United Nations

High-Level Event on Financing for Development in the Era of COVID-19 and Beyond

Convened by Canada, Jamaica and the Secretary-General

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Discussion Notes

1. Global Liquidity and Financial Stability
2. Debt Vulnerabilities
3. **Private Sector Creditors Engagement**
4. External Finance and Inclusive Growth
5. Illicit Financial Flows
6. Recovering better for Sustainability

Discussion Note

Private Sector Creditors Engagement

1. Background

The global health and development emergencies caused by COVID-19 require urgent response and recovery measures for testing, tracing, isolation and treatment, as well as supporting the most vulnerable, securing livelihoods and stimulating the economy. Most developing countries do not have sufficient domestic resources and fiscal space to fund adequate response and recovery measures. Tnternational cooperation and external finance to bridge these fiscal gaps are crucial to recover better and prosper together.

Today, global debt levels are at record highs. Despite rock-bottom interest rates, debt service payments can be very high in absolute terms, leaving sovereign borrowers – particularly the poorest and most vulnerable -- increasingly exposed to market disruptions .

In the last decade, funding from international bond markets provided many developing countries with access to much-needed resources to finance investments in the SDGs. While official debt remains the most significant component of the long-term external debt of most IDA-eligible developing countries (those countries eligible for the G20 Debt Service Suspension Initiative or DSSI), commercial credit increased more than four-fold from 2010 through 2019, rising from 5 to near 20 percent. This greater reliance on commercial borrowing was particularly notable in frontier markets (i.e., low-income and least-developed countries with international bond issuance). Nearly thirty percent of these countries' external public debt is owed to private creditors, with two-thirds of that in bonds. These countries will have to refinance more than USD 6 billion of Eurobonds annually over the next five years.

The participation of commercial creditors in debt initiatives is important for two reasons: (i) it helps provide meaningful fiscal space for countries to fight COVID-19 and to recover better in line with the 2030 Agenda and Paris Agreement on climate change; and (ii) it supports efforts to avoid public resources being used for purposes other than response and recovery. Only with their active and comprehensive engagement the world will be able to avoid a long-lasting health and development crisis and promote a faster, inclusive and sustainable recovery for everyone.

In April 2020, the G20 asked private sector creditors to participate in the suspension of debt service payments for 76 IDA-eligible countries and Angola on a voluntary basis. A number of public sector entities (led by the G20 but including the IMF, WB, and Paris Club) that crafted the DSSI, together with the Institute of International Finance (IIF), have been working with creditors to find ways to accomplish this. In addition to numerous bilateral discussions with the IMF and World Bank, the IIF organized a meeting between private creditors and the Paris Club in April. On May 11, the IIF also held, together with the United Nations Economic Commission for Africa (ECA), an extraordinary meeting of representatives of 15 African finance and development ministries and the African Union to discuss implications of private sector involvement in the DSSI. The IIF has also been actively engaging with the three main credit rating agencies and other stakeholders to discuss whether in-scope countries could achieve suspension or payment deferral without triggering negative rating actions on country and bond ratings.

The International Capital Markets Association (ICMA) has developed a COVID-19 resource page including monetary and fiscal policy responses around the world, responses of regulators and supervisors, market practice initiatives and conditions in each of the market segments in which ICMA operates. In addition, ICMA is reviewing the timetables of consultation papers and regulatory implementation that were already in progress and is working with its members and appropriate authorities to have them postponed.

The Securities Industry and Financial Markets Association (SIFMA) is closely monitoring COVID-19 and its impact on the financial industry and the capital markets, to keep markets operational, resilient and efficient through this global pandemic. SIFMA's Emergency Crisis Management Command Center identifies the status of industry participants, disseminates vital information and facilitates actions to assist market response and recovery. Coordination is arranged amongst financial firms, exchanges, industry utilities, regulators, government agencies and public sector emergency managers.

2. Main challenges

Including private creditors in debt standstills can be challenging. For many DSSI-eligible countries, the size and nature of debt and debt service obligations are not fully transparent, making inter-creditor equity difficult to establish.[1] Complex issues of creditor coordination could make private bondholders' participation in the standstill a lengthy process. From the private sector perspective, key outstanding considerations and challenges regarding the DSSI include:

- Pre-defining net present value neutrality and finding agreement on underlying terms and assumptions.
- Assessing the meaning of "similar terms" in debt suspension between official and private creditors.
- Assessing contractual obligations, regulatory requirements and national laws relating to the proposal.
- Fiduciary duty—whether participation is the right thing to do for underlying clients
- Risk of curtailing market liquidity, as participation could curtail international market access for countries that currently have it.
- Assessing market access in the context of DSSI term sheet limitations on new non-concessional external financing.
- Credit ratings implications, as private sector participation in the DSSI may trigger a wave of sovereign downgrades, defaults and cross-defaults, with knock-on effects for benchmark indices and capital flows to affected countries.

[1] Full transparency as underscored in IIF work on the Voluntary Principles for Debt Transparency would facilitate finding effective solutions to debt service problems.

- Loan loss provisions, accounting impairments, and regulatory capital and tax treatment regarding deferred debt service payments to banks.

3. Exploring scenarios and implications

Addressing both sides of this puzzle would require significant collaboration and support. Without additional support, many developing countries, including some middle-income countries, will be unable to adequately respond to the pandemic or invest in recovery. Many countries likely will be unable to service commercial debt. A wave of disorderly defaults may loom, with significant impacts on countries' ability to recover, and possibly on broader market stability, ultimately threatening the fiduciary duty that owners and managers are trying to protect.

Additionally, ensuring fiscal space to make the policy choices toward SDG and Paris-compatible investments now will set the stage for recovering better, buiding resilient, inclusive, gender-equal and sustainable economies and societies.

To help support the important goals of the intiative, private sector creditors and lenders are developing Terms of Reference that can be used by firms participating in the DSSI on a voluntary basis, to underpin a common understanding of the contemplated private sector support. Innovative solutions to debt service problems and provision of cash flow relief remain important considerations. It is also important from a private creditor perspective that in-scope borrower countries have adequate tools and the information necessary for their decision-making on whether to participate in the DSSI, given the risk that such participation could negatively impact future access to international markets. It remains a priority of the public sector and its development partners (MDBs, IMF, etc) to take a leading role in the above-mentioned processes, given that private creditors do not have either the mandate or capacity to provide the needed technical assistance.

4. Next steps

- Seek widespread participation of commercial creditors in the standstill on debt service for low-income countries through the DSSI.
- Assess measures that could be taken to incentivize participation of commercial creditors, such as through the establishment of a credit facility with MDBs or legal incentives, and to extend it to other countries in need.
- While the focus should remain on this standstill phase through the end of 2020, it is important to begin to advance the dialogue on debt relief and sustainability, including SDG considerations, as part of a broader initiative.
- IIF continues to play a key role in convening both public and private sectors, creditors and borrowers—offering a platform to share views, understand and address challenges, and facilitate opportunities to learn from each other to support the aims of the DSSI and beyond.
- Enhance dialogue and understanding among all actors to preserve and improve access by developing countries to resources for response, recovery and beyond.

5. Continued Collaboration

A. By mid- July 2020, at the margins of the High-Level Political Forum

- Discussion of measures that could be taken to incentivize participation of commercial creditors.
- Reflection on the Terms of Reference for firms participating in the DSSI.

B. By mid-September 2020, at the margins of the UN General Assembly

- Discussion on the results in terms of participation of private creditors in debt sustainability initiatives.
- Consider medium-term actions to provide debt relief, including SDG considerations, as part of a broader initiative.
- Reflection on possible avenues to advance the Secretary-General's Strategy and Roadmap for Financing the 2030 Agenda in support of the process.

C. By mid-December 2020

- Stock-taking and placing progress in the context of our common ambition to deliver the 2030 promise—by mobilizing together around the Decade of Action, needed now more than ever to prevent losing decades of progress towards sustainable development.