POTOMAC
GROUP

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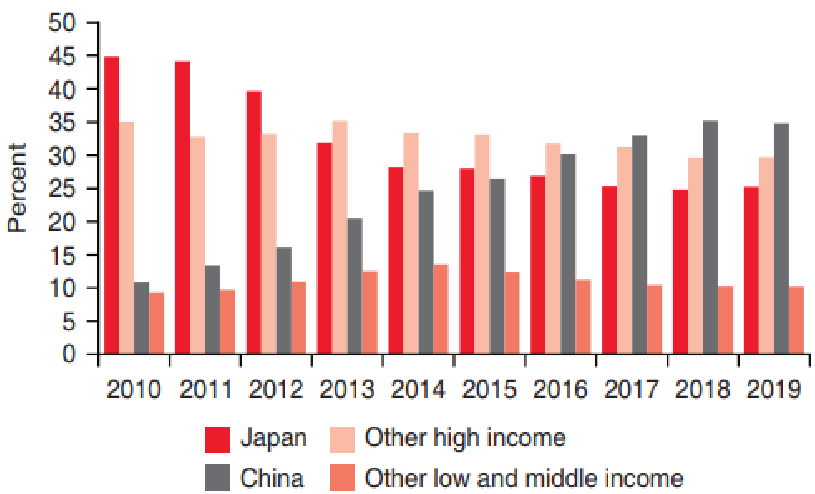
I.

THE INTERNATIONAL FINANCIAL ARCHITECTURE AND NEW DEBT RELIEF FRAMEWORKS

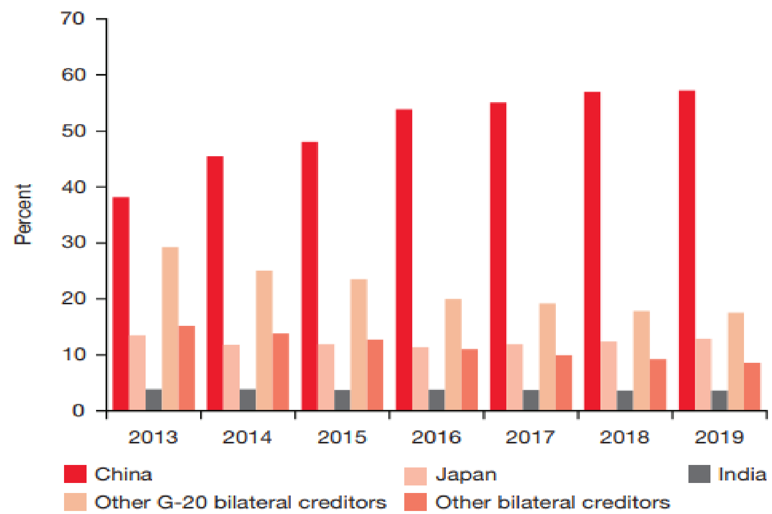
- The rise of non-traditional bilateral lenders has necessitated reform of the International Financial Architecture.
- Due to the pandemic, the international community mobilized emergency support for low-income countries through the IMF, World Bank, and regional development banks and introduced two new mechanisms for delivering official bilateral debt relief to low-income countries:
  - — The Debt Service Suspension Initiative (DSSI)
  - — The Common Framework for Debt Treatments beyond the DSSI (Common Framework)
- Middle-income countries continue to rely on ad hoc debt negotiations with creditors.

Creditor Composition of Debt Owed to Bilateral Creditors



Source: World Bank Debtor Reporting System

DSSI-Eligible Countries' Bilateral Debt-Creditor Composition



Source: World Bank Debtor Reporting System

DSSI

- G20 members agreed to provide relief on debt service falling due in the period from May 2020 to December 2021, for 73 low-income countries.
- Imposes limits new non-concessional borrowing and conditions for debt transparency, both of which are contentious issues that have frustrated past efforts of collective action.
- Comparable treatment with private creditors is encouraged under the DSSI.

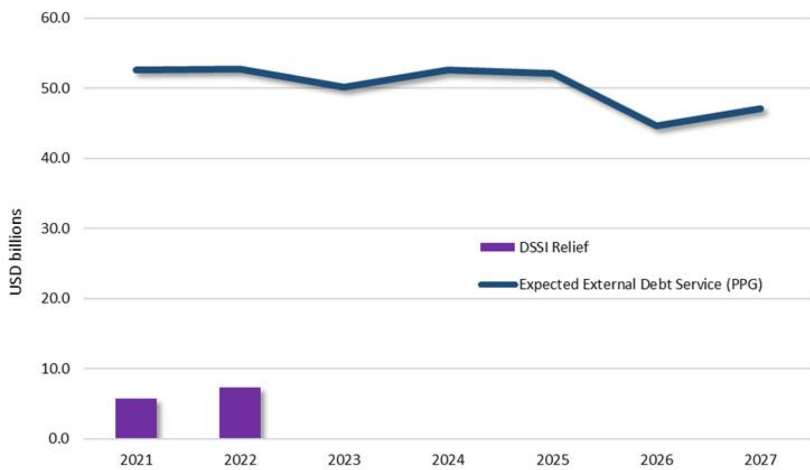
Common Framework

- Available only to DSSI-eligible countries that are under an IMF-supported program.
- Delivers deeper debt restructuring for countries where public debt is unsustainable and a reduction in the net present value of debt is needed to restore sustainability.
- For other countries with only liquidity issues, the Common Framework can provide a deferral of debt service payments (beyond the DSSI) through a rescheduling/reprofiling of the debt.
- Comparable treatment with private creditors is required under the Common Framework.

Ad Hoc

- Middle-income countries are currently excluded from DSSI and the Common Framework and continue to rely on an ad-hoc system of debt relief negotiations, regardless of the sovereign's standing with the IMF.

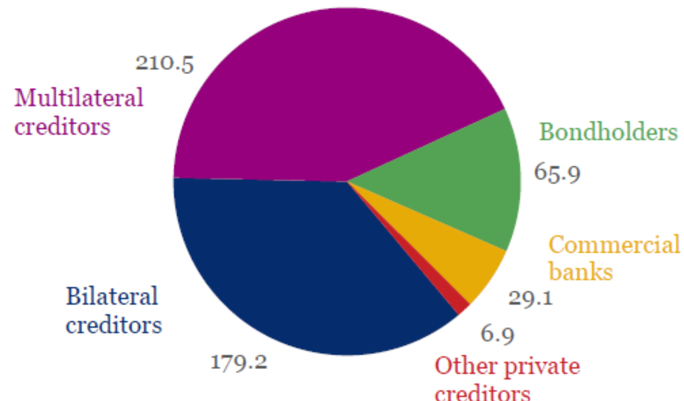
DSSI Relief as a Share of Total External Debt Service Requirements



Note: Aggregates for 68 of the 73 Eligible DSSI Countries (due to unavailability of data for: Kiribati, Marshall Islands, Micronesia, South Sudan, Tuvalu)

Source: World Bank International Debt Statistics, IMF

Long-term PPG external debt of DSSI-eligible countries



Source: World Bank, IIF

Private Sector Participation

- The Common Framework requires the debtor to seek from other creditors, including private creditors, a treatment at least as favorable as the one agreed under the Common Framework.
- This has had the unintended consequence of the international credit rating agencies taking the stance that an application to the Common Framework would lead to a credit default and downgrade.
- Many countries that have outstanding Eurobonds therefore have chosen not to apply for debt treatment because of the perceived risk to their future market access and cost of borrowing.

Transparency

- The Common Framework states clearly that a beneficiary country will be required to provide to the IMF, the World Bank, as well as creditors participating in the debt treatment, the "necessary information regarding all public sector financial commitments (debt), while respecting commercially sensitive information."
- This is consistent with the efforts of the IFI's and G20 to promote debtor countries' debt disclosures, recording, and management of non-standard debt.
- Obligations to China and other non-traditional lenders are particularly under scrutiny as they have often been contracted in non-transparent ways.
- Lenders are increasingly inserting confidentiality clauses in their loan documentation, which can complicate the disclosure of information during a restructuring.

II.

RECENT CASE STUDIES

Chad

- Chad was the first country to apply for debt relief under the Common Framework in January 2021. Participating official bilateral creditors, including China, France, India and Saudi Arabia, formed a committee that met virtually on June 10, 2021. IMF and World Bank staff were also in attendance. The committee supports Chad's envisaged IMF upper credit tranche (UCT) program and are committed to negotiate a restructuring of their claims. It is expected that Chad will also seek comparable treatment from its private creditors.

Ethiopia

- In January 2021 Ethiopia announced its plans to reschedule its debt under the Common Framework and the IMF reached staff-level agreement on a program in February. Ethiopia's outstanding eurobonds, however, immediately plunged on the news as the international credit rating agencies downgraded the country's sovereign rating due to the expected negative impact on private creditor claims. (S&P is currently at B-; Moody's at Caa1; and Fitch at CCC.) The actions of the credit rating agencies caused some stir in the international capital markets as various stakeholders – including the IFIs, issuer countries, and creditors – tried to decipher what this meant for future debt relief discussions. As a result, some eligible countries have chosen not to participate in the Common Framework for fear of losing market access.

Zambia

- Zambia was experiencing debt distress before the pandemic and had already initiated negotiations with its creditors prior to the introduction of the DSSI and Common Framework. Like other eligible countries, Zambia benefited from the DSSI debt treatment without further scrutiny, and it has now applied for further relief under the Common Framework. A major part of the negotiations for Zambia, however, is its negotiations with China and private sector creditors. All parties have concern about comparable burden sharing and transparency and, as a result, the negotiations are progressing very slowly.

Argentina

- Argentina

Ecuador

- Ecuador

Lebanon

- Lebanon

Suriname

- Suriname

Belize

- Belize

III.

OTHER INNOVATIONS

THE TRIPLE THREAT: DEBT, CLIMATE, AND NATURE

DEBT

- The global economic contraction of 3.4% in 2020 due to the COVID-19 pandemic was the largest in the post-war period, compared with 2.6% growth in 2019. (Fitch)
- A major blow to world's poorest countries, the pandemic caused a recession that could push more than 100 million people into extreme poverty. (IMF)
- Sovereign downgrades increased nearly three-fold in 2020, to a record 32; Emerging market (EM) sovereigns saw 26 downgrades and no upgrades during the year. (Fitch)
- 73 countries are eligible for the G20 DSSI, and since it took effect on May 1, 2020, 40 eligible countries have applied for assistance equaling more than $5 billion. (World Bank)
- According to the IMF, half of low-income countries (LICs) (36 of 70 countries) were at high risk of debt distress or already in debt distress. Many emerging market economies were also at significant risk of debt distress.

CLIMATE

- Climate change is real and human activities, largely the release of polluting gases from burning fossil fuel (coal, oil, gas), is the main cause. (IPCC)
- To prevent warming beyond 1.5°C, we need to reduce emissions by 7.6% every year from this year to 2030. (UN EGR, 2019)
- 30% of the world's population is exposed to deadly heat waves more than 20 days a year. (UNEP)
- COP 26 in Glasgow, UK in November 2021 will be the most important intergovernmental meeting on the climate crisis since the Paris agreement was passed in 2015. (UN)

NATURE

- 75% of the Earth's land surface has been significantly altered by human actions, including for example the loss of 85% of the area of wetlands. (UN)
- 66% of the ocean area is experiencing multiple impacts from people, including from fisheries, pollution, and chemical changes from acidification. (UN)
- Conserving and restoring natural spaces, both on land and in the water, is essential for limiting carbon emissions providing one-third of the mitigation effort needed in the next decade. (UNEP)
- Since over half of global GDP has a high or moderately high dependency on nature, investing in nature-based solutions will not only limit global warming but also result in about 4 trillion dollars in revenue for businesses and over 100 million new jobs each year by 2030. (UNEP)

NEW MONEY INSTRUMENTS

- Middle-income countries with market access are increasingly turning to ESG and impact investors to finance green/blue projects.
- Sovereign sustainable-linked bonds (SLBs) would be for general budget purposes and are still under development.

GREEN BONDS

- Use of proceeds
- Green Bonds are any type of bond instrument where the proceeds or an equivalent amount will be exclusively applied to finance or re-finance, in part or in full, new and/or existing eligible Green Projects.

BLUE BONDS

- Use of proceeds
- The “blue” label for bonds under existing principles and frameworks allows issuers to signal sustainability strategies seeking to advance a healthy, productive and more sustainable ocean.

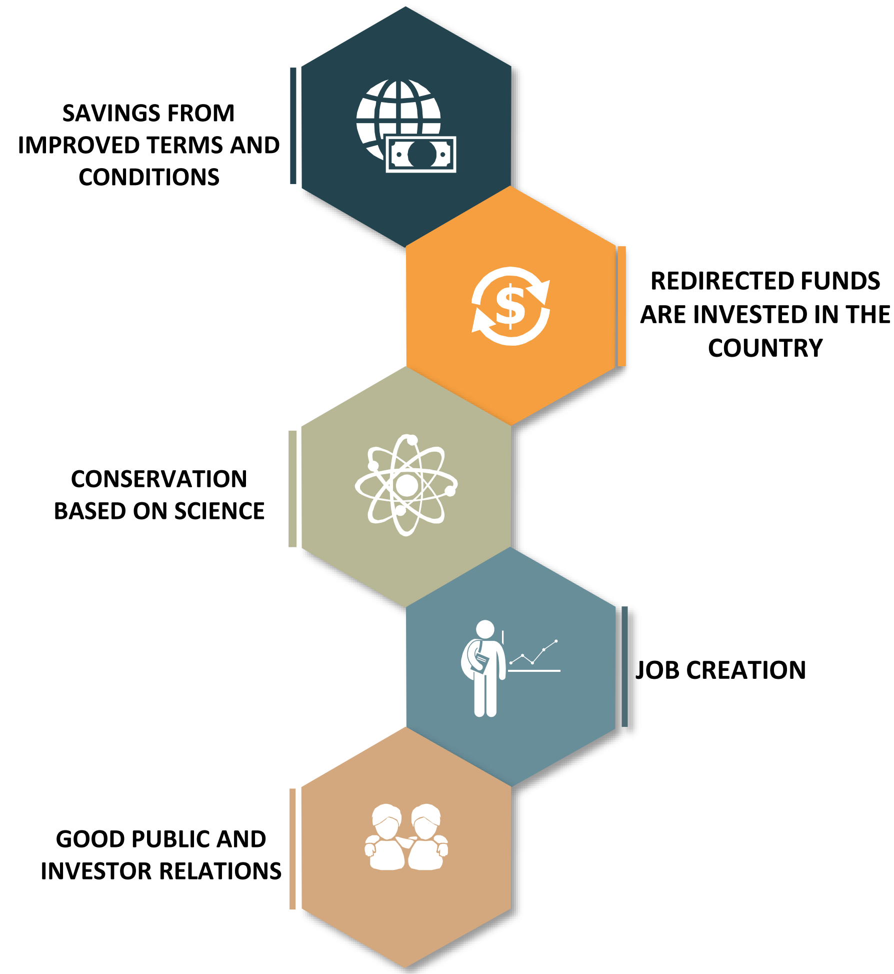
SOVEREIGN SLB

- Performance-linked bonds
- SLB proceeds would be primarily for the general purposes of a sovereign issuer in pursuit of identified Key Performance Indicators (KPIs) and Sustainability Performance Targets (SPTs).

DEBT FOR NATURE CONVERSIONS

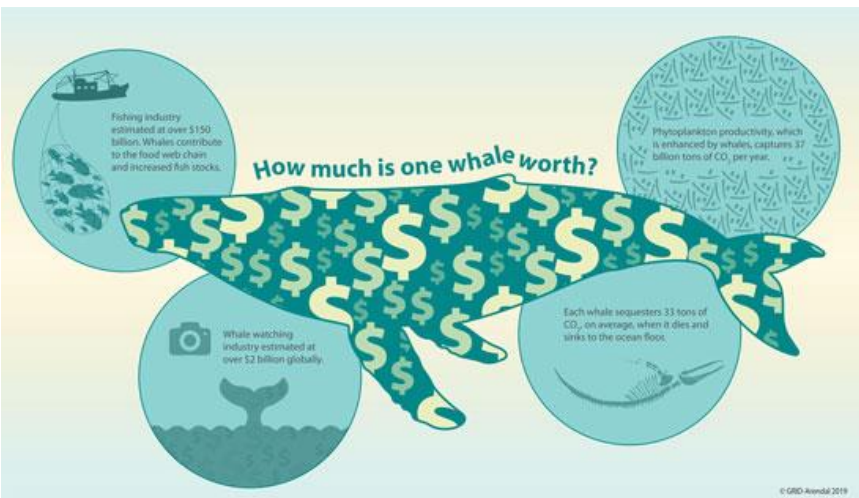
- The first debt-for-nature swap was agreed between Conservation International and Bolivia in 1987. Another notable example, which swapped Paris Club official debt, was the Seychelles in 2016 resulting in the creation of a USD 22 million investment in marine conservation. This was supported by The Nature Conservancy (TNC).
- Most recently, Pakistan announced in June it was set to sign agreements with Germany, Italy, Canada and the United Kingdom for "millions of dollars" in debt relief in exchange for investments in environmental conservation efforts across the country, in particular the restoration of the natural environment.
- TNC has established the Blue Bonds for Ocean Conservation program, which is a self-described "audacious plan to save the world's ocean" by supporting island and coastal nations to restructure their distressed sovereign debt and create long-term sustainable financing for marine protections, sustainable economic development, and climate change.
- TNC Blue Bonds for Ocean Conservation program allows a country to restructure a portion of its sovereign debt in a way that reduces their debt burden and secures long-term funding for marine conservation activities, as negotiated and agreed in the Marine Spatial Plan.

Key Advantages of Debt-for-Nature Conversions

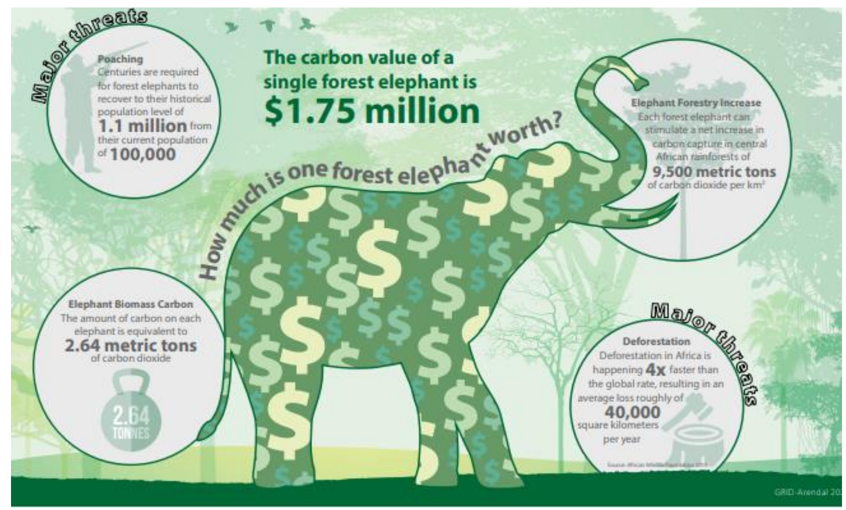


NATURAL CAPITAL AS SOVEREIGN ASSET

- A new area of research is the valuation of natural capital as a sovereign asset and the possible monetization of that asset.
- The international community is used to the valuation of non-renewable natural assets, such as oil, gas, minerals, timber, and ivory. The international community has a harder time valuing renewable assets, such as living forests or other flora, and it has almost no experience in valuing wild animals living freely.
- Recent work of Ralph Chami and his co-authors set out to **value the services of certain key species**, such as whales and elephants, living their natural life in the ecosystem:
  - — Chami's conservative estimates put the value of the average great whale, based on its various activities, at more than $2 million, and easily over $1 trillion for the current stock of great whales.
  - — In their paper, they calculated the total value of the service provided by African forest elephants and divided it by the current population, finding that each elephant is responsible for service worth more than $1.75 million.



Source: Nature's Solution to Climate Change, Chami et al.



Source: How African Elephants Fight Climate Change, Chami et al.

THANK YOU

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