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**A Review of Debt Restructuring Initiatives:
Experiences of Commonwealth Small Vulnerable
Economies (CSVEs)**

Paper prepared by Commonwealth Secretariat

Commonwealth Secretariat
Marlborough House
London SW1Y 5HX

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I. Introduction

1. This summary paper reviews the debt restructuring options available to Commonwealth Small Vulnerable Economies (CSVES), in particular middle income CSVES, as surveyed by Robinson (2010). The paper makes reference to the country cases reviewed, focusing particularly on the policy lessons learned and the key conditions for successful debt restructuring. At the end of the paper, a number of questions are posed for Minister's consideration.
2. High debt is hardly a foreign topic to many countries in 2012, whether developed or developing. However, the debt challenge of smaller middle income countries has long been overlooked by the international community, particularly those in the Caribbean, as highlighted in our assessment of the high debt burdens of CSVES¹.
3. Debts contracted by middle income CSVES are often non-concessional commercial credits with little scope for relief under the Paris Club. Rescheduling commercial debt through the London Club is also of limited benefit to many middle-income CSVES as, in contrast, to the 1980s, debt to private creditors has been contracted in the form of securities through the international markets rather than through syndicated loan markets.
4. Historically, bonds have been extremely difficult and costly to restructure because they are held by multiple investors, who are generally not homogenous but separated by institutional sector, region, investment size and motive. In general, options for highly-indebted middle-income countries are limited to traditional restructuring mechanisms. Moreover, the scale of the relief is much smaller than would be obtained by a similarly highly-indebted but low-income country.
5. Different types of debt restructuring operations have been recently employed by a number of middle income CSVES to reduce high debt burdens. In fact, Jamaica, Seychelles, St. Kitts & Nevis, Dominica and Belize have already undergone some form of debt restructuring with noted positive results. **It is advisable that highly indebted vulnerable countries seek to familiarise themselves with these country experiences and with the most recent innovations to debt restructuring, so as to maximise the options at their disposal.**

II. Debt Restructuring Initiatives

6. Debt rescheduling, debt refinancing and even debt forgiveness have been part of the debt restructuring landscape for a number of decades. These traditional methods of restructuring have been widely applied to countries with debt portfolios comprised mainly of loans owed to official and private creditors either externally or domestically. A less commonly applied debt restructuring initiative is a debt exchange.

¹ See Paper "The Debt Challenges of Commonwealth Small Vulnerable Economies: Trends and Policy Options (CSVE (12)2)".

Debt Exchanges

7. The increased use of debt exchanges in recent years reflects, among other things, the change in the debt composition of many developing countries, where over the past decade, borrowing has increasingly occurred through the issuance of securities in the international capital markets rather than through contracting loans. For countries facing payments difficulties and high levels of bonded indebtedness, the options for debt restructuring have been fairly limited. Debt exchanges have been a means by which sovereigns in debt distress can obtain some measure of debt relief.
8. Changing the payment terms so as to restructure a bond and to obtain a measure of debt relief requires a unanimous vote of all bondholders. Debt exchanges help sovereign borrowers avoid this problem. They circumvent the need to get a unanimous vote or agreement by a supermajority of bondholders in order to alter the terms of an existing bond. **Instead, they offer an alternative whereby sovereign governments can restructure their bonds by offering a new bond to bondholders, which reflects the restructuring terms, in exchange for the existing “old” bond.**
9. Critical to the success of a debt exchange is obtaining as close to **100 per cent participation rate** in the offer as possible. **Collection Action Clauses (CAC)** have been helpful in this respect, as these provisions allow a super majority of bondholders to make decisions regarding the terms of the bond to which all bondholders are bound, forcing the hands of holdout creditors. In essence, the higher the participation rate the greater the level of relief under the terms of the offer. Sovereigns may not always achieve this success rate, however, as the danger of stubborn holdout creditors is always present. Hence, achieving a successful debt exchange requires considerable **planning**.
10. Before implementation of a debt exchange, sovereigns must decide:
 - a. **Whether they opt for a pre-emptive debt exchange to avoid default or whether they should restructure only after they have defaulted on their obligations.**
 - b. **Whether they should negotiate terms with their bondholders or alternatively unilaterally design a restructuring offer and present them as given.**
 - c. **Whether to establish a formal consultative group or merely have informal discussions with key bondholders.**
11. In the end, the success of the debt exchange will depend on whether the outcomes are consistent with the objectives and whether the exchange secured the debt relief envisaged.

Debt Conversions

12. Debt swaps or debt conversions are another means by which countries can restructure their debt and obtain significant debt relief. **They involve the exchange of a debt, typically an external debt, at a discount for cash, assets or some non-debt obligation in domestic currency.**
13. The main benefit of a debt swap to a borrowing country is that it results in a reduction in its outstanding debt. **The extent of the debt reduction is dependent on the extent**

to which the creditor holding the claim is willing to discount the debt in the secondary market- its secondary market price- and the extent to which the debtor is able to redeem the debt at a price below its original value. Unlike a simple write-off of a debt, debt swaps carry an additional benefit. Because of the nature of the transaction, not only do debt swaps lead to debt reduction but they also lead to significant increases in investment or social and economic welfare. Historically, the most common swaps have been debt-for-equity swaps but these have since expanded to include debt-for-nature swaps and debt-for-development swaps, which include debt-for-education, health and other social investments.

Debt-for-Equity Swaps

14. Debt-for-equity swaps typically involve three parties: the borrowing government with outstanding commercial debt, the creditor with unpaid claims and a private investor, often a bank or private company, seeking to invest in the borrowing country. The investor purchases the external commercial debt in the secondary market, usually at a deeply discounted secondary market price and then sells it to the borrower at a negotiated value- the redemption price- close to the debt's original face value. The debt is extinguished and the proceeds received by the investor in local currency are used to acquire an equity investment.

Debt-for-Environment Swaps

15. Similar to debt-for-equity swaps, debt-for-environment swaps involve the cancellation of the borrowing country's external debt in exchange for local currency funding of an investment. However, in debt-for-environment swaps, the investment is the funding of an environmental project or programme. In addition the purchaser of the sovereign debt is usually an international non-governmental conservation organisation rather a private investor. The international non-governmental organisation (NGO) purchases the debt (bilateral commercial) at a discounted price in the secondary market and then sells the debt to the borrowing government at a redemption price lower than the face value of the debt but higher than the secondary market purchase price. The proceeds of the sale are then used to finance the desired environmental programmes and activities in the borrowing country.

Debt-for-Development Swaps

16. Debt-for-development swaps involve the purchase of the borrowing country's debt by a development organisation, such as an NGO or a UN agency. The debts involved are typically official bilateral debts. These debts are bought at discount from the original face value in the secondary market and then sold to the government at a redemption price below the face value of debt. Development projects are funded by the NGOs with the proceeds from the sale.

Liability Management Innovations

17. For some middle-income countries a large and increasing amount of their debt is owed to multilateral financial institutions. Since the onset of the global financial crisis, this share has grown, owing to the absence of access to the international financial capital markets and dwindling aid flows. However, multilateral loans expose borrowers to two

types of market risks - currency risk as well as interest rate risk for those loans contracted at floating rates of interest. A number of recent multilateral initiatives have been implemented to assist countries mitigate these risks in their portfolios.

IADB Loan Conversion

18. With a rebound in global economic health, an upturn in market rates is possible as concerns shift from growth and stimulating recovery to curbing inflation. Borrowing countries will be exposed to an increased interest service burden should rates increase. Against this background, the Inter-American Development Bank (IADB) announced a major initiative to assist member countries that wished to limit their debt portfolio's exposure to interest rate rises by providing them with the option to convert their floating-rate debt to fixed-rate obligations. While not a debt restructuring operation in the traditional sense, this initiative, "a liability-management exercise" helped to minimise risk in member countries' portfolios, providing the potential for significant relief in the event of future interest rate rises.

Issuing in Domestic Currency

19. Recently a number of multilateral financial institutions have initiated lending to member countries in their local currency. The impetus for these institutions issuing in local currencies is the recognition that countries issuing debt in foreign currency expose their portfolios to significant currency risk. National governments earn their income predominantly in their domestic currency. Therefore, significant currency mismatches arise when governments contract debt and, as a consequence, service their obligations in foreign currency. Lending in local currency has twofold benefits: (1) it has reduced currency mismatches, as both the debt liability and the income generated by the asset are denominated in the same currency and (2) it has helped foster domestic capital market development by opening new markets and providing diversification opportunities for local institutional investors.

Debt Exchange Warrants

20. Debt exchange warrants are financial instruments that give the holder the right, but not the obligation, to exchange on a specific date, the "exercise date", foreign currency bonds for local currency bonds.

Other Innovative Financial Instruments

21. Small vulnerable countries with high levels of indebtedness could opt to index their debt to real variables, such as GDP or exports, or to some of their underlying determinants, such as commodity prices, imports or natural disasters to hedge against these exposures. Bonds indexed to GDP, exports or other real variables carry two main benefits: (1) they better correlate to a country's ability to pay thereby reducing the likelihood of defaults and debt crises; and (2) they can help stabilise government spending, since smaller debt payments are made at times of slower growth, limiting pro-cyclical fiscal spending.

GDP Indexed Bonds

22. Growth or GDP indexed bonds are bonds that link a country's debt payments to their rate of economic growth. They benefit the issuing country by reducing their debt burden in the event of an adverse shock that affects growth. Increased debt payments only occur in an economic upturn. As such, growth indexed bonds are better tailored to a country's capacity to repay. Despite the obvious benefits of these types of bonds, concern about issuing these instruments persist, including: (1) The quality and accuracy of GDP data; (2) revisions and methodological changes to GDP data; (3) market liquidity for growth indexed bonds; (4) pricing; (5) premium incurred relative to standard bonds; and (6) callability- concerns that investors would call the bond during high growth periods.
23. Few countries have issued real-indexed bonds. However, they provide a good way of helping countries highly vulnerable to external shocks mitigate these risks and maintain stable debt-to-GDP levels.

Catastrophe Bonds

24. Coping with natural disaster is beyond the scope of many small countries. Public finances are quickly overwhelmed as sources of revenue are disrupted and unanticipated spending for recovery, rehabilitation and reconstruction rise significantly. Catastrophe bonds or 'cat' bonds are a possible means by which small, disaster-prone developing countries can insure themselves against natural disasters. They are typically structured as floating rate securities which pay an attractive yield to investors but waive some or all of the interest and principal payments when a specific, predetermined shock such as a natural disaster occurs. Cat bonds therefore transfer some of the risk to a country's public finance from a natural disaster to the purchasers of the bond.
25. **Triggers** can take a number of forms: (1) *indemnity*- issuer's/sponsor's actual loss from an event above a specified threshold; (2) *modelled loss*- rely on catastrophe modelling software to determine whether losses exceed a specified threshold; (3) *parametric*-triggers are indexed to the natural hazard rather than to the actual loss claims of the issuer; (4) *parametric index*- combines parametric index with loss calculations to determine specific threshold.
26. **Benefits** are: (1) *debt sustainability*- allows for debt payments to decline in the event of a catastrophe; (2) *fiscal space*- prevents the curtailment of government spending because of revenue decline; (3) *portfolio diversification*- allows investors to diversify their portfolio; and (4) *higher returns*- allow investors to hold higher yield instruments.
27. **Concerns** are: (1) *cost*- costs are much higher as catastrophe bonds pay higher interest rates to compensate for risk of the loss of interest and/ or principal; (2) *the trigger*- investors are concerned that issuers will design triggers that places them at a disadvantage; (3) *liquidity*- low level of liquidity relative to conventional bonds; and (4) *market size*- fear that there may be insufficient demand for catastrophe bonds because of the relatively small size of the market.

III. Debt Restructuring Outcomes

28. This section briefly summarises the outcomes of debt restructuring operations which have been summarised in the appendix.
29. **Debt reduction.** It seems that most, if not all of the countries undertaking debt exchanges experienced some form of reduction in the value of debt outstanding. However, the scale of debt reduction varied considerably for a number of reasons including the comprehensiveness of the debt restructuring operation or lack thereof, rate of participation of creditors and type of debt restructuring operation undertaken.
30. **Credit worthiness.** Belize, Jamaica and Seychelles witnessed almost an immediate improvement in their credit ratings after their debt exchange operations. This improvement was accompanied by a fall in borrowing costs.
31. **Debt cancellation.** Debt cancellations sought through debt conversions have shown mainly mixed results. Debt cancellations in Jamaica, Nigeria and Indonesia through various debt swaps were less than anticipated but the operations recorded fairly successful social impacts.
32. **Risk management.** Liability management operations seem to be effective in mitigating the risks associated with public debt. Reviews of Mexico's debt warrants and catastrophe bonds as well as selected experiences with indexed bonds reveal broad improvements in risk management. Experience shows that GDP indexed bonds can be somewhat more complicated, however, due to potential ambiguities surrounding the source of reference data and GDP units of measurement.
33. **Comprehensiveness.** Countries' inability to achieve a significant reduction in debt in a majority of cases is linked strongly to the lack of comprehensiveness of the debt restructuring operation. Of the country cases and set of operations reviewed, only one country- St. Kitts and Nevis undertook a comprehensive debt restructuring, targeting both the external and domestic debt overhang. Most other operations were fairly piecemeal and targeted only the debt of immediate concern or the classification of debt eligible for financing, for example, through debt swaps. However, the lack of comprehensiveness is likely to be related to issues of access to finance.
34. **Timeliness.** The debt exchange and debt conversion operations undertaken by CSVEs reviewed were largely on the heels of persistent reductions in economic growth and associated surges in respective debt ratios. On the one hand, these operations were timely from the point of view of crisis prevention, in most instances, but as to the prevention of the build-up in public debt there is no clear cut answer. With regard to liability management operations, based on the cases reviewed, these can be considered timely since they are set-up ex-ante in recognition of the potential risks surrounding, for example, debt composition, threat of natural disasters, currency risk and interest rate risk etc.

IV. Key Lessons and the Way Forward

35. This section briefly summarises the key lessons of recent debt restructuring operations which have been summarised in the Appendix.

Debt Exchanges

36. ***Close creditor dialogue and cooperation.*** Debt exchanges conducted within a framework of close creditor involvement seem to have been the most successful in achieving the stated objective. This was particularly noted in the case of Belize, Jamaica and the Seychelles.
37. ***Financial advisors.*** The role of financial advisors seems essential in the process of carving out an implementation and communication strategy. It is particularly important to select financial advisors who have a strong track record in sovereign debt restructuring and who have sound local or country knowledge.
38. ***Transparency and Well Developed Communication strategy.*** Belize, Jamaica and the Seychelles made substantial financial and economic information available to creditors and the general public. These three countries ensured the availability of information on their official websites. It was particularly noticeable that Belize, Jamaica and the Seychelles developed an information strategy to accompany their financial strategy.
39. ***Well-structured transaction.*** A well designed transaction is essential to the success of the exchange. On-going dialogue with creditors who are knowledgeable about financial structures is vital.
40. ***Comprehensive and accurate debt data.*** An area that should not be overlooked is the availability of comprehensive and accurate debt data and in particular those that are affected by the debt exchange. Dominica encountered noted problems in the timing of the exchange because of inadequate debt information and delays in data reconciliation.
41. ***IMF Support Letter.*** Letter from the IMF appeared to provide significant leverage in prompting creditors to accept the terms of the exchange. It also provided comfort to the creditors as to the extent of the authorities' commitment to economic and structural reform.
42. ***IMF programme.*** An economic programme with the IMF seal of approval carries significant weight in creditors deciding to support a debt exchange. Creditors are not likely to proceed with the exchange unless they can gauge the authorities' commitment to a programme of economic reform and fiscal restraint to avoid a repeat of debt difficulties.
43. ***Partial Credit Guarantees.*** The AFDB's partial credit guarantee to the Seychelles was a considerable boost to the debt exchange as investors had a further assurance of receiving their payments. Such guarantees offered as part of a small countries debt exchange exercise could contribute significantly to its success.
44. ***Multilateral Involvement.*** Even though multilaterals are generally not a party to debt restructurings, the case of the participation of the CDB in Dominica's collaborative debt exchange does indicate that multilateral financial institutions are willing to be flexible, if only on a case-by-case basis. Their explicit support or tacit pressure

through pre-conditionalities (as in the case of Jamaica and the IMF) is a key determinant in the outcome of the exchange.

Debt conversions

45. **Extent of Debt Reduction.** To benefit from debt conversions, the country's portfolio should have a significant share of debt eligible for conversion. For many countries, these are mainly concessional bilateral debt which can be targeted for debt-for-development or debt-for environment swaps. At present, the scope for debt reduction through conversions of commercial debt appears more limited given the small share of loans relative to bonds in many country's debt portfolios.
46. **Domestic Debt Capacity.** Debt conversions often involve the extinguishing and replacement of external debt by domestic debt. Countries with high domestic debt burdens may find that debt conversions may be a costly way in which to retire external debt.
47. **Additionality.** Debt conversions have been criticised for not creating any additional investment as much of the investment would have occurred even without the conversion. The key concern is that the quantum of debt relief under debt conversions is relatively small. Governments should not be seen to be using scarce revenue to subsidise an investment that would have, in any event, taken place, especially where the subsidy is more substantial than the debt relief. Countries should seek to ensure that the debt conversions supplement rather than replace intended investment.
48. **Multi-donor effort.** The Polish Eco-Fund demonstrates that creditors can coordinate their efforts and make debt conversions more cost-effective. Countries should seek to encourage such collaborative efforts as a) they increase the level of development aid at any particular point in time b) lead to higher debt reductions, and c) lower transaction costs.

V. Questions for Ministers Consideration

1. Based on the options outlined, what are some of the options you would consider to restructure your country's debt?
2. Ministers who have experience with debt restructuring are asked to comment on the timeliness of debt restructuring operations. When should countries start to consult their creditors?
3. The lack of comprehensiveness observed with respect to the outcomes of debt restructuring operations could be linked to issues of limited access to finance, in particular, non-official and private finance. Ministers are asked to comment on the above.
4. Given the number of countries with debt challenges, the diverse set of options available and the positive results gained from past operations; do Ministers think that there is still a negative stigma around debt restructuring?
5. An IMF letter/support programme has been found to be important to a successful outcome in the case of a debt exchange. Ministers' views are sought on this.
6. Is there scope for the Secretariat to assist in this area? If so, what role do you see the Secretariat playing?

DEBT EXCHANGES

Table 1: Belize Debt Exchange

| Country | Economic Background and Debt Dynamics | Implementation and terms of Debt Exchange | Outcome of Debt Exchange and contributing factors | Chronology of events in exchange offer |
|---------|---|---|--|--|
| Belize | Expansionary macro policies 1999-2004, Fiscal and external imbalances, Storms 1996-2004 | *Transparency and *timely flow of information | Outcome: Debt reduction- NPV reduction of 21% in debt | July 2006- Appoint financial advisors: Houlian Lokey, Howarda & Zukin |
| | Fiscal ratio at 14.7% GDP at end 2004 | *Close creditor dialogue and cooperation | Drop in interest costs to 5.5% of GDP-2007 from 7.7% of GDP-2006 | Aug. 2, 2006- Announcement of debt restructuring |
| | External current at 6.4% GDP at end 2004 | *Good faith actions, *Fair treatment of creditors | Overall savings US\$301 m, over 5 years | Aug.2, 2006, Invitation to form creditor committee |
| | Deficits financed by external debt on ICAPM, Weighted avg. interest rates 10.1%-2005, 11.25%-2006 | Exchange= US\$144.2 million of debt (50% of GDP) held by private creditors for new bonds | Improved credit rating: S&P from CCC to B and Moody's upgrade to B3 | Dec. 12, 2006- Statement by IMF indication support of exchange |
| | Reserves at less than 1 month imports end 2004 | New bonds final maturity: 2029, a 14 year maturity extension | Improved pricing of new bond | Dec. 18-2006- Launch of offer |
| | Growth deceleration, 3.4%-2005 from 12.1%-2000, External debt 91% GDP-2004 from 65.6%-2000 | Equal semi-annual principal amortizations commencing in 2019 | Factors: Cooperative approach- establishment of creditor committee for close dialogue with creditors | Dec. 21, 2006- Announcement of creditor support |
| | <i>of which: 61% priv., 21% multilateral & 18% bilateral</i> | A step up coupon structure: 4.25% interest y+3 and 6% interest y+4 and y+5, 8.5% y+5 to y+n | Prior creditor support, IMF support letter, Appointment of financial advisors, collective action clause in existing bonds- allows supermajority vote | Jan. 26, 2007- Original closing date of offer |
| | Total PPG debt 100%-2004 from 71.6%-2000, Debt service: 43.6% of exports and 106% of revenues | Cash payment at closing equal to unpaid interest on tendered claims up to closing date. | High participation rate and extension of closing date. | Announcement of amendment of Old Notes, revised closing date of exchange offer |

Table 2: Dominica Debt Exchange

| Country | Economic Background and Debt Dynamics | Implementation and terms of Debt Restructuring and Debt Exchange | Outcome of Debt Exchange and contributing factors | Chronology of events in exchange offer |
|----------|---|--|--|--|
| Dominica | 4.5% GDP decline in 2002 on the back of poor banana and tourism value-added | *Hired financial advisors,* used a co-operative approach with creditors | Outcome: Multilateral debt restructuring- successful, longer grace periods, extended maturities, lower interest rates. | April 6, 2004: Announcement of debt restructuring |
| | Quadrupling of Public Sector deficit to 12.5% GDP due to capital expenditure expansion PPG debt grew from 75%-2000 to 114%-2003, ext. debt as share of GDP from 65% to 79%, ext. debt service increased to 9% of exports. | *Transparency, *creditor consultations and* inter creditor equity. Debt restructuring negotiations with the 3 main classes of creditors: Multilateral (CDB), official bilateral and private creditors | Post Debt Exchange: Debt to GDP fell from 122% end 2003 to 78% end 2008. Official bilateral restructuring- initially unsuccessful (Paris Club route), only 2 Paris Club members (UK & France) out of pool. GoD negotiated bilaterally for NPV 50% reduction in official bilateral debt | April 30, 2004: Original closing date of offer June 11, 2004: Revised closing date of offer |
| | Ext. debt 67% of total debt-2003, multilaterals (particularly CDB) 64% of ext. debt and 3% official bilateral creditors. Domestic debt 23% of total debt but significant domestic arrears (mainly Social Security) | Exchange Offer (all private creditors): US\$144.2 million of external and domestic private debt for new bonds (54% or eligible debt). Short bond- bullet maturity of 10 years, 30% discount on principal, debts maturing in 2 years eligible. Intermediate bond- bullet maturity of 20 years and 20% discount. Long bond- issued at par with 30 year bullet maturity. *Collective Action Clauses and *Mandatory Debt Management Clause. | Debt exchange not entirely successful: 70% initial participation rate (less external priv. creditors). Holdouts sought litigation. Final result, 50% NPV reduction. Factors: Extensive Creditor Consultations, Inter creditor Equity Approach, Good Faith Actions. Negative Factors: Inadequate creditor information, manual debt system, lack of internal capacity in debt management, absence of collective action clauses, inclusion of complex instruments and hostile creditors. | June 15, 2004: CDB restructures claims and September 2004: Closing date for late participation |

Table 3: Jamaica Debt Exchange

| Country | Economic Background and Debt Dynamics | Implementation and terms of Debt Exchange | Outcome of Debt Exchange and contributing factors | Chronology of events in exchange offer |
|---------|---|--|--|---|
| Jamaica | <p>Low growth rate of 2.3% over the past two decades. -2.4% GDP between 2008 and 2010.</p> <p>Public Debt at 135% of GDP in 2009 (domestic debt 55% of share).</p> <p>Domestic debt increase due to Government's intervention in 1990 financial collapse and assumption of financial sector obligations on Government's budget in 2001.</p> <p>Domestic debt rose from 25.9%-1995 to 70.5%-2001 and 75%-2009</p> <p>Domestic debt portfolio-mainly medium to long-term debt with 15% of total domestic debt denominated or indexed to the U.S dollar.</p> <p>Domestic debt service was 99% of tax revenues, 60% of total budget, domestic interest payments 76% of total annual interest payments, 27% of debt maturing in 2 years and nominal interest rates of 15%.</p> | <p>Objectives of debt exchange: Reduce interest burden and extend maturities, alter composition of portfolio to reduce exposure to interest rate risk, ensure stability of financial sector, achieve a high participation rate.</p> <p>Issues: Due to quantity and nature debt possible fallout from financial sector and losses to small retail investors and pensioners.</p> <p>Implementation: *Appointment of financial advisors, *formation of communication strategy team, *extensive stress testing of the financial sector, *broad based market consultation, *public relations management and *implementation of an IMF programme. 340 securities affected. Debt securities to be exchanged for 24 new notes with a variety of payment terms.</p> <p>Condition of Offer: Acceptance based on following participation rates- 90% of all debt securities, 100% of old securities with < 2 yrs maturity remaining and 100% of all fixed rate securities</p> | <p>Outcome: Debt service reduction (interest savings of 3% GDP-2010/11), improved pricing of new bond, improved credit rating, high participation rate, restructured domestic debt portfolio, consolidation of issues.</p> <p>Post Debt Exchange: significant reduction in debt payments 2010/11 budget. Negative cash flow fallouts from institutions affected by restructuring and increased unemployment.</p> <p>Factors: 1. Broad national consensus that present levels of debt were unsustainable and restructuring was the only option. 2. Extensive market consultation 3. Commitment to economic and structural reform 4. Precondition to exceptional multilateral support 5. Supporting network 6. Simplification of the debt exchange for small retail investors 7. Closure of the international capital markets</p> | <p>November 2008- Debt Management began work with financial advisors to develop debt exchange offer</p> <p>February 2009- Local market initiative proposed to Government of Jamaica.</p> <p>March 2009- Broad market consultations begin. December 2009- Final consultation with financial advisors, the IMF, IADB, World Bank to ensure full integration with medium term-economic programme</p> <p>January 10-13, 2010- Final pre-market consultations. January 14, 2010- statement by IMF indicating support of exchange. January 14, 2010- Launch of offer</p> <p>January 18, 2010- opening date of exchange offer. January 26, 2010- original closing date of exchange offer. February 3, 2010- revised closing date of exchange offer February 16, 2010- original settlement date of exchange offer. February 17, 2010- Fitch upgrades Jamaica's ratings. February 24, 2010- revised settlement date of exchange offer.</p> |

Table 4: Seychelles Debt Exchange

| Country | Economic Background and Debt Dynamics | Implementation and terms of Debt Exchange | Outcome of Debt Exchange and contributing factors | Chronology of events in exchange offer |
|------------|---|---|---|---|
| Seychelles | <p>7.5% GDP decline over 2005-07, -3.1% in 2008 and 9.5% in 2009. Exacerbated by global downturn and food and oil prices increases 2007-08</p> <p>Shortage of reserves forced floating of the rupee, which fell by 50% in the following year.</p> <p>Gov't issued 3 bonds on the Int'l market between 2006 and 2007 to sustain gov't spending.</p> <p>2007-08 inflation surged to 32% from 5.2% a year earlier.</p> <p>Current account widened and there was a build-up in external payment arrears.</p> <p>Reserves were almost exhausted and Seychelles defaulted on bonds</p> <p>Public debt was 151% of GDP-2008. External debt was 60% of total or 98% of GDP. Mainly commercial creditors- 61% of external debt, bilateral- 32% and multilateral- 8%.</p> | <p>Objectives: Authorities negotiated a restructuring of official Bilateral debt on Evian terms with Paris Club creditors in April 2009.</p> <p>Involved 45% reduction in debt, lower interest rates and extension of maturities. Other bilateral creditors-Malaysia, South Africa and non-OECD signed subsequently on similar terms.</p> <p>However, this was insufficient for external debt sustainability. Gov't launched debt exchange offer for private creditors holding the 3 bonds (US\$200M, US\$30M and E54.7M) and certain commercial bank loans (US\$9M).</p> <p>Implementation: Two new notes offered- new discount note (50% discount on principal) and new par note (100% of face value with 2% coupon rate).</p> <p><i>*Goodwill payment-</i> applicable to the two notes in lieu of past due interest.</p> <p><i>*Principal Reinstatement-</i> bondholders receive 25% of face value of new discount bond if Seychelles fails IMF 1st 3-year ECF review.</p> <p><i>*AfDB provided partial credit guarantee on new discount note-</i> AfDB would pay up to US\$10M in interest on new bonds. Dovetailed with AfDB and IMF's aim for financial and economic reform as well as improved medium term repayment capacity, respectively.</p> | <p>Outcome: Very successful. Private creditors voluntarily exchanged US\$283M (89% of eligible debt) for new discount notes.</p> <p>Low participation in new par note- 100% participation in all instruments save US\$230M bonds (84% participations). Authorities invoked collection clause embedded in Euro bond.</p> <p>Resulted in 100% participation rate for new par note. Reduction in external debt stock: Final result was 50% nominal reduction in external debt, extended maturity and lower interest rates. Debt to GDP projected to 60%-2010 from 144%-2009.</p> <p>Immediate improvement in creditworthiness: Fitch foreign and local IDRs to B- and B, respectively with positive outlook.</p> <p>Post Exchange Developments: Improved macro environment, reserves doubled between 09' and 10', growth projected at 4%-2010.</p> <p>Factors: 1. Prior creditor support 2. Private guarantee by the AfDB 3. Principal reinstatement clause</p> <p>4. Collection action clause in existing bonds 5. IMF support letter 6. Appointment of financial advisors 7. Transparency of exchange process 8. Comprehensive fiscal and structural reform</p> | <p>September 30, 2008: Announcement of debt restructuring. July 13, 2009: Appointment of White Oak as Financial Advisors</p> <p>August 13, 2009: Appointment of Fitch Credit Ratings Agency.</p> <p>September 28, 2009: Appointment of DF King as Information Agent.</p> <p>December 18, 2006: Launch of offer</p> <p>December 22, 2006: IMF Executive Board approves US\$31.1m Extended Fund Facility. December 23, 2009: Statement by Informal Group of Creditors supporting exchange offer. January 14, 2007: Original closing date of offer</p> <p>February 1, 2010: Fitch upgrades Seychelles rating to B-</p> <p>February 8, 2010: Extraordinary meeting of bondholder to implement collective action clause</p> <p>February 11, 2010: Settlement date of exchange offer. April 12, 2010: New bondholders to receive one-off 'goodwill' payment.</p> |

Table 5: Saint Kitts and Nevis Debt Exchange

| Country | Economic Background and Debt Dynamics | Implementation and terms of Debt Exchange | Outcome of Debt Exchange and contributing factors | Chronology of events in exchange offer |
|---------------------|--|--|---|--|
| St. Kitts and Nevis | <p>St. Kitts and Nevis saw increased indebtedness owing to reconstruction costs after periodic tropical hurricanes, fall in tourism and costs of unwinding the sugar industry since the 1990s</p> <p>Significant reduction in growth in 2009/10 following U.S financial crisis.</p> <p>Slowdown in FDI and tourism related activities</p> <p>Closure of Four Seasons Hotel following Hurricane Omar</p> <p>Overall fiscal deficit widened to 9.4% of GDP</p> <p>Public debt reached 200% of GDP</p> <p>Debt service to total revenue increased sharply</p> | <p>Objective: To exchange eligible debt for new instruments and significant debt relief for Saint Kitts and Nevis.</p> <p>Implementation: Offer of two new instruments: a new discount bond (50% reduction in face value, 20 years maturity, step-down coupon rate 6%-3%) denominated in US dollars and a new par bond (45 year Maturity, 15-year grace period on principal, 1.5% fixed interest rate) denominated in EC dollars. In exchange for US\$150M of St. Kitts' US\$1.1Bn of overall debt. EC\$900M in loans and other debt facilities owed to domestic creditors will be transformed into ownership of encumbered lands located in Saint Kitts and Nevis through Special Purpose Vehicles (SPVs).</p> <p>*Collective Action Clauses- to force compliance on the 3.2% that failed to participate in exchange</p> <p>* <i>Formation of domestic creditors committee and public relations management.</i></p> <p>*<i>Employed financial advisors- White Oak Advisory LLP and legal advisor- Clifford Chance LLP.</i></p> <p>*<i>Formed a debt unit within the Ministry of Finance</i></p> <p>*<i>Caribbean Development Bank provided a partial guarantee of up to US\$12M</i></p> <p>*<i>IMF 3-year standby arrangement US\$84M agreed one year earlier</i></p> <p>*<i>One off 'good-will' payment: US\$130 per US\$1000 face value of new discount bonds and EC\$11.25 per EC\$1000 of new par bonds</i></p> | <p>Outcome: 96.*% of eligible loans decided to participate in exchange with 2/3 opting for new discount bonds and the remainder for new par bonds. Collective action clauses forced participation of holder creditors giving 100% overall participation.</p> | <p>June 1, 2011- announce of intention to restructure debt. June 3, 2011- Announcement of IMF US\$84M standby arrangement agreement. July 27, 2011- 2011 Article IV Consultation</p> <p>November 28, 2011- CDB expresses interest in providing partial guarantee on restructured debt. January 10, 2012- CDP approval of partial guarantee on restructured debt</p> <p>January 25, 2012- First review of IMF standby arrangement</p> <p>February 27, 2012- Launch of debt exchange offer. March 7, 2012- Creditor Committee support of exchange offer. April 18, 2012- Settlement date</p> |

DEBT CONVERSIONS

Debt for Equity Swaps

Table 6: Jamaica Debt-for-Equity Swap

| Country | Economic Background and Debt Dynamics | Implementation and terms of Debt Exchange | Outcome of Debt Exchange and contributing factors | Chronology of events in debt conversion |
|---------|--|--|--|--|
| Jamaica | <p>Weak economic activity and mushrooming external debt</p> <p>Over 1980-85 doubling of debt from 89% of GDP to 161% of GDP.</p> <p>External debt in 1987 amounted to US\$4.0 billion or 141% of GDP.</p> <p>Commercial bank debt was approximately US\$370 million or 10% of Jamaica's total external debt.</p> | <p>Objective: achieve reduction in public external debt and attract and generate foreign investment in designated priority sectors. Transform Jamaica into an export driven economy. US\$185 million of commercial bank debt (50%) eligible for debt restructuring.</p> <p>Implementation: *Targeted Tranche A debt- debt with short maturities and then later included Tranche B- debt with longer maturities.</p> <p>*Original programme restricted programme to foreign investors only, later lifted to allow for domestic investors under two conditions- sufficient foreign capital and ability to borrow overseas.</p> <p>*Equity investments could be used in both listed and non-listed companies as well as public sector entities but could only be funded through a Jamaica investment vehicle.</p> <p>*Restrictions to repatriation of profits (3 years if in priority areas and 7yrs other) *Block deposit accounts established for deposit of local currency to avoid round-tripping. *Projects approved on a case by case basis by the Central Bank and not by auction.</p> <p>*Conversion fee capped at 10% and bonds issued has same tenor as cancelled debt to avoid inflationary pressures. * Bonds attracted a variable interest rate benchmarked to the Jamaican Treasury bills plus a 2% margin.</p> | <p>Outcome: Mixed results. Debt cancellations were far less than the US\$30 million targeted annually. Impact on external debt minimal since commercial bank debt only 10%. US\$107 million or 27% of debt outstanding at the start of the programme converted.</p> <p>Of the debt converted: tourism projects (64%) and export agriculture and manufactures (20%). Programme suspended because of rise of Jamaican paper in secondary market.</p> <p>Negative Factors: *Commercial banks unwilling to sell claims as loans asses were still performing.</p> <p>*Delays in implementing equity investment bond which provided funding for equity investments. *Inconsistent government policies with eroded investor confidence.</p> <p>Positive Factors: Modifications to the original programme</p> | <p>July 1987- Launch of debt-to-equity programme</p> <p>1990- foreign residency investment sanctions against locals lifted</p> <p>1990- Other modifications to the programme.</p> <p>December 1992- US\$106 million of debt retired</p> <p>1993- suspension of debt-to-equity programme</p> |

Table 7: Nigeria Debt-for-Equity Swap

| Country | Economic Background and Debt Dynamics | Implementation and terms of Debt Exchange | Outcome of Debt Exchange and contributing factors | Chronology of events in debt conversion |
|---------|---|---|--|---|
| Nigeria | Large central government deficits, rapidly accumulating external debt and a collapse in oil prices (Nigeria is an oil exporter) | <p>Objective: reduce Nigeria's external commercial debt, repatriate flight capital and promote foreign direct investment.</p> <p>Implementation: *eligible debt limited to promissory notes and conversions limited to debt-for-equity and debt-for-cash in the first instance and then expanded to include refinanced commercial bank debts and debt-for-debt transactions were later included</p> <p>*Debt-for-cash allowed for gifts and grants to Nigerian non-profits entities such as educational institutions, charitable organizations, religious bodies and trusts</p> <p>*Programmes approved through an auction system and the amount to be converted into cash or equity determined by the Central Bank and related to the projected money/credit requirements for the year.</p> <p>*Monthly auctions determined the discount applied to bids. Bidders required to indicate redemption price and lowest price or highest discount was successful.</p> <p>*Central Bank provided for local currency funds to be invested in interest bearing bonds or gov't securities. *To avoid inflationary pressures proceeds were only redeemed in tranches and not immediately allowed to be repatriated and could be used for qualified equity investments, carefully monitored to avoid round-tripping.</p> <p>*Priority sectors targeted were manufacturing, agriculture and agricultural-related industries, hotels and tourism and building and construction.</p> | <p>Outcome: <i>Mixed results.</i> 1st auction: Forty projects participated but only eight were successful. Debt of US\$40 million converted.</p> <p>Next 14 auctions: US\$311 million in debt converted. Total debt converted US\$500 million but total debt remained in excess of US\$30 billion.</p> <p>Increased investment and employment but impact on external debt stock was minimal</p> | <p>February 1988- establishment of conversion programme</p> <p>November 1988- first auction</p> <p>1989-1990- next 14 auctions</p> |

Debt-for-Environment-Swaps

Table 8: Poland Debt-for-Environment Swap

| Country | Economic Background and Debt Dynamics | Implementation and terms of Debt Exchange | Outcome of Debt Exchange and contributing factors | Chronology of events in debt conversion |
|---------|--|--|--|---|
| Poland | <p>High external debt owed to Paris Club Creditors</p> <p>US\$18 billion eligible of which 50% to be cancelled and a further 10% written off through debt-for-environment conversions.</p> | <p>Objective: to reduce trans-boundary air pollution, pollution in the Baltic Sea, greenhouse gas emissions and to protect Poland's bio-diversity, waste management and polluted land reclamation.</p> <p>Implementation: Establishment of the Polish Eco-Fund to oversee and manage debt-for-environment projects. Grants were awarded to 1500 projects in five priority environmental areas: air, water, nature pollution, climate protection and waste management.</p> <p>Debt-for-environment projects funded by five donor governments party to the Paris Club agreement- France, Italy, Sweden, Switzerland and the United States. Germany excluded since export credits not eligible for rescheduling under German law.</p> | <p>Outcome: US\$500 million invested in debt-for-environment swaps between 1992 and 2007 (87% of US\$571 total to be invested over 1992-2010). Significant increase in social investment and a good example of a harmonized and coordinated donor strategy for long-term social benefits.</p> <p>Factors: 1. Conditionality- participating creditors could veto the use of the account to finance programmes funded by the Eco-Fund if Poland breached any of the terms of the agreement 2 Creditor Coordination and Collaboration- involved a coordinated debt conversion between many creditors and a single borrower.</p> <p>3. Project Inspection- inspection at various stages of execution to ensure the efficient implementation of the project. Proceeds transferred to the project after each implementation stage was approved.</p> <p>4. National Capacity Building- institutional capacity acquired by the Polish Eco-Fund in efficiently implementing projects and the transfer of this capability to other public entities and non-governmental organizations within Poland.</p> <p>Negative Factors: 1. Lack of additionality- Eco-Fund's assistance was not necessary for many of the projects implemented as the majority of the applicants rejected by the Eco-Fund succeeded in securing funds elsewhere (<i>Environment and Development Economics</i>)</p> <p>2. Debt relief- terms of debt conversion did not provide for a reduction in the redemption price of the affected bilateral debts.</p> | <p>1991: establishment of debt-for-environment swaps and establishment of Polish Eco-Fund</p> <p>1992-2010: Programme period.</p> <p>1993-94: Payments to Eco-Fund amounting to US\$6.9million to US\$8.7million (small)</p> <p>2000: US government decision to re-profile amounts paid into fund replacing with a schedule of increased payments beginning in 2000</p> |

Debt-for-Development-Swaps

Table 9: Indonesia Debt-for-Development Swap

| Country | Economic Background and Debt Dynamics | Implementation and terms of Debt Exchange | Outcome of Debt Exchange and contributing factors | Chronology of events in debt conversion |
|-----------|--|---|--|--|
| Indonesia | <p>Rapid growth between 1970s and 1980s accompanied by increased levels of external borrowing</p> <p>1996 Asian Crisis: Indonesia's debt rose to 49% of GDP (US\$42.3 billion)</p> <p>GDP declined by 13.2% and for a short period the Rupiah lost 84% of its value.</p> <p>Indonesia agreed to US\$10 billion IMF rescue package to help stabilize the Rupiah and restore investor confidence</p> <p>Reforms included overhaul and restructuring of the financial system Reforms not enough stabilize banking system and by 1998 authorities had to intervene with a rescue package. As a result total external debt ballooned- doubled to US\$136.9 billion or almost 60% of GDP with official creditors holding US\$60.7 billion in claims. Not available for relief under HIPC. Tight fiscal constraints and widespread poverty. 2004 Tsunami with severe infrastructural damage</p> | <p>Objective: reduce external debt stock, ease fiscal burden and direct resources to key development areas such as health and education.</p> <p>Implementation: Agreement between Indonesia and Germany for debt-for-development based on Paris Club guidelines.</p> <p>Paris Club Guidelines: debt could be written off if 50% of local currency equivalent spent on development initiatives in education, environmental conservation or poverty alleviation.</p> <p>Debt-for-development swaps with Germany and Italy for reconstruction of tsunami affected areas in certain regions of the country.</p> | <p>Outcome: <i>Mixed Results.</i> *1st swap- EURO 12.8 million used to fund over 500 projects in the education sector. Project reached 33, 000 elementary schools with approximately 5000 students. *Subsequent wave of swaps-between 2003 and 2008 Germany cancelled EURO 60 million and invested EURO 33 million in primary and secondary education.</p> <p>However, amount cancelled amounted to 1% of the total debt outstanding and by 2005 debt repayments were 8 x outlays on health and education combined.</p> <p>*2nd swap- debt-for-development swaps of US\$4.2 million and EURO 5.7 million.</p> | <p>1996- Asian crisis 1998- Indonesia intervention to stabilize the banking system</p> <p>2000- Indonesia and Germany agree to a debt-for-development swap 2002- Indonesia signs agreement with Germany to fund projects in the education sector 2003- doubling of external debt 2003-2008- wave successive debt swaps</p> <p>2004- Indonesia Tsunami 2005- debt-for-development swaps with Germany and Italy for reconstruction</p> |

LIABILITY MANAGEMENT

Debt Warrants

Table 10: Mexico's Debt Warrants

| Country | Economic Background and Debt Dynamics | Implementation and terms of Debt Exchange | Outcome of Debt Exchange and contributing factors | Chronology of events in debt conversion |
|---------|--|--|---|--|
| Mexico | High proportion of foreign currency denominated debt in the Mexican debt portfolio | <p>Objective: to change the currency composition of its public debt portfolio and reduce its holdings of foreign currency debt substituting if for peso denominated debt.</p> <p>To lengthen the maturity structure of the domestic currency debt and to determine the extent to which foreign investors would be willing to participate in Mexico's local bond and money markets without the risk of a failed local currency issue in international capital markets.</p> <p>Implementation: Rate of conversion established at a predetermined ratio, equal to the ratio of forward prices for both types of debt, on the day of the issue</p> <p>Face value of local currency debt determined by the exchange rate on the day the exchange was applied.</p> | <p>Outcome: Successful. Significant reduction in the exchange rate risk associated with public debt portfolio and a reduction in the external debt.</p> <p>More precisely: 1. broadening of its investor base for domestic bonds with new foreign investors 2. reducing foreign currency debt and therefor exposure to foreign currency risk</p> <p>3. Lengthening the maturity of domestic currency securities and thereby reducing interest rate risk</p> <p>4. lowering the cost of domestic debt because of the broader investor base and more liquid market</p> | <p>November 2005- issuing of debt exchange warrants</p> <p>March 2006- April 2008- Mexico issues three more debt warrants. November 2006- warrant holders exercise option</p> |

OTHER INNOVATIVE FINANCIAL INSTRUMENTS

Indexed Bonds

Table 10: Selected Country Experiences with Indexed Bonds

| Countries | Implementation and terms of Indexed Bonds | Outcome of Bond-Index link | Chronology of events |
|------------------------|---|--|--|
| Bulgaria | <p>Bond payments triggered if: GDP reached 125% of its 1993 level and a year to year increase in GDP was recorded</p> <p>If conditions met, 50% of the year's GDP growth rates paid on the underlying principal amount in addition to the conventional coupon amount.</p> <p>Source of data- a. World Tables of the World Bank or b. Any other publications in which the World Bank published GDP data</p> | <p>Outcome: <i>Complicated.</i> Ambiguity with regards source of reference data and GDP unit of measurement</p> <p>World tables produced 4 measures of GDP and the World Bank replaced the World Tables with the World Development Indicators, publishing GDP in both constant and current prices and in US dollars and Bulgarian leva.</p> <p>Bulgarian authorities chose to use constant value local currency units and as a result growth indexed payments were never triggered.</p> | 1990s- issuing of growth indexed bonds |
| Bosnia and Herzegovina | <p>Bond payments triggered if: GDP reached a predetermined level and remained at that level for two years and GDP per capita rose above in US\$2800 in 1997 units, adjusted for German consumer price inflation.</p> | <p>Outcome: <i>Complicated.</i> Poor quality of existing data, aggravated by the existence of a large informal sector which was not included in official GDP statistics; and the perceived unreliability of population statistic, which were one of the variables upon which the trigger for payments was based</p> | 1990s- issuing of growth indexed bonds |
| Argentina | <p>1. Maturity: 30 years</p> <p>2. Principal repayment: payments on peso principal converted to US dollars, Euros or Yen at the time of payment</p> <p>3. Warrant payment: An annual payment of 5% of the difference between actual GDP and threshold GDP in nominal terms during the relevant year.</p> <p>4. Trigger conditions: actual GDP, expressed in peso terms, as at the reference date exceeds threshold GDP and Annual rates of GDP, expressed in constant peso terms, as of the reference date exceed 3%</p> <p>5. Basis of calculations: value of debt payments calculated on November 1 each year. GDP reference date is December 31 of the year preceding the calculation date</p> <p>6. Call option: not callable</p> <p>7. Other features: GDP warrants detachable from bond and tradable.</p> | <p>Outcome: <i>Improved.</i> Improved in comparison to those issued in the 1990s.</p> <p>However, complexity calculations- led to significant under-pricing of the bonds</p> <p>Potentially large upside payments- instrument design could lead to larger than desired payments when Argentina is only slightly over performing</p> | June 2005: issue of a 30 year growth indexed bond |

Catastrophe Bonds

Table 11: Mexico Catastrophe Bonds

| Country | Implementation and terms of Catastrophe Bonds | Outcome of Catastrophe Bonds | Chronology of events |
|---------|---|--|--|
| Mexico | <p>Objective: To protect against earthquake risk as the first step in a comprehensive plan to insure against natural disasters, including hurricanes.</p> <p>Implementation: 2 components- (1) straight parametric insurance under which the government would receive payments in the event that an earthquake of a certain magnitude hit prescribed regions over a specified 3 years.</p> <p>(2) Catastrophe bonds structured as follows:</p> <p><i>Principal value-</i> the two catastrophe bonds had a total face value of US\$160 million</p> <p><i>Compensation-</i> provided for a total compensation of US\$450 million, with US\$150 million contingent on occurrence of an earthquake in each region.</p> <p><i>Cost-</i> annual spread of 230 basis points. Insurance premium of approximately US\$14 million</p> <p><u>MultiCat Bond</u> US\$290 million in a series of catastrophe bonds under the World Bank's MultiCat programme.</p> <p>Objective: to protect against earthquake as well as Pacific and Atlantic hurricane risks in 3 regions around Mexico city.</p> <p>Implementation: Maturity of 3 years and a Special Purpose Vehicle used to issue the instrument.</p> <p>Oversubscribed and distributed among investors in Bermuda, Europe, Japan and United States</p> | <p>Outcome: Successful although it took almost 3 years to structure largely because of Mexico's budgetary approval process</p> <p>Outcome: n/a</p> | <p>May 2006- Mexico's 1st issue of catastrophe bonds</p> |