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UNDER THE RADAR

Private sector debt and coronavirus in developing countries

The G20 must step in and compel private creditors to cancel the debts of developing countries to avoid the loss of many more lives.

In the global south, coronavirus is leaving a trail of devastation - from widespread loss of life from the virus itself, to huge economic disruption that has left hundreds of millions of people, who were already struggling to make ends meet, without jobs or sufficient food. Despite this huge economic shock, many developing countries are continuing to pay off debts to rich countries, public institutions like the World Bank and IMF, and some of the richest banks and hedge funds in the world. This means they have less money to meet the immediate needs of the population.

This briefing aims to shine a light on the debt owed to private creditors by five African countries - Ghana, Kenya, Nigeria, Senegal and Zambia - and it outlines the steps which the G20 needs to take immediately to avert further economic chaos. It highlights the central role of enormous financial corporations like **BlackRock, HSBC, Goldman Sachs, Legal & General, JP Morgan** and **UBS**, which have become increasingly important in the world of sovereign debt. Private creditors' share of the foreign debts of low- and lower-middle income governments increased from 25% in 2010 to 47% in 2018.[1] Multi-trillion dollar asset manager BlackRock alone holds close to US$1 billion of 'Eurobonds' in Ghana, Kenya, Nigeria, Senegal and Zambia through a number of funds.[2]

It is clear that a voluntary approach has not and will not work. Since April, the G20 has called on private creditors to voluntarily suspend some debt payments. That has still not happened, leading World Bank President David Malpass to remark in early October, "these investors are not doing enough and I am disappointed with them."[3]

Private sector debt is shrouded in secrecy and complexity, with no comprehensive or independent mechanism for reviewing or writing this debt down. This gives private creditors enormous power over developing countries. An independent space is urgently needed where developing countries can negotiate comprehensive, swift and orderly restructurings, allowing governments to respond to the consequences of COVID-19. Without urgent reform to the one-sided debt system, the economic crisis will be exacerbated further, leading to unnecessary loss of life and livelihoods.[4] Perversely, action is also necessary to stop the limited debt relief given by governments being diverted into the coffers of these private creditors.

Ahead of the G20 Finance Ministers meeting we call for urgent action. The G20 should:

- use all legal, political and financial mechanisms available to compel private creditors to suspend debt payments and write-down developing country debts.
- jumpstart a process to create an international debt workout mechanism that allows for comprehensive debt restructurings. This mechanism must be independent of creditors, rapid and fair, assigning priority to developing government's primary responsibility for the welfare of their people.

The problem of private sector debt

Private sector creditors play an ever more important role in lending to developing country governments. In 73 of the lowest income developing countries - those eligible for the G20's April 2020 Debt Servicing Suspension Initiative (DSSI) - 27% of foreign debts are owed to private creditors. In some countries, the amount is much higher. In 2020, 69% of all debt payments due in Zambia is owed to private creditors, while the share is 59% in Ghana, 55% in Nigeria and 45% in Senegal. In total, $13 billion in debt service payments from these countries to private creditors are due between 1 May and the end of 2020.[5]

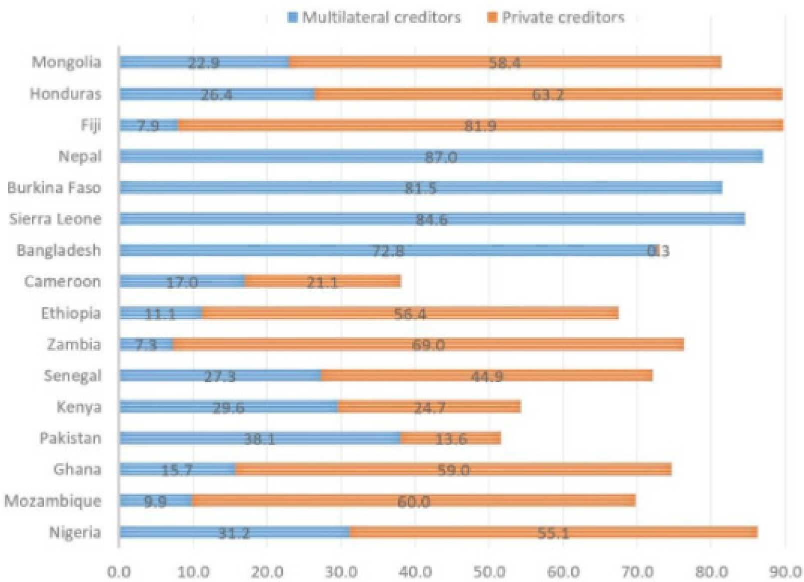
Among these private creditors we can pull out four different types of lenders: commercial banks, commodity traders, holders of bonds denominated in foreign currency known as 'Eurobonds', and finally bondholders of domestic currency bonds (not included in Figure 1). In this briefing, we will focus mainly on the role of commercial banks and Eurobond holders as they tend to be located in large financial centres and we have been able to find out more about them by looking at financial risk disclosure data from commercial databases.

Private creditors are well aware of the risk these bonds often carry. African sovereign debts offer some of the highest yields to investors globally, and are normally in the "high risk, high yield" portfolios of investment funds. Annex 1 maps outstanding Eurobonds yields, and their interest rates payable to a selected number of asset managers and investment banks. The rates of interest tend to be much higher than for those owed to multilateral creditors such as the IMF or the World Bank, who provide concessional lending (typically between 0% and 3% interest, depending on the lending programme).

Eurobonds explained and their financial costs exposed

Eurobonds are foreign currency bonds, usually paid in US dollars, and to a lesser extent in euros. These Eurobonds should be prioritised in debt relief schemes, as they have some of the highest debt servicing costs, due to the combined effect of high interest rates and currency fluctuations. For example, the Zambian kwacha has depreciated 35% against the US dollar during the pandemic.[7] The Kenyan shilling has dropped 7% in value and the Nigerian naira has fallen 5.8%. These fluctuations all impact heavily on the debt servicing burden of the respective countries, particularly at a time when tax revenues and domestic revenues that are levied in home currency are falling dramatically. As a result, servicing Eurobond payments painfully drains countries' revenues.

Figure 1: Debt service payment in 2020 not included in the G20 DSSI debt relief programme (as % of total, 2020)



Source: 'Passing the buck', July 2020[6]

Despite the pandemic, and calls from the G20 and international institutions for private creditors to offer voluntary debt relief,[8] the vast majority of developing countries have continued to pay these high cost debts to private creditors. That's because the global economy thrusts developing countries into a weak position vis-à-vis their creditors. If they keep paying private creditors, they drain their treasuries, and find themselves unable to expand spending to deal with the pandemic in the way rich countries have done. If they request debt relief from private creditors to gain financial breathing space, they face being punished by the credit ratings agencies with credit downgrades which could make future financing more expensive, even forcing them into default.

No wonder that most prefer to take whatever debt relief and emergency finance is available, including new private loans and support from the World Bank and IMF, to make the payment instead. But this simply creates an even bigger problem down the road, as money urgently needed to support lives and livelihoods ends up flowing to some of the richest countries and companies in the world.

As things stand, creditors hold most of the power and are able to act collectively against individual countries, while governments need to deal with their private creditors alone. In fact, some very large corporations own so much debt that they have a significant leadership role in restructuring debts. BlackRock is one of the largest asset managers in the world, with around $7 trillion of assets under their management. This is close to 2.5 times more than the GDP of the entire African continent ($2.9 trillion). As this briefing highlights (see Annex 1), BlackRock also manages some of the largest emerging market bond funds. It is the most important private creditor in the five African countries covered in this briefing, and a key player across the region. Because of its size and importance, BlackRock is often a leading voice in debt negotiations, as seen in Argentina when, in August 2020,[9] it played a pivotal role in deciding the terms of that country's debt restructuring package after negotiating with Argentina's finance minister.[10]

Only a concerted global effort can redress this deep power imbalance. Developing countries must be able to assert their needs to put the rights and livelihoods of their citizens ahead of debt servicing. That means rich country governments and international institutions using the tools they already have available to force private creditors to write down debts as part of a comprehensive international effort to restore a country's financial solvency.

Kenya: fear of punishment a deterrent to debt relief

Kenya is one of many countries which have so far not requested debt relief from their private creditors. This is partly because it fears the consequences on its credit rating which would impact the long-term cost and availability of future private sector loans, and make it difficult to refinance existing debts.[11] In 2018, Kenya spent around $1.86 billion on public healthcare. In 2020 the country was spending around $2.7 billion servicing its debt. The high cost of servicing private sector debts during the pandemic is partly to blame for this; for example, the country is paying interest of between 6.9% and 8.3% on its Eurobonds.

To give an idea of how private creditors hold debt in Eurobonds, Figure 2 examines one of Kenya's bondholders: asset manager AllianceBernstein

Figure 2: AllianceBernstein estimated holdings in Kenya's Eurobonds (in US$)

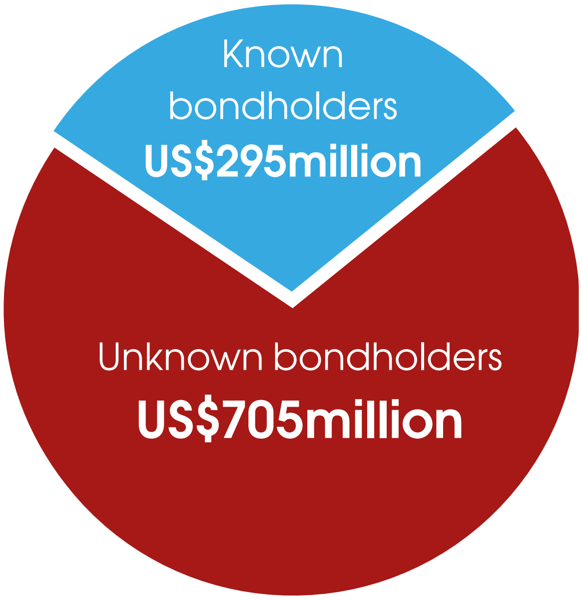
	US$2 billion Coupon: 6.875% Maturity date: 2024	US$900 million Coupon: 7% Maturity date: 2027	US$1 billion Coupon: 7.25% Maturity date: 2028	US$1.2 billion Coupon: 8% Maturity date: 2032
AllianceBernstein LP (US) Funds/portfolios e.g. AllianceBernstein Global High Yield	US$168,793,000	US$38,602,000	US$62,272,000	US$21,580,000
AllianceBernstein Japan Ltd Funds/portfolios e.g. Alliance Global High Income A	US$353,000	US$294,000	US$198,000	
Total estimated holding for each bond	US$169.1 million	US$38.8 million	US$62.4 million	US$21.5 million
Aggregate for all five Kenyan Eurobonds (US$)	US$292 million in four Kenyan Eurobonds 4.79% of Kenya's five Eurobonds (US$6.1 billion outstanding)			

Source: Eikon financial data platform as at 23 September 2020. Holdings are estimates because there could have been trading since data was submitted to Eikon.

(which is based in the United States and has stakes in four out of five of Kenya's Eurobonds, together totalling an estimated US$292 million).

Iif the Kenyan government was freed from making these debt payments across its foreign debt and chose to direct these funds to healthcare, it would make a real difference to its citizens. Kenyan healthcare could be dramatically improved with this money. Currently, about 45 children in 1,000 die before reaching the age of five and the infant mortality rate is 33.6 deaths out of 1,000 infants.[12] High debt servicing costs may put new

Figure 3: Known and unknown bondholders for Zambia's $1 billion Eurobond due to mature on 14 April 2024



Source: Eikon financial data platform as at 23 September 2020

and existing public health and social protection programmes, which could address gender inequalities,[13] at risk, with the IMF hinting that Kenya will require 'fiscal consolidation' (i.e. austerity and cuts to public spending) to balance its books.[14]

Zambia: secrecy and complexity of debt markets a deterrent to debt relief

Zambia is receiving some relief on debt payments through the DSSI,[15] but says it will struggle with debt service payments still owed to its private creditors which are not covered by the scheme. In addition to its bilateral and multilateral debt, Zambia has $3 billion outstanding in Eurobonds and owes approximately $2 billion more in other forms of external loans to private lenders.[16] The government has asked creditors for a 6-month interest-payment holiday from October 2020 until April 2021.

Zambia's case is instructive because simply knowing who the country's creditors are is not straightforward. There are often hundreds of private creditors, debt is traded on regularly, and there is little transparency in the market.[17] One of Zambia's Eurobonds is worth US$1 billion and is due to mature on 14 April 2024. Bondholders holding around US$295 million are known, but remaining bondholders who hold $705 million are not (Figure 3).[18] Of the known group, 76 bondholders manage 170 funds or portfolios between them, though trading may change who manages which fund at which time (Figure 4). But the size of the unknown group is symbolic of the opacity of debt markets, and could also point to the amount of debt held in tax havens which do not participate in disclosure

Figure 4: Known bondholders who hold $295 million of Zambia's $1 billion Eurobond due to mature on 14 April 2024

Source: Eikon financial data platform as at 23 September 2020 rules on such assets. It's no surprise that countries feel they are in such a weak position to reach agreement on debt cancellation when they can't even identify most of their creditors.

But Zambia's problems don't end there. Identifying your creditors is only the first stage of the process. How do you ensure agreement between so many different organisations and individuals? Some creditors are always likely to 'hold out' against any cancellation or restructuring. These 'holdout' creditors stay out of collective agreements and use legal action to pursue full recovery of the debt, despite most creditors agreeing to negotiate.

In fact, some funds have even made a business model of this behaviour. So-called 'vulture funds' buy debt very cheap when a country is about to default, and refuse to accept any restructuring in the hope they will be repaid in full.[19] Such funds have hounded countries in the past, seizing assets overseas and repeatedly challenging governments in courts in London and New York. Collective action clauses (CACs) try to make it easier for countries to proceed with orderly debt restructuring, by enabling the majority of creditors to restructure debt,[20] and forcing those terms onto the minority who might otherwise try to hold out.

Zambia's negotiating process has started, but it will be difficult. The government has requested a debt payment holiday on its three outstanding Eurobonds (total $3 billion), which could mean a deferral of $120 million of debt payments.[21] But Zambia's call has to date been rejected by a consortium representing a group of Eurobond holders,[22] although they may still agree to discuss a lesser deal. If, as seems highly likely, some creditors try to hold out, delays and litigation will have real consequences for the citizens of Zambia.

The G20's inadequate response to date

In April 2020, the G20 agreed to the Debt Servicing Suspension Initiative (DSSI), which provides a process for suspending debt repayment for up to 73 countries to other, richer governments (known as bilateral creditors) until the end of 2020. Sadly, this scheme does not offer debt cancellation, does not include all the countries in need, does not include public institutions like the World Bank and IMF and, crucially, does not include private creditors. The IMF has voluntarily cancelled 6 months' worth of debt payments owed to it by the 25 poorest countries under its catastrophe containment and relief trust (CCRT),[23] but this only amounts to US$500 million.[24]

Although the debt relief on offer is highly inadequate for the countries concerned, it is also at risk of simply being diverted into the pockets of some of the richest investors in the world. As World Bank President David Malpass said in late September, "commercial creditors are not participating in the moratorium, draining the financing provided by multilateral institutions".[25]

The G20 has called on private creditors to *voluntarily* offer a similar suspension on debt payments. However, with the cards stacked so heavily in the creditors' favour, there has been little movement. To date we only know of three countries, Chad, Angola and Zambia, that have requested private sector debt relief. The inaction on private creditor debt relief means that some of the biggest financial corporations in the world, like **BlackRock, HSBC, Goldman Sachs, Legal & General, JP Morgan** and **UBS**, continue to get paid while countries run out of reserves, see their economies and their currencies devastated, and struggle to finance crucial health services for their people. Each of these creditors holds millions of dollars in developing country debt. Through a number of funds BlackRock holds close to US$1 billion across thirty-one Eurobonds in Ghana, Kenya, Nigeria, Senegal and Zambia (see Annex 1).[26]

Some countries are now borrowing more to cover their existing debt payments, with estimates that since the beginning of April developing countries have raised over $100 billion via international bond markets.[27] But this is simply making the problem bigger in the long-run. The problem faced by many countries is not a liquidity crisis – a short-term problem that will resolve itself as long as there's sufficient cash flow – it's a solvency crisis (something the IMF's Managing Director recognised in a blog in early October[28]) – in which debt levels are simply too high to enable countries to meet their responsibilities to their citizens.

This is not the first time countries have experienced such a crisis. In the 1980s, many countries in Africa, Asia and Latin America faced huge levels of debt that were used as justification to decimate public services and cut back on social protections. The result was that poverty ballooned and development went into reverse. Although some debt was cancelled, after many years of campaigning, little was done to change the debt system as a whole. In fact, the increase in financial deregulation has fuelled ever greater quantities of risky lending. Yet we still have a global economy which places the risk of these loans entirely on the heads of the poorest citizens in the world.

While some sub-Saharan African countries have weathered the health crisis relatively well so far, others, particularly in Latin America, face disastrous loss of life and a new wave of austerity. This economic fallout will be felt across the whole world, most acutely in those countries with large informal sectors and without the resources to protect jobs and stimulate employment.

Countries in the global south now face another lost decade. A failure to act on unsustainable debt levels would severely undermine their ability to achieve the Sustainable Development Goals (SDGs) and the Paris Agreement in the next ten years, areas which these banks and asset managers have been supportive of in their promotion of sustainable investing linked to the SDGs.[29]

The way forward

Immediate cancellation of private sector debt

The G20 should use all legal, political and financial mechanisms available to compel private creditors to suspend debt payments and write-down developing country debts.

The G20 is currently discussing what will replace the current debt relief scheme, known as the DSSI. Several options are under consideration for dealing with the problem of private sector debts identified in this briefing, including swapping debts for new, longer term bonds and helping countries buy back some of their debt. While some of these mechanisms can help ease short-term financial pressure, they would not ease the long-term debt crisis, or the rapid acceleration of poverty which will result from it.

Several G20 governments have expressed that they are not happy that private creditors are, in effect, being bailed out with taxpayers' money by the G20's DSSI, as well as new lending from the World Bank and the IMF. In a statement released in late September, the G7 said, "voluntary private sector participation has been absent, which has limited the potential benefits for several countries."[30] World Bank President David Malpass has also criticised the fact that private lenders continue to get paid in full, saying: "There is a risk of free riding, where private investors get paid in full, in part from the savings countries are getting from their official creditors. That's not fair to the taxpayers of the countries providing development assistance and means poor countries don't have the resources to deal with the humanitarian crisis."[31] Ignoring the World Bank's hypocrisy in not itself offering debt cancellation, this criticism of private sector creditors is correct.

The entire world is going through an unprecedented moment in history and the worst economic crisis in nearly a century. Several of the corporations mentioned in this briefing have acknowledged that the immediate priority should be to respond to the health emergency,[32] but without debt relief, developing countries' options are limited. We cannot wait for countries to collapse while the largest corporations in the world collect payments. It's time to act. As part of a renewed debt relief package, that includes proper cancellation of debt stock, the G20 must include private sector creditors on a mandatory basis.

To prevent problems with holdout creditors, governments in key jurisdictions (including England and New York) must also pass legislation to prevent private creditors using their courts to compel countries paying out on debts which should have been cancelled. Similar action could be taken at the IMF (via use of Article VIII Section 2(b) which allows the IMF to impose a debt standstill through the temporary suspension of enforceability of debt contracts in domestic courts) or the UN (via a Security Council resolution which allows the UN to order a suspension of private creditor litigation with regards to certain countries' sovereign debt).

The IMF and bilateral lenders also have soft tools available to them to incentivise private creditor participation in debt relief. For example, the IMF could decide to only lend to countries in debt crisis if a debt restructuring takes place first in order to reduce debts down to a sustainable level.

Long-term solutions to avoid a lost decade in the global south

The G20 should jumpstart a process to create an international debt workout mechanism that allows for comprehensive debt restructurings. This mechanism must be independent of creditors, rapid and fair, assigning priority to developing government's primary responsibility for the welfare of their people.

Ultimately, we need a transformation of the debt system which prevents reckless lending and unsustainable debt accumulation. This requires a fair, transparent and comprehensive debt work out process, which rebalances the power asymmetry of debt in the global economy. This would include:

- **Fair burden sharing**

  Private creditors lend and invest in developing country bonds knowing that their capital is at higher risk. When that risk materialises, as in a global health emergency, it is reasonable to expect fair burden-sharing.[33] As the G7 highlighted in late September, it is vital that there is "fair burden sharing among all official bilateral creditors, and debt relief by private creditors at least as favourable as that provided by official bilateral creditors."[34]

- **A focus on swift and orderly debt restructuring**

  As the IMF argues, orderly debt restructuring is needed to "provide speedy and sufficiently deep debt relief to countries that need it, benefitting not only these countries but the system as a whole."[35] Restructuring often take a long time;[36] time which developing countries simply do not have. Research by the IMF shows that entering into a restructuring before default happens can reduce the economic damage of waiting until after it has happened.[37] Given the urgent need to boost the economic recovery in developing countries, this has to be the priority.[38]

- **A comprehensive approach**

  There is a clear need for coordination[39] to ensure that all types of debt are covered and all creditors participate because of the huge number and diversity of commercial creditors (highlighted in Figure 3 and Figure 4).[40] Resorting back to a country-by-country traditional approach undermines the economic recovery and capacity to respond to the crisis of indebted countries. In relation to the situation in Zambia, IMF spokesman Gerry Rice said recently that given the country's "complex creditor base, the debt restructuring there is expected to take some time."[41] This could undermine those private creditors who are already in discussions behind the scenes with developing country governments.[42]

- **Prioritising human rights**

  Any fair work out system must be able to judge the human rights implications of continuing to pay debts, rather than lifting debt repayment above all other considerations. It should also have the power to adjudicate on the legitimacy of initial lending. Where lending was made in a grossly irresponsible manner, or where lenders were complicit in human rights abuses, debts should not carry any weight under international law.

Annex I

Holders of Eurobonds of Five Selected DSSI Countries

Table 1: Selected private creditors with UK and US headquarters and subsidiaries estimated aggregated holdings in Eurobonds (in US$) and percentage of total Eurobonds (in US$). Each holding is often managed by several funds.

	Ghana	Kenya	Nigeria	Senegal	Zambia
Number of bonds and amount outstanding	Twelve US$ Eurobonds. Total: $10.2 bn	Five US$ Eurobonds Total: $6.1 bn	Ten US$ Eurobonds Total: $10.8 bn	Five US$ Eurobonds Total: $4 bn	Three US$ Eurobonds Total: $3 bn
Maturity dates and interest rates (fixed coupon)	2022: 9.25% 2023: 7.875% 2026: 8.125% 2027: 6.375% 2027: 7.875% 2029: 7.625% 2030: 10.75% 2032: 8.125% 2035: 7.875% 2049: 8.627% 2051: 8.95% 2061: 8.75%	2024: 6.875% 2027: 7% 2028: 7.25% 2032: 8% 2048: 8.25%	2021: 6.75% 2023: 6.375% 2025: 7.625% 2027: 6.5% 2030: 7.143% 2031: 8.747% 2032: 7.875% 2038: 7.696% 2047: 7.625% 2049: 9.248%	2021: 8.75% 2024: 6.25% 2028: 4.75% 2033: 6.25% 2048: 6.75%	2022: 5.375% 2024: 8.5% 2027: 8.970%
Private creditor (total of all subsidiaries)	**Estimated holdings in and percentage of all US$ Eurobonds**				
Aberdeen Standard Investments (UK, US, Hong Kong, Australia)	US$38mn (0.37%)	US$65.7mn (1.08%)	US$45.5mn (0.42%)	US$36.6mn (0.90%)	US$28.2mn (0.94%)
BlackRock (US, UK)	US$228.2mn (2.22%)	US$198.8mn (3.26%)	US$340.3mn (3.13%)	US$106.9mn (2.63%)	US$85.7mn (2.86%)
Goldman Sachs (US, UK, Japan)	US$10.8mn (0.11%)	US$2.5mn (0.04%)	US$15.1mn (0.14%)	US$2mn (0.05%)	US$8mn (0.29%)
HSBC (US, UK)	US$57mn (0.0006%)	US$49.1mn (0.81%)	US$123.8mn (1.14%)	US$13.2mn (0.33%)	US$6.0mn (0.20%)
JP Morgan (US, UK, Taiwan)	US$89.6mn (0.87%)	US$112.1mn (1.84%)	US$216.1mn (1.99%)	US$62mn (1.53%)	US$65mn (2.17%)
Legal & General (UK)	US$26.6mn (0.26%)	US$28.1mn (0.46%)	US$17.8mn (0.16%)	US$11.5mn (0.28%)	US$11.2mn (0.38%)
UBS (Switzerland, Germany, US)	US$68.7mn (0.67%)	US$61.1mn (1.00%)	US$106.3mn (0.98%)	US$19.3mn (0.48%)	US$39.1mn (1.30%)

Source: *Eikon financial data platform. Data as at 23 September 2020. Holdings are estimates because there could have been trading since 23 September 2020.*

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