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INSTITUTE OF INTERNATIONAL FINANCE

September 22, 2020

His Excellency Mohammed Al-Jadaan
Minister of Finance
Ministry of Finance, Kingdom of Saudi Arabia
King Abdulaziz Road
Al Wazarat Area 6902
Riyadh 11177
Saudi Arabia

Dear Minister Al-Jadaan,

As the consequences of the COVID-19 pandemic for the global economy and financial markets continue to unfold, we at the Institute of International Finance (IIF) have been encouraged by the progress of the G20 Debt Service Suspension Initiative (DSSI). Your rapid efforts to provide cash flow relief and liquidity to some of the world's most vulnerable countries have been a valuable complement to the more comprehensive financing measures that the IFIs, official donors, and private-sector investors are providing to support their economies at this difficult time.

We remain strongly supportive of the intent behind the DSSI. However, we also recognize that the underlying premise may have changed—the issues in some countries are no longer temporary liquidity problems, but rather more fundamental solvency concerns. This letter sets out three key points which we believe are crucial:

1. Private finance is an essential component of the financing equation and market access is therefore vital;
2. A case-by-case approach is unavoidable; and
3. The focus going forward must be on sound policies and long-term sustainability—including ESG considerations and support for the Sustainable Development Goals.

Over the past five months, in response to your request for private sector participation in the DSSI on comparable terms, we have acted with speed and energy to engage with the initiative and support the proposal. Coordinating closely with the IMF, World Bank and Paris Club, we have generated a valuable set of tools and protocols to facilitate private sector support for this important effort. At the same time, we have encouraged a robust public-private sector dialogue, including with civil society organizations and borrowing countries—believing that borrowers should be consulted, and their perspectives fully reflected in policy discussions of next steps.

Our efforts, which have had broad support from international private sector lenders and bondholders, have been communicated to you in our letters of April 9, May 1 and May 28, at which time we also published a Terms of Reference for Voluntary Private Sector Participation in the G20/Paris Club DSSI. Since then, at the request of borrowing countries via the United Nations Economic Commission for Africa (UNECA), we have added a Template Letter Waiver Agreement with respect to the DSSI. These achievements have also been catalogued in the [Progress Update on Private Sector Engagement] provided to the G20 on July 15.

We note the discussion of potential extension and/or expansion in scope for the DSSI and offer the following observations in the event that further engagement with the private sector is seen as beneficial. These observations have been informed by recent conversations with our Committee for Sovereign Risk Management (CSRM), which now numbers over 200 members from more than 100 financial firms worldwide, representing some $45 trillion in assets under management. The CSRM, which was launched in the early 2000s, has evolved from a small group of global banks to a heterogeneous forum including many of the world's largest asset managers and asset owners as well as smaller fund managers specializing in emerging and frontier market debt. These changes in the CSRM reflect the increasingly diverse nature of the international creditor base for emerging economies, including for low-income and developing countries (LIDCs).

Private finance is an essential part of the equation

Many LIDCs now have unprecedented ability to tap global sources of private capital, allowing them to fund growth-generating projects and support sustainable development goals (SDGs). Indeed, over the past 10 years, there have been over 85 LIDC international bond issuances from 22 individual sovereigns, for a total of over $65 billion. Most of these countries had previously not had access to international bond markets and all have worked hard to establish it, thereby adding valuable diversification to their menu of financing options. In our conversations with borrowing countries, many have stressed that preserving their credit ratings and maintaining access to international debt markets will be essential to financing current operations as well as to supporting economic recovery and sustainable growth. Many have said that they are committed to meeting all their obligations to commercial creditors on a timely basis. More broadly, **borrowers have clearly been reluctant to seek private sector involvement given rational concerns that doing so would compromise access to private capital**—which remains crucial for countries to meet their development financing objectives. We believe that such key debt management decisions should be left to the discretion of the borrowing countries.

One cornerstone of market access is good investor relations, as noted in the *Principles for Stable Capital Flows and Fair Debt Restructuring* ("*Principles*). Transparency is a key element of strong borrower-creditor relationships, and in any proposed change to debt arrangements we would underscore the **importance of a level playing field for all creditors**—official bilateral, multilateral and private—as noted in the *Voluntary Principles for Debt Transparency*. All parties should also have a common understanding of key concepts, e.g. NPV neutrality, which has a different meaning for public and private creditors. Achieving NPV neutrality in a DSSI context would require either different (higher) assumptions for accrual rates on suspended debt service, or some form of credit enhancement. Such credit enhancements—structured, for example with the World Bank—have achieved little traction, and merit further exploration.

With mature market governments facing growing fiscal constraints, **the SDG funding gap for emerging markets will require substantial private sector financing**. The IMF estimates that meeting the SDGs in five priority areas—education, health, roads, electricity, and water and sanitation—by 2030 will require additional private and public annual spending of nearly $530 billion for low- and lower middle-income countries and $2.1 trillion for emerging countries. Development of a domestic investor base and local currency bond markets could provide an important complementary source of funding. However, local currency markets will also rely on participation from international investors if they are to achieve scale.

Preserving and expanding international market access should thus be a key consideration in any discussion of debt service suspension, restructuring or sustainability. If private capital is unavailable or prohibitively expensive, how will these countries recover and attain the high growth rates needed to improve living standards? Absent private creditors, the public sector would need to be willing and able to act as sole creditor to LIDCs far into the future. Even if possible, would this be an optimal outcome for these countries—or for investors eager to put capital to work in ways that support sustainable development?

Markets normalizing

Given the highly uncertain global economic backdrop, the recovery in debt markets has been impressive. Both emerging and frontier market bond spreads have narrowed sharply from their peaks in mid-March (though the latter a, while international bonds from in-scope IDA countries have been trading above par, signaling a cautious return of investor confidence.

This progress is even more impressive given the initial market reaction to the launch of the DSSI itself—spread widening and disruption to market access for DSSI-eligible countries, with broader spillover effects for emerging markets. **As you consider an extension of the DSSI, we note that this could result in a higher risk premium for market access countries**. We would also highlight the significant diversity of both borrowers and creditors, which makes debt service suspension a very complex undertaking with no evident "silver bullet."

A case-by-case approach is unavoidable

In the active policy debate around the DSSI, it is understandable that many are advocating across-the-board, one-size-fits-all solutions. From a legal perspective, this is not currently possible for countries that borrow in private capital markets. However, we have developed tools to make achieving debt service suspension from private creditors easier, including the Terms of Reference. At the same time, some countries may be in a position to work with their creditors on voluntary liability management or loan refinancing, whereas other countries may have had "pre-existing" debt sustainability vulnerabilities prior to the COVID-19 crisis.

Throughout discussions with our CSRM, an underlying theme has been **sanctity of contracts**; i.e. that debt contracts should be honored in accordance with their agreed terms, and that any amendments (e.g. to take account of pandemic-related disruption) should be addressed on a consensual basis among the relevant parties. This is underscored in the *Principles* as well as in the 2012 Report of the Joint Committee on Sovereign Debt Crisis Prevention and Resolution, a public-private sector response to issues arising from the Greek sovereign debt crisis. Given the great diversity of borrowers, creditors and financial instruments under consideration, the contracts underpinning the loans and bonds issued by DSSI-eligible borrowers all have unique characteristics and would need to be amended on a voluntary case-by-case basis. **Any coercive or top-down approach would put debtors at risk of default and undermine the functioning of private financial markets, jeopardizing market access and capital flows well beyond those to DSSI-eligible countries**.

With this in mind, we are formulating two new additions to the toolkit. A Framework Agreement will create a streamlined, market-based approach for banks and sovereign debtors to inform the process for amending loan contracts while addressing concerns about breaches of contract and cross-default risks. It will include a waiver element, a standstill element and an adherence mechanism. We are also preparing a technical guidance note on consent solicitations, which are required to attain requisite approvals when borrowers wish to propose changes in material terms of securities agreements to their bondholders.

This drive to develop practical solutions reflects the commitment of our CSRM members to find ways to help troubled sovereign borrowers, both with short-term liquidity problems and with longer-term solvency risks.

Looking ahead—focus on sound policies and long-term sustainability

A growing number of investors believe that sustainability must be central to any coordinated debt initiative—both the classical view of debt sustainability and a broader, longer-term focus on ESG concerns. To date, discussions around the DSSI have focused on a debt service moratorium. However, these longer-term ESG problems could well be exacerbated if not addressed in the DSSI context. Ahead of the IMF World Bank Annual Meetings, we will be surveying CSRM members on their experience with the DSSI, views on a potential extension, and proposals for solutions to both liquidity and solvency challenges. Recent conversations offer three preliminary observations:

- First, **liquidity problems that persist beyond the short term may indicate underlying solvency problems and should be dealt with using well-established mechanisms**, including an IMF program and debt restructuring negotiations. Some commentators have expressed concerns that multiple countries may need to restructure debt at the same time, raising questions as to whether institutional resources available for the debt restructuring process could be overwhelmed. We are confident that the existing market-based architecture combined with the engagement of our members on these issues would deliver consensual solutions in the context of good faith engagement between debtors and private creditors. We will continue to explore potential enhancements to this architecture including a review of collective action clauses and recent developments with respect to creditor committees.
- Second, **debt sustainability relies on sound economic policies**—so it is critical that countries engage in feasible policy adjustment to alleviate debt distress that may result from the pandemic. Debt sustainability analysis should be dynamic and forward-looking. To the extent that additional financing is needed to alleviate a liquidity problem, private creditors have a track record of demonstrated willingness to participate as part of a comprehensive solution.
- Third, **effective solutions to LIDC debt problems will require more active participation from multilateral institutions**—some of the largest creditors to these countries. We welcome the support provided by the IMF's Catastrophe Containment and Relief Trust and encourage the official sector to consider other mechanisms such as an SDR allocation and greater liquidity for the MDBs. The latter could be facilitated by bolstering their balance sheets—for example, by bringing forward agreed contributions to the 2018 World Bank capital increase. Participation could include support for a number of proposals for credit enhancement designed to catalyze voluntary private sector participation, including the exchange proposed by UNECA and the African Union.

As we think through solutions for the debt sustainability problems ahead, it is vital to focus on longer-term considerations and building for the future. While the current pandemic must be a top priority in the near term, it has also brought broader ESG challenges to the fore. A growing number of investors are looking for consideration of climate and related environmental sustainability factors in debt solutions—for example, SDG-aligned bond funds, partially guaranteed SDG bonds, or debt-for-nature swaps. Many of these solutions would rely on credit enhancement (e.g. partial guarantees), highlighting the benefits of MDB participation.

We believe that collaborative, market-friendly solutions—bringing together policymakers, development finance experts, civil society, and the private sector financial community—will offer the best chance of successful long-term outcomes to the challenging problems ahead. We look forward to exploring ways to support these solutions, and to continued productive dialogue.

Sincerely,

cc:
Taro Aso, Finance Minister, Japan
Roberto Gualtieri, Finance Minister, Italy
Kristalina Georgieva, Managing Director, IMF
David Malpass, President, World Bank
Angel Gurria, Secretary General, OECD
Odile Renaud-Basso, Chairperson, Paris Club
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