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INSTITUTE OF INTERNATIONAL FINANCE

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Odile Renaud-Basso
Director-General of the Treasury
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Dear Managing Director Georgieva, President Malpass, Minister Al-Jadaan and Chairperson Renaud-Basso,

Since being tasked by the G20 and your organizations to help, the Institute of International Finance (IIF) has worked intently over the past six weeks to facilitate discussions between the official and private sectors on voluntary participation in the G20 Debt Service Suspension Initiative (DSSI). The IIF's Committee on Sovereign Risk Management (CSRM) has been a leading forum for these discussions, convening over 100 of the world's foremost asset managers, banks, and others across the intermediation spectrum. CSRM members have been highly engaged and constructive, providing a valuable sounding board as well as a source of technical expertise to the official sector. This has allowed us to channel candid feedback and reaction to public sector authorities. In turn, the group has benefited from the guidance and clarifications provided by your staff and other official sector stakeholders.

As a result, we believe a frank and productive dialogue has been established between the official and private sectors, with genuine willingness to air questions, understand complexities and propose novel solutions. Importantly, the process has also facilitated meaningful direct dialogue between countries and creditors—a positive step forward for all stakeholders.

Throughout these efforts, as noted in our April 9 letter, we have referred to the *Principles for Stable Capital Flows and Fair Debt Restructuring*, endorsed by the G20 in 2004. Designed to support debt sustainability and help with crisis prevention, management and resolution, the *Principles* are a voluntary code of conduct between sovereign debt issuers and their private sector creditors. The *Principles* emphasize sound policies and transparency on the part of borrowers, open dialogue between creditors and borrowers, good-faith negotiations and fair and comparable treatment—i.e., non-discriminatory treatment—of all creditors. These *Principles* are thus highly relevant to the DSSI process and more broadly should be referenced during any current or future episodes of debt restructuring.

The Voluntary Principles for Debt Transparency under development complement the existing *Principles*, and are particularly applicable in the DSSI context given the evident benefits of transparency on the part of all creditors, both private and official. Publication of information on requests for debt service suspension from applicant countries is vital to comparability of treatment. It is equally important in the context of any requests to the private sector for debt service suspension that requesting countries fully disclose the stock and payments forecasts for their debts owed to the official sector as well. The need for transparency also extends to the use of resources freed up by debt service suspension—private creditors consistently underscore the need to monitor adherence to the DSSI condition that these savings be "directed towards vital emergency medical and other relief efforts while these members combat the impact of the pandemic."

Drawing on these core principles and informed by our working group discussions, this letter is meant to frame the accompanying Terms of Reference for private sector consideration of borrower requests within the DSSI. We consider these Terms to be the best possible response at this time to the call from the official sector for private sector participation. As dialogue between private creditors, sovereign borrowers and official sector stakeholders continues, we would anticipate potential future improvements/amendments to the Terms of Reference could be agreed.

Importance of market-based solutions and a case-by-case approach

Our discussions with CSRM members have made it clear that private creditors and lenders appreciate the underlying intent of the DSSI—to provide temporary assistance, if needed, for diverting resources to emergency COVID-19 response. However, some reservations remain about the extent to which it is practicable to implement the private sector response to the DSSI in the way designed—and about potential unintended consequences for market access of in-scope countries (see below).

There has also been widespread interest in exploring market-based approaches to facilitate private sector participation in the initiative and deliver the NPV-neutral approach included in your call to the private sector to support the DSSI. Our May 1 letter to you highlighted some of the challenges around NPV neutrality; in particular, because forbearance on its own is NPV-negative, it must be combined with economic improvements, some seniority, or credit enhancements to achieve NPV neutrality. However, given the heterogeneity of both creditors and borrowers, tremendous diversity of financing instruments and contract provisions, and wide range of fiduciary considerations, it is evident that there can be no one-size-fits-all solution.

A starting point: private sector Terms of Reference

We offer the attached private sector Terms of Reference as a flexible template that can be used as a starting point to advance individual conversations between sovereign borrowers and their private creditors. These broad Terms of Reference can subsequently be built on at the implementation level to reflect individual country circumstances, which will vary with regard to creditor base, market access, financing needs and fallout from the pandemic. These Terms, for purposes of simplicity, clarity and quality of treatment, do not differentiate between bond and bank creditors, thus upholding the vital principle of non-discriminatory treatment of all creditors. However, we would emphasize that the mechanical and legal challenges of bank or bond forbearance are distinct for each creditor group—and equally complex. The Terms of Reference also incorporate views from our working groups and reflect valuable feedback from the IMF, World Bank and Paris Club.

We have also sought perspectives from in-scope sovereign borrowers, including via an extraordinary virtual meeting with delegates representing 15 African finance and development ministries, hosted by the United Nations Economic Commission for Africa and the IIF on May 11. Building on input from this wide range of stakeholders as well as civil society and the academic community, these private sector Terms of Reference should assist in the promotion of a common understanding of the voluntary nature of private creditor (and borrower) participation, scope of the initiative and process for execution.

Urgent need to preserve market access

Given the need for individualized, case-by-case solutions, our discussions with both creditors and borrowers have consistently underscored the need to ensure liquidity for in-scope countries and to do everything possible to ward off a genuine solvency crisis. Official bilateral creditor participation in the DSSI—complemented by multilateral flows that can be mobilized quickly—is key in this regard.

We estimate, using data from Bloomberg and the World Bank International Debt Statistics, that of the $30 billion in debt service payments from in-scope countries due between May 1 and December 31, 2020, roughly $17.7 billion is due to official/multilateral creditors and $12.6 billion to private creditors. These obligations to private creditors tend to be concentrated in a subset of DSSI-eligible countries, highlighting the importance of market access. Over 25 countries in scope for the DSSI have Eurobonds; we estimate that some $5 billion in debt service on these Eurobonds comes due between May 1 and end-2020. For private sector creditors to help with maintaining liquidity—and to avoid future solvency problems—market access, at an acceptable cost, must be preserved. Private capital flows will be essential for economic recovery and sustainable growth in the years to come. In this context we would highlight encouraging signs of a recovery in capital markets in recent weeks, with market access returning for some sovereigns.

Indeed, many in-scope borrowers have expressed to the IIF and its members that while they appreciate the need for additional financial support from the official sector (particularly in the crisis-fighting phase), their development financing objectives—including attainment of the UN Sustainable Development Goals—cannot be fully met through long-term reliance on official creditors and donor financing. Accordingly, these countries have expressed support for the belief of private sector creditors and lenders that retaining market access is critical.

Challenges associated with credit ratings and NPV neutrality remain unresolved

We continue to emphasize the importance of credit ratings as a determinant of cost of funding, index inclusion and ultimately of market access. We have discussed the implications of potential private sector participation in the DSSI with the major ratings agencies, concluding that it is virtually impossible to avoid downgrades and credit rating agency-designated default ratings (which stem from net present value losses) without an additional economic component, an improvement in bond covenants or other incentives/credit enhancements that would be needed to achieve the NPV neutrality specified in the DSSI term sheet.

If such enhancements prove difficult to engineer—which you have explained is the case in such a short time frame—then countries that currently enjoy market access may be reluctant to request forbearance from their private creditors; a number of eligible borrowers have already expressed these concerns. This would decrease private sector participation in the DSSI.

The road ahead

By developing a Terms of Reference for voluntary private sector participation in the DSSI, we hope to offer a practical tool that both private creditors and in-scope borrowers can refer to and take forward in a manner suited to their unique circumstances. Given these divergent circumstances, we would underscore our understanding that the decision on whether to ask for suspension from some or all of their creditors should be made by the respective countries themselves.

Let me also take this opportunity to reiterate the widespread goodwill of the private sector towards the vital objectives of the DSSI. As we have noted, while there is no one-size-fits-all solution, we are committed to exploring mechanisms to simplify and expedite this process within the framework of the *Principles* discussed herein and the Terms of Reference—and with full awareness of the urgency of the situation. As the scale of the economic fallout from the COVID-19 pandemic continues to unfold, we believe that if carefully and transparently administered this initiative could provide substantial benefits for some of the world's poorest and most vulnerable countries.

We trust these efforts will contribute to the success of the initiative and look forward to continued dialogue and productive engagement.

Sincerely,

Timothy D. Adams
President and CEO
Institute of International Finance

cc:
OECD Secretary General Gurria
G20 International Financial Architecture Working Group