

International Monetary Fund
African Department



Collateralized Sovereign Debt – Costs and Benefits

Patrick Imam

International Monetary Fund

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Road Map

- Definitions
- Characteristics of a Typical Collateralized Future
- Benefits and risks associated with collateralized borrowing
- Recent Cases of Collateralized or Secured Sovereign Debt
- Implications for the rise and resolution of sovereign debt crises
- Implications for Official Multilateral Lending
- Challenges
- Solutions



DEFINITIONS



Definitions

- Collateralized sovereign debt comprises bonds/loans backed by an existing asset/future income stream owned by the sovereign
- These may be issued by the sovereigns directly or by public sector entities, including state owned enterprises (SOEs), with or without an explicit state guarantee
- Underlying collateral can take many forms
 - assets of an SOE,
 - physical commodities destined for export markets – oil, gold, diamonds
 - a future revenue stream
- Collateralization is covered in a contract in the event of a default, a creditor would obtain control over the said collateral



Recent trends

- There is an expansion of lending by non-Paris Club and private creditors contributing to increased collateral-backed loans in commodity-exporting LICs e.g. Angola and Chad.
- The commodity price boom enabled several resource-rich economies to increase their borrowing via collateral-backed debt.
- Recent debt distress e.g. in Chad highlight the complications derived from secured sovereign debt, and the need to more fully understand its implications for debt restructurings.



Characteristics of CFR

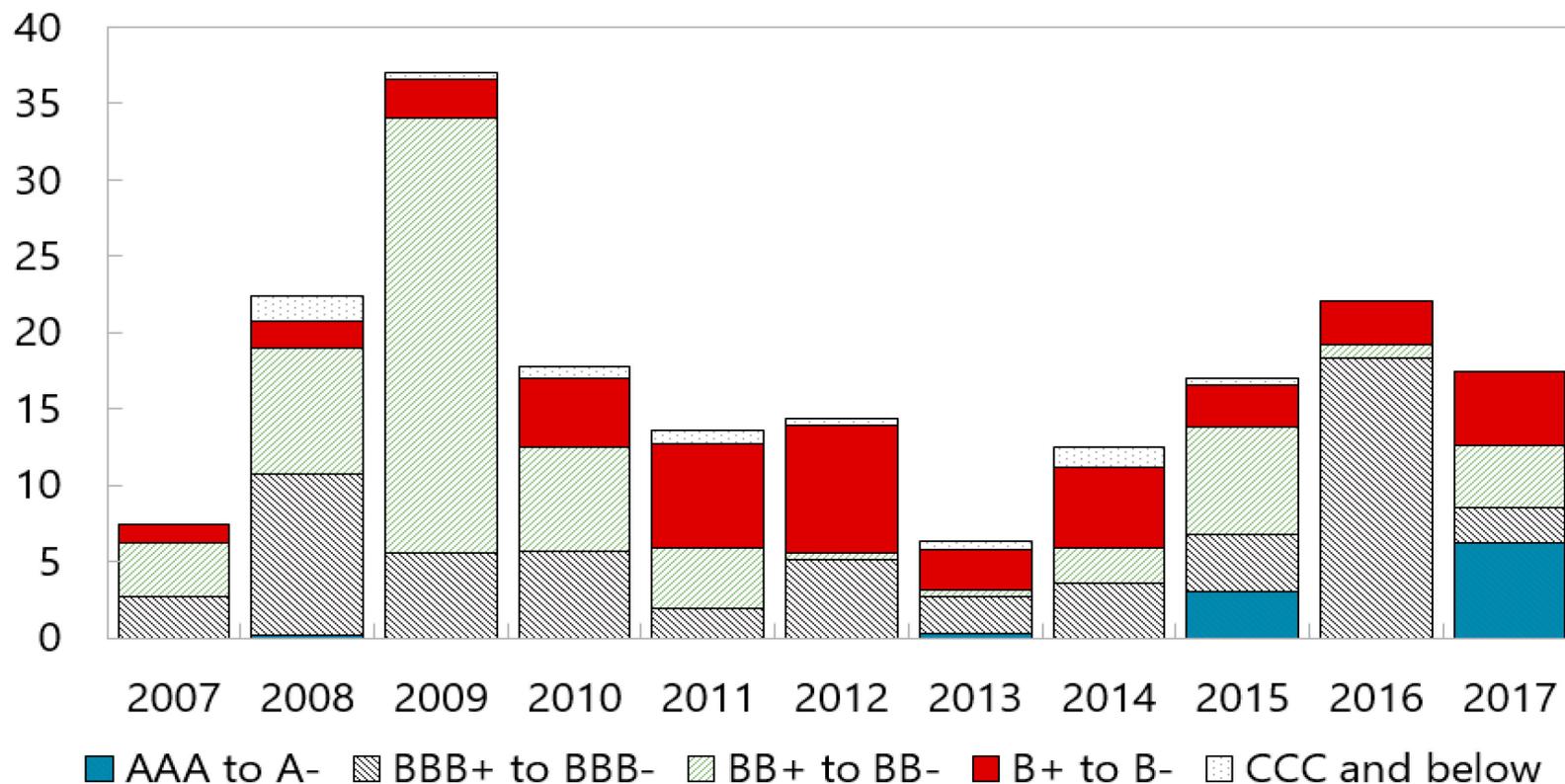
- **Direct CFR arrangement** - Creditor is given priority claim over an asset
- **Indirect CFR arrangement** – public sector sells its right and interests in future receivables to an offshore entity (SPV) and proceeds are paid into an escrow account
- Examples of CFR
 - ◆ Commodities - oil, cocoa, tobacco, sesame, iron ore, copper
 - ◆ Future revenue – from infrastructure use or revenue from exports
 - ◆ Securitized lending can also be used by trade financing commercial banks, specialized trade bank or large commodity traders



Collateralized loans by credit rating

Figure 1. Collateralized Loans by Credit Rating

(EMDE public sector, billions of USD)



Source: Dealogic

Note: Sovereign foreign currency long-term credit rating is used in cases where SOEs' rating information is not available.



What are the benefits to countries

- Provides access to external financing when conventional unsecured financing is not available
- Collateralized borrowing can also provide access to funding during liquidity crisis
- It can be used as a bridge to more conventional financing, or to avoid borrowing at very short term and/or at very high cost



What are the costs to countries

- Breaches the negative pledge clause (NPC)
- Increases conventional financing costs
- Constrains future fiscal flexibility where debt sustainability is a concern



Collateralized borrowing poses macro risks

● Lack of transparency would only exacerbate these risks:

- ◆ Weakens the link between sustainability of public debt and fiscal position in general
- ◆ Lessens the availability of conventional financing
- ◆ Protects the creditor in case of default, thus removes incentives for creditors to take due account of weak fiscal and external sustainability
- ◆ **False comfort** - may lead countries to postpone needed adjustment, and thus, encourage overborrowing
- ◆ **Lack of flexibility** - Can narrow future policies leg room. Could constrain the debtor country's options in the event of a sovereign debt restructuring



HOW PREVALENT IS THE PRACTICE



Practice prevalence

Since the global financial crisis, external debt has risen in both EMDEs and LIC :

- The rise in EMDEs' external debt has been supported by increased market access.
- For the 154 EMDEs, public and publicly guaranteed debt, in nominal U.S. dollars, rose
LIC are defined as the 54 PRGT/IDA-eligible countries.



Angola

- Securitized borrowing dates back to early 2000s, when large post-conflict reconstruction and rehabilitation costs could not be met with concessional or alternative sources of financing.
- Oil-backed loans in Angola were at first arranged by international banks and later, bilateral creditors including China.
- However, currently, oil-backed debt remains an important financing source despite access to more conventional sources of financing, including Eurobonds (since 2015) and unsecured bilateral credits.
- With lower oil prices, more barrels of crude are now required to service Angola's oil-backed debt, leaving less revenue for other government spending mandates.



Chad

- Recently reached an agreement with its commercial creditors to restructure its oil-backed loan (accounting for over 50 percent of its total public external debt) in the context of a Fund-supported program.
- The deal was intended to help restore debt sustainability and covers a significant portion of the financing gap under the program.
- The same loan was previously restructured in 2015, which led to an increase in the net present value.
- Since then, the servicing costs of this loan placed an excessive burden on the budget, and consumed a large share (about 85 percent) of the government's oil revenue.



Republic of Congo

- An oil producing country, has seen its debt level rise rapidly since debt relief under HIPC was delivered, and its debt is currently assessed by Fund staff as being unsustainable
- A significant share of its debt is reportedly securitized (about 70 percent of total public external debt): i) commercial loans to commodity traders that are repayable through future oil deliveries; and, ii) concessional bilateral credits from China that are partially secured by oil receipts deposited in an (offshore) escrow account.



Venezuela

- Venezuela has pledged a rising amount of oil-related assets to creditors as its borrowing situation has become increasingly difficult
- In 2016, the state oil firm PDVSA put up 49.9 percent of its shares in its U.S. subsidiary CITGO as collateral for a US\$1.5 billion loan from Rosneft, on which it later defaulted

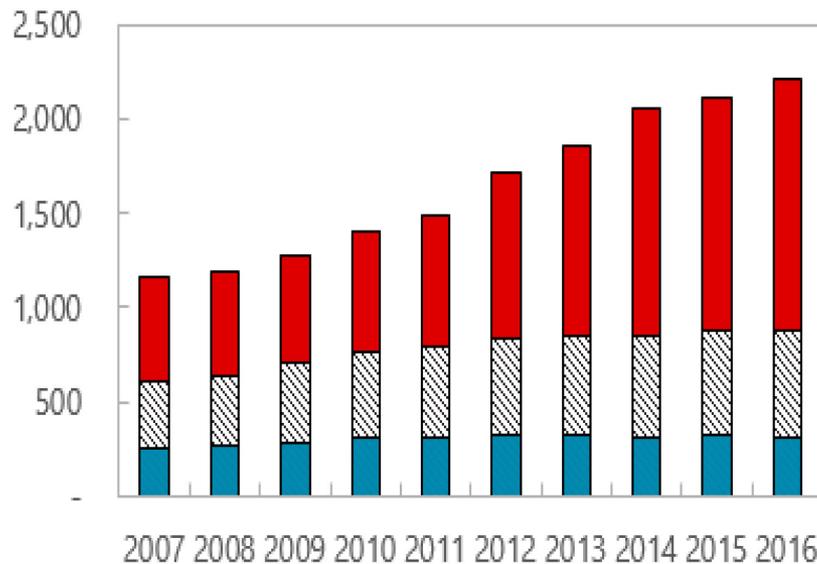


External debt composition by creditor

Figure 2. External Debt Composition by Creditor

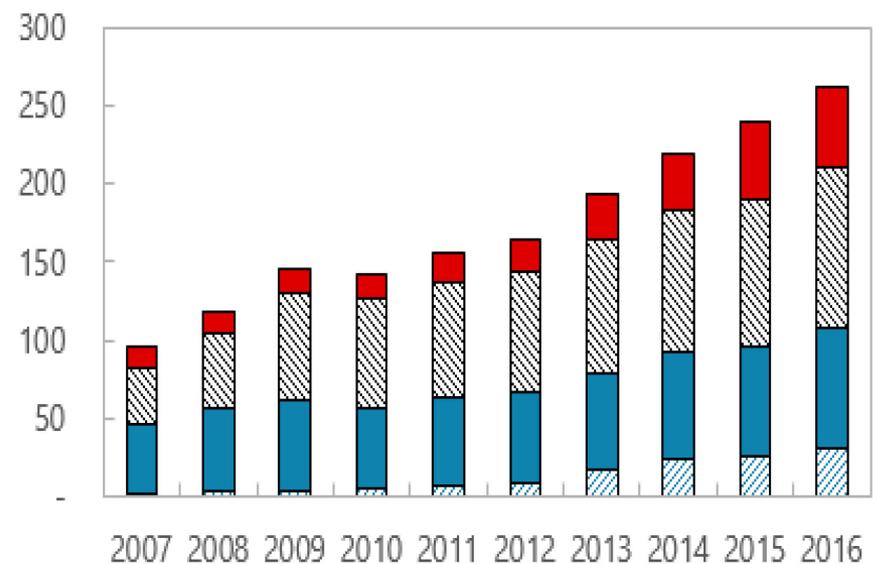
(billions of USD)

Emerging and developing economies



■ Bilateral ■ Multilateral ■ Commercial

Low-income countries



■ Bilateral from China ■ Bilateral from others
 ■ Multilateral ■ Commercial

Sources: IMF-World Bank Joint External Debt Hub and Fund staff calculations



Data and information

- Most sovereign and SOE commercial borrowing by EMDE is not collateralized
- Since 2010, collateralized borrowing has not exceeded 10 percent of annual EMDE commercial debt issuance, that is both bonds and loans
- Data is only available for internationally syndicated sovereign commercial borrowing,
- Available commercial data does not capture *all* secured or collateralized debt arrangements.
- some bilateral deals continue to take place without appropriate recording
- Deliberate misclassifications to improve fiscal or debt positions



EMDEs vs. LICs: Public sector bond and loan insurance

Table 1. EMDEs vs. LICs: Public Sector Bond and Loan Issuance

(in billions of U.S. dollars)

	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
EMDEs: Bonds and Loans	186.0	187.7	254.7	219.4	205.5	210.5	247.0	227.9	205.0	308.1	318.5
Collateralized bonds and loans	15.9	26.7	39.1	19.3	16.5	19.0	9.4	19.5	17.9	30.2	23.8
Collateralized share %	9%	14%	15%	9%	8%	9%	4%	9%	9%	10%	7%
LICs: Bonds and Loans	3.4	3.6	3.6	4.1	10.4	9.9	14.7	19.4	15.1	11.9	19.7
Collateralized bonds and loans	1.0	2.2	1.3	1.8	5.3	3.9	2.5	5.9	2.5	2.9	3.6
Collateralized share %	28%	60%	36%	44%	51%	39%	17%	30%	17%	24%	18%

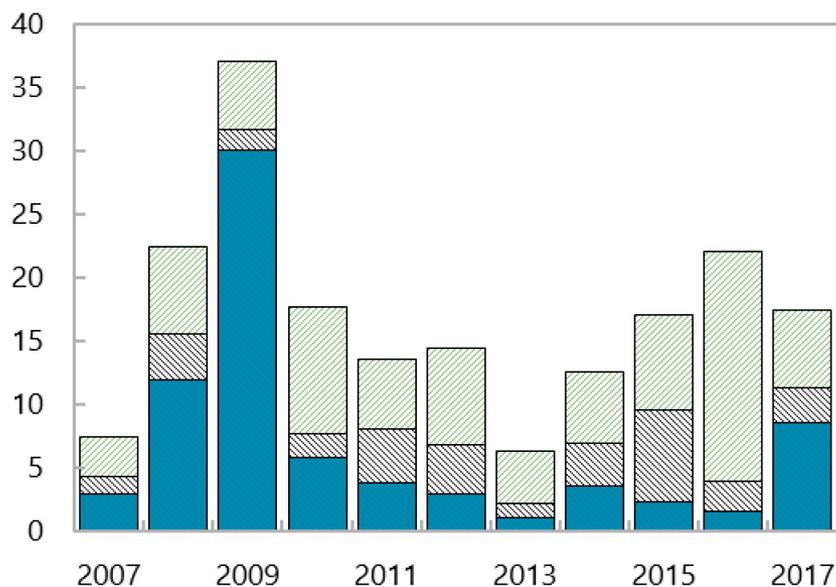
Source: Dealogic.



Commercial collateralized loans

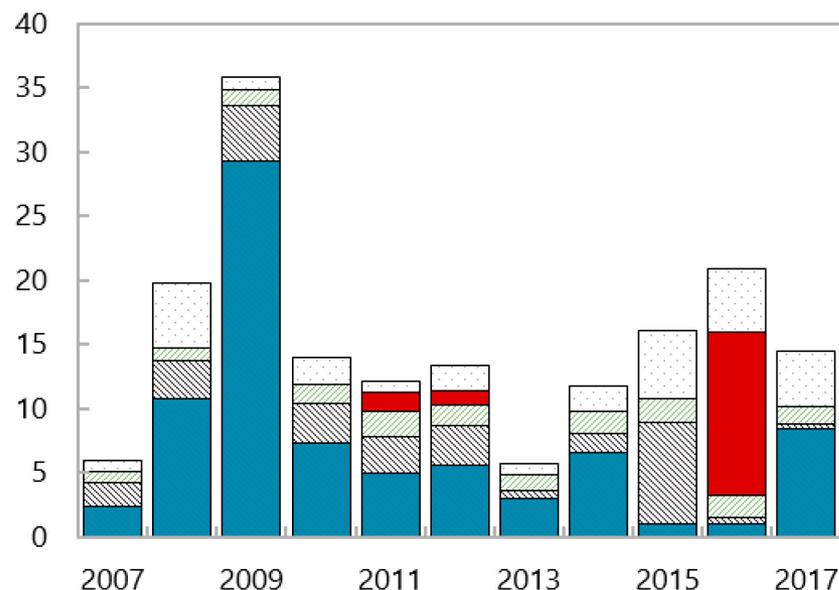
Figure 3. Commercial Collateralized Loans
(billions of USD)

EMDE Public Sector: By Commodity Exporters



- Non-Commodity exporters
- ▨ Other commodity exporters
- Oil exporters

EMDE SOEs: By Industry



- Oil & Gas
- ▨ Agribusiness
- ▨ Transportation
- Chemicals
- Others

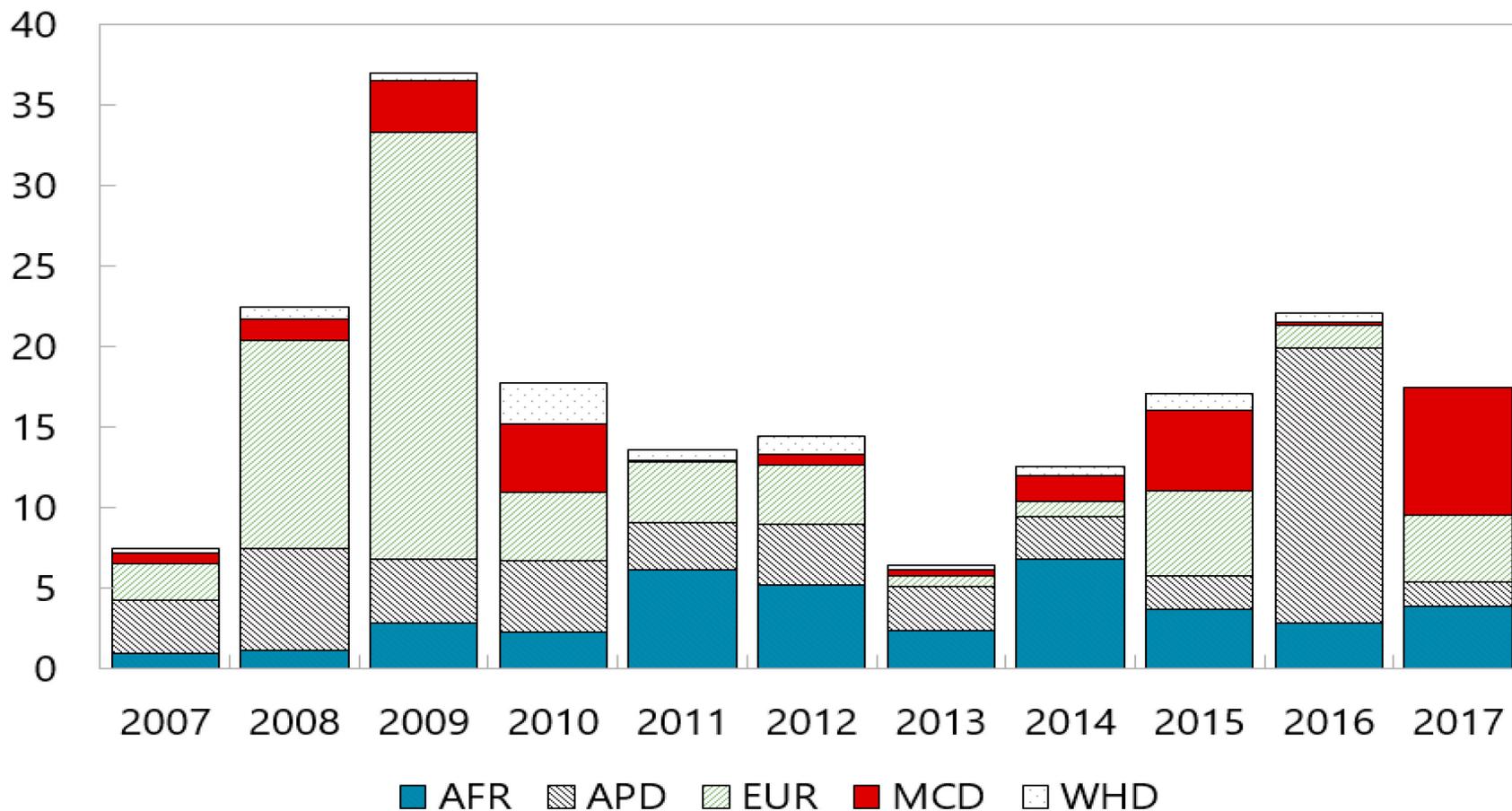
Source: Dealogic



Collateralized loans by region

Figure 4. Collateralized Loans by Region

(EMDE, billions of USD)



Source: Dealogic



ZIMBABWE'S DEBT



Zimbabwe's debt (SMP 2019)

	Public Sector		
	Total Billions	% Arrears	% of Total
External Debt	\$ 9,106	69%	100%
excluding RBZ balance sheet	\$ 8,172	76%	90%
Bilateral Creditors	\$ 5,159	69%	57%
Multilateral Creditors	\$ 2,573	88%	28%
RBZ Debt	\$ 1,374	32%	15%



Zimbabwe's collateralized loans

- There is limited public information on collateralised debt
- Zimbabwe's collateralized loans amount to \$700 million about 8 percent of total debt– all owed to Afreximbank (Bloomberg)
- There are probably more loans on platinum collateralization
- Data availability to the public is constrained by the inability to follow the Public debt Management Act and Public Finance Management Act procedures in loan contracting



IMPLICATIONS FOR OFFICIAL MULTILATERAL LENDING



IMPLICATIONS FOR OFFICIAL MULTILATERAL LENDING

- A member is allowed to enter into collateralized borrowing agreements, but collateralization may raise safeguards concerns for future Fund lending
- The Fund does not include NPC in its financing arrangements with member countries
- Nevertheless, collateralized borrowing may impact the member country's ability to borrow from the Fund if it significantly undermines its capacity to repay the Fund if the Fund determines that there are no adequate safeguards for the use of Fund resources



Challenges

- There is need for a better understanding
- Creditors should be encouraged to share information
- Unsustainable debt situations with collateralized debt disrupts economic activity and for the IMF it impacts program implementation?



Solutions

- Stronger public finance management (PFM) frameworks, including for SOEs
- Enhanced debt management capacity are key



Thank you