

Timothy Adams
President and CEO

May 1, 2020

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Dear Managing Director Georgieva, President Malpass and Chairperson Renaud-Basso,

The Institute of International Finance (IIF) has been greatly encouraged by the swift and decisive action taken by your institutions to support vulnerable countries as the impact of the COVID-19 pandemic unfolds. In response to the G20 Debt Service Suspension Initiative (DSSI) and calls in the IMFC, Development Committee and Paris Club communiqués for private sector participation, I would like to update you on our activities, share views from the international financial community, and outline thoughts on a potential approach to voluntary private sector participation in the DSSI.

Since our [letter](#) to you of April 9, we have reached out to over 100 leading firms that are investing in or lending to countries in scope for the DSSI. Collectively, these firms represent close to \$45 trillion in AUM and account for a significant proportion of the external sovereign debt service of in-scope countries in 2020. Our outreach has been primarily via two IIF policy working groups—the public-private Principles Consultative Group and the private sector-only Committee on Sovereign Risk Management (CSRM). Most of these firms are IIF members; many other private creditors and lenders have also contacted us in recent weeks to learn more about the DSSI. Based on these conversations, we believe there is a deep appreciation for the challenges facing these most vulnerable countries and strong interest in finding ways to support them and the proposed debt service suspension. We have also initiated discussions with the official sector—IMF, World Bank, Paris Club, and individual G20 countries—to seek clarification, particularly given the short timelines that have been proposed. The April 28 meeting of the IIF and Paris Club with private

creditors allowed for a productive exchange of views and a better understanding of the issues for both sides around participation in the DSSI.

Informed by these discussions, we are garnering private sector support and developing a set of assumptions to underpin core terms of reference for a potential approach to voluntary private sector participation in the initiative.

Building support from the private sector

Role of the IIF: Drawing on over 35 years of experience in sovereign debt policy and the alliances built in creating the [Principles for Stable Capital Flows and Fair Debt Restructuring](#) (“Principles”) and the evolving [Voluntary Principles for Debt Transparency](#), the IIF is working rapidly to solicit views and build consensus regarding the nature of an effective response from private creditors and lenders. As this consensus develops, we will share these perspectives with official sector stakeholders and civil society, with the aim of developing terms of reference that can be used by private sector firms participating in the DSSI on a voluntary basis, and to underpin a common understanding of the contemplated private sector support. We anticipate that regular meetings between the Paris Club and the private sector will be an important channel for engagement; we are also inviting officials from the international financial institutions and other public sector bodies to our creditor group discussions to facilitate open and robust dialogue. In addition to building support for a common approach, a key goal of these discussions will be to foster innovative solutions to debt service problems and provision of cash flow relief, e.g. structures with participation from the multilateral development banks, debt instruments with innovative features, etc.

Complex landscape: The private and international creditor and lender community encompasses a wide range of different firms including asset owners and managers, banks, insurers, family offices, sovereign wealth funds, hedge funds and non-financial corporates such as commodity traders. Some may have active exposures and others primarily via indexes, and the ways in which they could support the DSSI will differ. Many will have fiduciary duties to their own clients, and contractual obligations around specific lending and investment vehicles are often complex. Similarly, there are many different sovereign borrowers included in the initiative, and their respective positions are each unique. Any effective approach to voluntary creditor/lender participation must take this into account. In the absence of a widely accepted toolkit to achieve debt service suspension, a lengthy contract by contract approach may be required. For this reason, we view a broad private sector terms of reference—that would be tailored to individual country circumstances—as very helpful in supporting voluntary private sector solutions with regard to the DSSI.

Assumptions for private sector terms of reference

- **Scope—borrowers:** Market participants appreciate the limitation of scope to the countries referenced in the DSSI term sheet that request debt service suspension and agree to commit to the associated requirements. Many highlight the significant differences among in-scope countries, and suggest an approach tailored to each specific country would be most appropriate. Recent comments from IMF and Paris Club officials noting that there is no intention to make the DSSI broader in scope have also been helpful.
- **Scope—creditors:** We understand that participation of private creditors in the initiative would be on a voluntary basis.

- **Scope—debt:** We understand that debt instruments in scope include international debt securities and loans in foreign currency, as well as other transactions by the sovereign having the economic effect of a borrowing. Local currency debt is out of scope, as are financial market or other transactions with central banks, swaps and securities lending arrangements, debt linked to trade finance or with an original maturity of less than a year, debt incurred by state-owned enterprises and most contingent debt.
- **Process:** We anticipate that each borrowing country wishing to receive debt service suspension from private sector firms will approach its relevant creditors as applicable. As each country should evaluate its own situation and weigh advantages and disadvantages before deciding whether to take advantage of the DSSI, we are hopeful that technical assistance is being offered to each eligible country to provide the tools and information necessary to make an informed decision—as any participation triggering unforeseen consequences could hinder future access to international markets, and such access will be critical for a rapid economic recovery.
- **Expectations regarding use of proceeds:** Private creditors will not have monitoring obligations with regard to the use of redirected payment capacity (proceeds); we therefore appreciate and believe it is essential that the international financial institutions do this monitoring to ensure that funds freed up by debt service suspension are used to lessen the impact of the COVID-19 pandemic. This could include measures to prevent capital flight, which could in some cases require the implementation of targeted macroprudential measures or addressing gaps in transparency. However, the implications of imposing capital controls in countries participating in the DSSI should be carefully considered, as doing so can significantly impact the cross-border functioning of local currency government bond markets.

Key remaining considerations

- **Assessing NPV neutrality:** Private creditors consistently highlight challenges in pre-defining NPV neutrality and finding agreement on underlying terms and assumptions. For example, for many private creditors—particularly bondholders—NPV neutrality may require different assumptions for accrual rates on any suspended debt service, or some form of credit enhancement. Assessment of NPV neutrality would need to be made by the relevant private creditors based on the circumstances of the case.
- **Terms of private sector participation:** Private sector participation would be on a case by case basis, reflecting the terms of the DSSI where appropriate and practicable. A key challenge for the private sector is assessing the terms of the DSSI as implemented by official bilateral creditors; full transparency around the terms and conditions being used by the eligible debtor and its official bilateral creditors is essential. For index investors, similar accounting and listing of the debt service suspension provisions will be key. As noted in the *Principles*, broad creditor participation in an initiative such as this will support fair burden sharing.
- **Fiduciary duty:** Private sector participation in the DSSI would also need to remain consistent with contractual obligations, fiduciary duty, regulatory requirements and national laws, among other considerations. Fiduciary duty in particular—whether participation is the right thing to do for underlying clients—will be a key consideration for asset managers and owners.

- **Preserving market access:** Our discussions with creditors have highlighted significant concerns that the DSSI could curtail international market access for countries that currently have it. As noted above, it is imperative that borrowing countries be well-informed about the potential consequences for market access when requesting debt service suspension (especially from the private sector), when certain commercial norms are being adjusted to accommodate the current global situation.
- **New financing:** Questions have arisen around market access in the context of DSSI term sheet limitations on new non-concessional external financing. If beneficiary countries request new financing from private sector firms, they should ascertain whether this is consistent with the terms of the DSSI, and inform their private creditors accordingly. Further clarification of the applicability of the IMF Debt Limit Policy and the World Bank Group Non-Concessional Borrowing Policy would also be helpful.
- **Credit ratings implications:** Market participants are concerned that the DSSI will trigger a wave of sovereign downgrades, defaults and cross-defaults, with knock-on effects for benchmark indices and capital flows to affected countries. While NPV neutrality is a matter for the relevant private creditors to assess, rating agencies may take the view in respect of any sovereign bonds that NPV neutrality may require credit-enhancing features such as an exchange into new bonds with partial credit guarantees from a multilateral development bank or through an improvement in bond covenants. Furthermore, any lack of NPV neutrality for private creditors would likely result in credit rating downgrades, given that rating agencies use economic loss for private creditors as a key metric for ratings downgrades and/or the assignment of a Selective Default rating. While total lending and investment to countries in scope for the DSSI is relatively small in scale, a spread of debt service problems to broader emerging markets would have even more serious repercussions for financial stability. To the extent possible, debt service suspension should be executed in ways that do not lead to default. We note that similar rating constraints have been highlighted in connection with participation of the multilateral development banks in the DSSI.
- **Implications for banks and insurers:** Our discussions with lenders have highlighted concerns about loan loss provisions, accounting impairments, and regulatory capital and tax treatment in respect of deferred debt service payments, noting that special consideration may be warranted for assets affected by private sector participation in the DSSI. In particular, given the circumstances, regulated institutions might look for some form of regulatory forbearance or exemption with regard to the Basel requirements that would otherwise apply. For insurers, participation would have a significant impact on NAIC ratings and capital charges, potentially affecting equity valuations and shareholders.
- **Need for transparency:** For many DSSI-eligible countries, the size and nature of debt and debt service obligations are not fully transparent. Full transparency as underscored in IIF work on the [Voluntary Principles for Debt Transparency](#)—which was initiated by your organizations and supported by the G20—will make it more feasible to find effective solutions to debt service problems.

As policymakers and the private sector financial community assess the immediate and potential longer-term financial, economic and social impact of COVID-19, we believe that the G20 DSSI is of great importance for vulnerable in-scope countries. Our ongoing discussions with private and other international creditors and lenders indicate widespread willingness to support the aims of this initiative, subject to further clarity on the key issues highlighted in this letter.

We look forward to exploring ways to make this support most effective, and to continued frank and productive dialogue with the official sector.

Sincerely,

A handwritten signature in black ink, appearing to read "Timothy D. Adams", enclosed in a thin black rectangular border.

Timothy D. Adams
President and CEO
Institute of International Finance

cc:

OECD Secretary General Gurría
Saudi Arabia Minister of Finance, Economy and Planning Al-Jadaan
G20 International Financial Architecture Working Group