitation and exchange offer inviting holders of ten series of bonds to consent to the amendment of those bonds and exchange them for new bonds in three series maturing in 2030, 2035, and 2040. Holders who chose to participate in the exchange offer and receive the package of new bonds also consented to modify the payment terms of the outstanding existing bonds (held by holdout creditors) to replicate the terms of the least attractive, longer-dated new bond. Concurrently, Ecuador solicited the consent of holders to delete a contractual provision (dubbed the “No Less Favorable Treatment” clause) restricting Ecuador’s ability to leave non-consenting holders financially impaired vis-à-vis consenting holders. After prevailing in a New York lawsuit brought by an investor seeking to enjoin the restructuring, Ecuador reached the requisite CAC thresholds in all series and achieved a 98% creditor participation in the process.

Argentina in 2020

While Argentina was pursuing its restructuring concurrently with Ecuador, it initially took a more confrontational approach towards its creditors, launching a unilateral exchange offer where it attempted to take advantage of certain deficiencies in the drafting of the ICMA CACs to consummate a restructuring that was not supported by a bondholder supermajority. Following months of failed negotiations and a series of rejected offers, Argentina agreed on the terms of a debt restructuring with its largest creditor groups. In August 2020, Argentina proposed these terms to its bondholders via a structure combining the use of the two-limb CACs with the use of exit consents, in a combined exchange offer and consent solicitation. Under this structure, holders who agreed to participate in the exchange offer and tender their bonds for a new bond chosen from a menu of options would also be deemed to consent pursuant to the two-limb CACs to substitute any outstanding existing bonds (which would thereafter be held only by holdout creditors) for new bonds with the least favorable maturity structure.

Argentine Provinces in 2020/2021

Similarly to the Argentine sovereign, the Province of Buenos Aires launched a unilateral offer in 2020 which was repeatedly extended for over a year due to lack of participation. Ultimately, PBA reached a deal with its largest creditor and committee member in July 2021 and subsequently launched an amended offer. The amended offer provided that while participating holders were entitled to receive new “A” or “B” bonds, non-participating holders would receive new “C” bonds that have materially worse terms compared to A and B bonds, if the CAC thresholds were met under each series. Because certain of PBA’s bonds issued under its “old” 2006 indenture contained higher CAC thresholds than bonds issued under its more recent 2015 indenture (which contained ICMA CACs), PBA incorporated additional exit consents in the restructuring proposal for those series to disincentivize holdout behavior. Although PBA launched

GLOSSARY

Acceleration
a clause in a debt contract, typically a loan or a bond, allowing a creditor to request earlier repayment of the outstanding principal amount of the debt if one or more specified events occur.

Bilateral creditors
Bilateral creditors are sovereign governments (or government agencies) which lend to other sovereigns.

Collateral
an asset that a borrower offers as security for a loan

Collective Action Clauses (CACs)
provisions in bond contracts that allow a qualified supermajority of bondholders to vote to amend certain key terms of the bonds (including financial terms) that is legally binding on all bondholders, including those who voted against the amendments.

Common Framework
an initiative created by the G20 to coordinate among official and private creditors the restructuring of the debt of eligible low-income countries

Comparability of treatment
A core principle of sovereign debt restructurings whereby the sovereign undertakes to seek comparable treatment from each creditor, such that no creditor should benefit from a more favourable treatment than another, and that the burden of restructuring should be fairly spread across creditors

Contingent liability
a potential liability which can become an actual liability upon the occurrence of an uncertain future event

Coupon
the periodic payment of interest paid to the holder of a bond

Credit rating agency (CRA)
an institution that provides investors with information and ratings about a borrower's ability to meet its obligations

Credit risk
the risk that the borrower defaults under its financial obligations

Debt restructuring
a process where the debtor negotiates with its creditors changes to the terms of the debtor's existing debts to obtain debt relief. Such changes may include a reduction in the interest rate, extending the maturity, or reduction in principal amount.

Debt sustainability
the ability of a government to meet its debt obligations without requiring debt relief or accumulating arrears

Debt Sustainability Framework (DSF)
a framework that informs a country's borrowing decisions to meet their financing needs while maintaining debt sustainability. The DSF provides a framework for analysing the debt and debt service dynamics under a baseline scenario and a set of standardised economic shocks.

Debt Service Suspension Initiative (DSSI)
G20 initiative launched in 2020 to reschedule the debt payments due by a list of low-income countries to their official creditors

Eurobond
an international bond issued by a country denominated in a currency other than the country's local currency.

Event of Default
a specific condition or event defined in a loan or bond agreement that, if it occurs, gives the lender the right to demand immediate repayment of the loan or take legal action to enforce the agreement

Export Credit Agency (ECA)
known in trade finance as an "ECA" or investment insurance agency is a private or quasi-government institution that acts as an intermediary between national governments and exporters to provide export financing. The financing can take the form of credit or credit insurance and guarantees or both, depending on the mandate the ECA has been given.

Gross Domestic Product (GDP)
the estimated total value of all the finished goods and services produced within a country's borders in a specific time period.

Liquidity Risk
financial risk that for a certain period of time, a given financial asset, security or commodity cannot be traded quickly enough in the market without impacting the market price

Market Risk

risk associated with the possibility of adverse changes in interest rates, foreign currency exchange rates or commodity prices

Net Present Value
the value of all future cash flows over the entire life of an instrument, discounted to the present.

Paris Club
a group of official bilateral creditors that has met regularly in Paris since 1956 and considers the debt of developing and emerging countries. Paris Club creditors usually make their lending conditional on adoption of initiatives or policies aimed at fostering institution-building and governance

Par value
the face value of a bond, i.e., the value of the principal repayable at maturity

Preferred Creditor Status (PCS)
the de facto seniority of certain debt claims and creditors, typically multilateral creditors and claims, in a debt restructuring.

Primary market
The market where the borrower initially issues and sells new securities

Refinancing Risk
risk associated with the maturity of an obligation that may not be refinanced or only at a higher cost.

Secondary market
a market for the resale of already issued and outstanding debt securities.

Secured debt
a form of debt against the assets of the borrower that can be seized by the holder in the event of default

Security (interest)
legal right that is granted by a debtor's collateral that allows the lender to have recourse in the eventuality of default.

Sovereign/Direct guarantee
a type of guarantee provided by the government directly to discharge the liability of a third party in case they default on their obligations

State-owned enterprise (SOE)
a legal entity wholly or partially owned by a government that participates in specific commercial activities on behalf of the government.

Syndicated loan
loan issued by a syndicate of lenders acting as a group with common terms and represented by an agent.

REFERENCES AND FURTHER READING

Part I

African Development Bank Group, African Economic Outlook 2021

African Legal Support Facility, Understanding Sovereign Debt: Options and Opportunities in Africa (Chapters on Types of Creditors and Types of Financing)

Antonio Fatas et al., The Motive to Borrow, In: Sovereign Debt, A Guide for Economists and Practitioners (edited by Ali Abbas, Alex Pienkowski, Kenneth Rogoff), Oxford University Press (2020)

Part II

African Legal Support Facility, Understanding Sovereign Debt: Options and Opportunities in Africa (Chapter on Public Debt Management)

International Monetary Fund, Collateralized Transactions: Key Considerations for Public Lenders and Borrowers, Policy Paper 2020/010

International Monetary Fund, A Primer on Debt Buybacks and Swaps, 2007

Stephen J. Choi et al., Political Risk and Sovereign Debt Contracts (John M. Olin Law & Economics (2d Series), Working Paper No. 583, 2011)

Thordur Jonasson et al., Debt Management, In: Sovereign Debt, A Guide for Economists and Practitioners (edited by Ali Abbas, Alex Pienkowski, Kenneth Rogoff), Oxford University Press (2020)

Part III

African Development Bank Group, Debt-for-Nature Swaps: Feasibility and Policy Significance in Africa's Natural Resources Sector, October 2022

International Monetary Fund, Review of the Fund's Sovereign Arrears Policies and Perimeter, 2022

International Monetary Fund (Staff Discussion Note), The Role of State-Contingent Debt Instruments in Sovereign Debt Restructurings, 2020

International Monetary Fund, Debt-for-Climate Swaps: Analysis, Design and Implementation (Working Paper), August 2022

International Monetary Fund, Restructuring Domestic Sovereign Debt: An Analytical Illustration (Working Paper), February 2023

Julianne Ams, Sovereign Default, In: Sovereign Debt, A Guide for Economists and Practitioners (edited by Ali Abbas, Alex Pienkowski, Kenneth Rogoff), Oxford University Press (2020)

Lazard, Policy Brief, How to Make Sovereign Debt Restructurings More Effective, May 2022

Lee Buchheit et al., The Restructuring Process, In: Sovereign Debt, A Guide for Economists and Practitioners (edited by Ali Abbas, Alex Pienkowski, Kenneth Rogoff), Oxford University Press (2020)

Paris Club, The Six Principles (available at clubdeparis.org/en/communications/page/the-six-principles)

ALSF SOVEREIGN DEBT KNOWLEDGE PRODUCT AND CAPACITY BUILDING PROJECT: PRE-CRISIS AND CRISIS MANAGEMENT DEBT GUIDE

WHITE & CASE

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