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Preferred creditor treatment and multilateral development banks' mobilisation agenda

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Abbreviations and acronyms

ADB	Asian Development Bank
AfDB	African Development Bank
Afreximbank	Africa Export–Import Bank
AIIB	Asian Infrastructure Investment Bank
BOAD	West African Development Bank
CABEI	Central American Bank for Economic Integration
CAF	Development Bank of Latin America and the Caribbean
CDB	Caribbean Development Bank
EBRD	European Bank for Reconstruction and Development
ESM	European Stability Mechanism
G20	Group of Twenty
GEMs	Global Emerging Markets Risk Database
GSDR	Global Sovereign Debt Roundtable
IBRD	International Bank for Reconstruction and Development
IDA	International Development Association
IDB	Inter-American Development Bank
IFC	International Finance Corporation
IF-CAP	Innovative Finance Facility for Climate in Asia and the Pacific
IFI	International Financial Institution
IMF	International Monetary Fund
MDB	Multilateral Development Bank
MIGA	Multilateral Investment Guarantee Agency
NPL	Non-performing loans
OECD	Organisation for Economic Cooperation and Development
PCS	Preferred creditor status
PCT	Preferred creditor treatment
PD	Probability of default
RAC	Risk Adjusted Capital
RWA	Risk-weighted assets
S&P	Standard and Poor’s
TDB	Trade and Development Bank

Executive summary

A key attribute of multilateral development banks (MDBs) is preferred creditor treatment (PCT) – the notion that MDB loans to government borrowers essentially always get repaid. PCT underpins MDBs' financial strength and preserving it is a top priority to ensure that they can continue to access bond market funding at privileged terms.

PCT is built on a consensus that MDBs are non-profit governmental cooperatives. The accelerating efforts of MDBs to mobilise commercial investment at scale, in new ways beyond their traditional mobilisation of bond market investors, pose questions about PCT. The goal of this paper is to sensitise MDB shareholders, management and private sector actors of the considerations involved, to better inform policy, operational and investment decisions.

Debates on the nature of PCT

PCT implies that borrowers prioritise repaying MDBs in the face of financial stress, and other creditors consider it legitimate for loans from MDBs to be excluded from sovereign debt restructuring, even if these other creditors accept losses themselves.

PCT ultimately rests on consensus between creditors and debtors. Sovereign borrowers comply because they value continued MDB support. Official and commercial creditors accept PCT because they value the stabilising role of MDBs, and to ensure counter-cyclical concessional funding will help countries regain a path to solvency. Efforts by MDBs to mobilise commercial investors on sovereign lending could call that consensus into question.

The growing number of MDBs around the world has led to questions about which ones should benefit from PCT. The International Monetary Fund (IMF) has proposed differentiating based mainly on MDB shareholding, although the link between shareholding and PCT is not obvious. Within the Common Framework, official creditors prioritise two main factors: i) that the MDB is non-profit; and ii) that past and future resources provided by the MDB to the borrower country are concessional and generate net positive financial flows.

What is PCT worth and how do rating agencies evaluate it?

The benefits of PCT to MDB sovereign loan portfolio performance can be seen in the very low levels of non-performing loans (NPLs)

over the past decade across MDBs. Those lending entirely to sovereign borrowers post NPL levels four times or more below the 2.6% level estimated by Standard & Poor's (S&P) for non-MDB creditors. Financial recoveries in the event of a default average 90–98%, far above the 48–53% estimated by Moody's for commercial creditors lending to sovereigns. An independent study found that MDBs were 3.5 times less likely to face a default compared to commercial lenders exposed to the same borrower, and faced total economic losses 14 times lower than private lenders.

The three largest credit rating agencies, S&P, Moody's and Fitch, factor PCT into their MDB rating methodologies in very different ways, partly because MDBs themselves have historically not had a uniform approach to incorporating PCT into their own models. Key differences across rating methodologies include metrics for defining PCT, whether PCT impacts each loan exposure or the whole MDB portfolio and the weight of loss given default.

Greater standardisation in how MDBs themselves incorporate PCT into their capital adequacy frameworks, as called for in a recent G20 report (G20, 2022), would encourage ratings agencies to take a more aligned approach.

MDB mobilisation instruments and PCT

As MDBs explore new ways to mobilise private capital, protecting PCT is a central policy concern due to its importance to MDBs' financial strength and credit ratings. New techniques to mobilise private investors – including risk transfers to external counterparties, MDB guarantees on sovereign borrowing and opening up MDB share capital to investors – could have implications for PCT.

Risk transfers

MDBs are increasingly exploring risk transfer mechanisms to shift MDB loan risk to third parties (commercial or official). If done with sovereign loans, risk transfers could impact PCT by weakening the willingness of borrowers to prioritise repaying the MDB, and of other creditors to agree that MDB loans are exempt from restructuring in the event of a sovereign default.

Thus far, only four risk transfer deals with sovereign MDB loans and commercial investors have gone forward: African Development Bank's Room-to-Run Sovereign transaction in 2022 with insurance companies, two credit insurance deals by Inter-American Development Bank in 2023 and 2024 and a sovereign loan securitisation by the West African Development Bank in 2023. MDB management consulted for this paper indicated that they view sovereign risk transfers as useful for regional MDBs to manage loan portfolio concentration risk, but not realistic to bring to scale in the current policy environment.

Risk transfers can also be done with a highly rated member government guaranteeing a portion of an MDB's loan portfolio, thus freeing up risk capital. If done for individual countries, this could raise issues for PCT if the guarantor country uses a guarantee for an MDB loan (which would be protected from restructuring in a default) instead of lending directly (which would not be protected from restructuring). Portfolio guarantees are less problematic because they represent broad, ex-ante support for MDB capacity. A common approach developed with MDBs and the Paris Club would be helpful.

MDB sovereign guarantees

The sovereign defaults of Argentina (2001) and Ghana (2022) highlighted the issue of MDB guarantees to sovereigns. The World Bank guaranteed a portion of these countries' sovereign bonds, and when they defaulted, the World Bank paid the guarantees and then converted the payout into a (PCT-protected) loan. Once called, the World Bank guarantees effectively transformed a private claim of bondholders into a PCT-protected multilateral claim.

In light of MDB plans to scale up sovereign guarantees, MDBs and the Paris Club should ensure a clear set of criteria to avoid complications in the event of a default. The World Bank views the guarantee as sharing its AAA rating with the borrower, just as it does with regular World Bank bond investors, rather than its PCT. Official creditors have no firm view on MDB guarantees and PCT – establishing broad guidelines would help inform policy and operational decisions by MDBs, borrowers and investors.

MDB share capital

Another mobilisation technique that could be deployed by MDBs would be to invite commercial investors in as shareholders. However, doing so would pose questions about the nature of the MDB as a non-profit entity focused on developmental goals, since commercial shareholders would expect a financial return. According to criteria laid out in a 2022 IMF background paper, the existence of non-sovereign shareholders would exclude an MDB from the group of MDBs normally accorded PCT. Official creditors and the Paris Club have no established rule on the issue.

Conclusions and policy implications

The evidence presented here suggests that mobilisation of sovereign MDB loans should be undertaken with caution and is not likely to be feasible at scale in the current policy framework. With careful deal structuring and on a limited scale, sovereign mobilisation may be feasible through risk transfers, sovereign guarantees or non-voting share classes. However, the tension between commercial interests and the cooperative consensus underpinning PCT indicates that mobilisation is not the answer to expanding MDB sovereign lending capacity at scale. Paid-in share capital remains essential for MDBs to invest at the scale needed.

A more systematic and agreed approach to PCT would help MDBs, borrower governments and private sector actors better understand when, how and at what scale MDBs can mobilise for sovereign lending. The Paris Club is now discussing the implications of MDB mobilisation techniques for PCT with its membership, and it may also be useful to take this up in the Global Sovereign Debt Roundtable. The main issues to be considered by policy-makers are threefold:

First, the main criteria to evaluate whether mobilisation techniques involving external partners (commercial or official) related to MDB sovereign loans would be exempt from restructuring.

Second, how to decide which MDBs should benefit from PCT in light of the growing diversity of MDBs and potential questions raised by sovereign debt restructuring.

Third, how MDBs can encourage convergence in credit rating agency methodologies to adequately reflect the financial value of PCT to MDB creditworthiness.

Options to mobilise on sovereign MDB lending without impacting PCT

MDBs can consider other innovations to mobilise external resources for sovereign lending capacity that do not negatively impact PCT.

Option 1: Develop other techniques to recycle sovereign-guaranteed loans, like the recent World Bank innovation to incentivise refinancing appropriate loans with commercial lenders.

Option 2: Small-scale sovereign risk transfers, including in blended structures, may be feasible to help MDBs manage exposures to specific high-risk countries. Risk transfers at scale should only be considered if the Paris Club and other stakeholders reach a new consensus on commercial mobilisation and PCT.

Option 3: Blended syndication arrangements may be possible whereby MDBs lend to sovereigns at traditional policy rates and commercial lenders provide B loans at market terms, thus providing blended finance for transformative infrastructure projects.

Option 4: Ring-fenced, non-voting share classes for impact investors could be possible without affecting PCT if investors earn a return in line with what MDBs normally generate the net income, and hence not embed additional profit motive into MDB operations. This could be attractive to impact-first investors such as philanthropies or individual retail investors with ethical priorities.

1 Introduction

Multilateral development banks (MDBs) are seeking new ways of mobilising private investment beyond their traditional use of bond markets. This makes sense in light of limited financial resources, unfulfilled development investment needs and the growing appetite of some investors to work with MDBs. However, commercial mobilisation arrangements can pose challenges to the unique relationship between borrower governments and MDBs.

Central to this relationship is preferred creditor treatment (PCT), sometimes called preferred creditor status (PCS).¹ PCT underpins MDBs' financial strength, as it means that they are essentially always repaid by their government borrowers. But PCT is not well defined and has no clear legal basis – it is a customary practice built on a consensus that MDBs are non-profit governmental cooperatives.

A more precise understanding of PCT is urgently needed. Mobilising commercial investors to support sovereign MDB lending could weaken the commitment of borrower governments and other creditors to respect PCT, depending on the nature and scope of the deals. This, in turn, could have implications for MDB ratings and the ability to borrow from bond market investors at low cost to fund development lending.

The MDB landscape is expanding, with some 30 MDBs in operation, and this diversity poses questions about which MDBs should benefit from PCT and why (Humphrey, 2025). These issues are likely to be tested in light of the deteriorating sovereign debt panorama of some developing countries (World Bank, 2024a).

The paper focuses on four questions:

- What is PCT and why do MDBs have it?
- How does PCT support the financial strength of MDBs?
- How do credit rating agencies evaluate PCT?
- How might different mobilisation instruments impact PCT?

Discussions related to sovereign debt, PCT and MDB mobilisation are currently under way among MDB management and shareholders, the Paris Club, the International Monetary Fund (IMF) and private

¹ There is no consensus in secondary literature, policy documents or rating agency reports on whether 'PCS' or 'PCT' is preferable. This paper uses PCT because it is somewhat more common and gives a sense of a treatment based on context, rather than a status granted.

sector investors working with MDBs. The paper systematically reviews the main issues involved to encourage reflection on how PCT can be preserved, while maximising the development financing available to sovereign borrowers.

Research consisted of a desk review of MDB reports and policy documents, other related policy papers, credit rating agency methodology and commentaries and secondary literature. Interviews were conducted with MDB staff and government officials for this and an earlier paper (Humphrey, 2025), and a workshop addressing this and related topics, convening MDB management, government representatives and private sector actors, was held on 14 October 2025 in Washington (under the Chatham House Rule).

2 Debates on the nature of PCT

PCT has two aspects. The first is that government borrowers will prioritise repaying loans from multilateral lenders such as the International Monetary Fund (IMF), the World Bank and other MDBs before all other debt obligations. The second is that other creditors (official and commercial) accept that MDB loans should be excluded from sovereign debt restructuring, even when other creditors take losses. 'This confers on the loans of MDBs a type of de facto seniority' (Perraudin et al., 2016: 1).

MDBs may also benefit from a type of PCT for their non-sovereign, private sector lending, as demonstrated by the Global Emerging Markets Risk database (GEMs, n.d.). This paper focuses specifically on MDB lending to sovereign borrowers.² The 'shadow' PCT for non-sovereign lending is addressed in Humphrey and McHugh, 2026.

2.1 PCT is a customary practice, not a legal obligation

PCT emerged in the 1970s and became more codified and accepted during the debt crises of the 1980s (Martha, 1990).³ In 1988, the IMF Board issued a communique asking 'all members within the limits of their laws to treat the Fund as a preferred creditor' (cited in Schlegl et al., 2019: 8). During the Highly Indebted Poor Countries initiative and Multilateral Debt Relief Initiative, MDB debt relief was paid for the most part by donor countries rather than the MDBs themselves, helping solidify PCT for MDBs.⁴

Several factors explain why debtor governments might 'prefer' repaying MDBs senior to other creditors.

- MDBs make investments to support a country's development rather than to earn a financial profit.

² More specifically, PCT relates to loans guaranteed by the sovereign government. This can include loans to sub-national governments, state-owned enterprises or even in some cases private sector actors, but in all cases the sovereign has given an explicit repayment guarantee.

³ The statutes of the World Bank and other early MDBs contain provisions explicitly permitting the MDB to restructure loans when sovereign borrowers face financial difficulties. This suggests that the concept of PCT evolved well after Bretton Woods. See World Bank (2012), Art. IV Section 4.

⁴ Several MDBs contributed net income to debt relief, but because this was not a direct restructuring of individual loans but rather a contribution to a general fund, it was considered not to violate PCT.

- Governments trust MDBs to reliably provide low-cost loans and technical support to a country year in and year out, even in a crisis when all other sources of financing dry up.
- MDBs are inter-governmental cooperatives of which borrower countries are also part owners, and defaulting can weaken a country's political standing in the international community.
- If a country defaults to one of the major MDBs, other major MDBs and the IMF are unlikely to extend loans until arrears are cleared.⁵

Other creditors have historically been willing to exempt MDB debt from restructuring in recognition of the systemic importance of MDBs (and the IMF, which is also preferred) to global financial stability and economic growth. The Paris Club – an influential grouping of 22 official creditor governments – normally excludes MDB debt from the 'comparability of treatment' applied to creditors during a sovereign restructuring. Commercial creditors have not challenged the exemption of MDBs, even in highly contentious restructurings such as in the wake of Argentina's 2001 default.

2.2 Does PCT have a statutory underpinning?

It is broadly accepted in the literature and by most MDBs⁶ that PCT has no legal basis in MDB statutes or contracts, but rather is a customary practice based on consensus among creditor and borrower governments. Nonetheless the argument is worth considering, as it has recently come up in debt restructuring (Humphrey, 2025). Afreximbank has maintained that its statutes require borrower governments to excluded Afreximbank loans from restructuring – a stance reaffirmed by shareholder governments at the July 2025 Board of Governors meeting (Afreximbank, 2025).

Art. VIII and Art. IX of the Agreement for the Establishment of the African Export-Import Bank (Afreximbank, 1993), related to immunity of assets and freedom of assets from restrictions, would appear to be the likeliest basis for this claim. The provisions do not reference PCT explicitly but rather speak in general terms about asset immunities, similar to provisions in the statutes of all the major MDBs that do not claim a statutory basis for PCT. Afreximbank's claim of a legal basis for PCT based on its statutes has never been tested in court.

Two multilateral institutions explicitly include PCT in their charter. The charter of the European Stability Mechanism states: 'ESM loans will enjoy preferred creditor status in a similar fashion to those of the IMF, while accepting preferred creditor status of the IMF over the ESM' (ESM Treaty, 2012). The East African Development Bank charter states that it 'shall be accorded in the territories of the Member States

⁵ IMF policy is defined by its Lending into Arrears guidelines (IMF, 2022a). Major MDBs have no formal cross-default agreements but generally do not lend when a country is in arrears to another MDB.

⁶ Based on interviews with legal teams at three major MDBs and the IMF. See also Cordella and Powell (2019), Moody's (2022) and Fitch (2024).

a creditor status no less than that accorded to' the IMF, IBRD, IDA, AfDB and ADF (EADB, 2012). No sovereign member of EADB has ever gone into arrears since it was established in 1967 (S&P, 2024).

These statutory obligations may strengthen the commitment of the borrower to repay the MDB. However, they have no legal force requiring other creditors to agree to exclude an MDB loan from sovereign restructuring, since other creditors did not sign the treaty. As one observer noted, even if an MDB's treaty contains provisions on PCT, 'those promises apply only between the Bank and its member states, not to other parties' (Ojeh, 2025: 4).

The dilemma is neatly encapsulated by a quote from Zambia's finance minister regarding Afreximbank's claims: 'We have to adhere by the rules agreed upon with all the creditors – in as much as we would want these African banks to have a preferential status, but that's not our decision. That was not the decision of Zambia. That was the decision of the creditors – all of them' (Hoije and Hill, 2025).

2.3 Post-2020 context: questioning PCT and IMF guidelines

PCT has in recent years become a more sensitive policy issue. External debt in low- and middle-income countries has risen substantially since the 2000s. A series of international shocks – the Covid pandemic, the Ukraine conflict and rising global interest rates – have increased sovereign debt stress (World Bank, 2024a).

In the G20 discussions on the Debt Service Suspension Initiative and the Common Framework for sovereign debt restructuring, Chinese authorities called MDBs to participate in sovereign loan restructuring. This position received some support from African governments (Kebret and Ryder, 2023).

MDBs and many Western nations argued that the loss of PCT and potential spike in MDB funding costs (and hence lending rates to borrowers) would far outweigh any short-term debt relief benefits (Humphrey and Mustapha, 2020). An agreement was reached within the Global Sovereign Debt Roundtable (GSDR)⁷ that MDBs would remain exempt from restructuring as long as they provide 'net positive flows of concessional finance and grants' to countries facing debt restructuring (GSDR, 2023: 9).

A further complication is that the number of institutions claiming PCT has multiplied with the creation of new MDBs and the rapid growth of smaller, regional MDBs. Should all of these MDBs be eligible for PCT, just like the World Bank and major regional MDBs? As a recent report put it: 'The international community is faced with a dilemma:

⁷ The GSDR was created in 2023 to address sovereign debt issues. It comprises the Paris Club, other official creditors (notably China), the IMF, World Bank, G20 presidency, commercial creditors and borrowing countries (World Bank, 2025a). GSDR principals meet twice a year, while technical staff hold further meetings.

either shelter all the institutions claiming to be entitled to PCS at the risk of making it impossible to deliver debt relief (or imposing exceptionally high losses on commercial creditors, possibly leading to litigation rather than a deal); or exposing these institutions to the risk of rating downgrades' (Lazard, 2025: 4).

In 2022, IMF staff proposed a new policy (IMF, 2022a) to decide how to treat different multilateral institutions in a sovereign restructuring. The proposed policy has a strong influence on other stakeholders due to the IMF's central role in sovereign debt restructurings. The paper delineated three main criteria that would all need to be met for an MDB to be treated by the IMF as a preferred creditor (ibid.: 18):

- 1 At least two sovereign shareholders and no non-sovereign shareholders.
- 2 Global membership, defined as 'more than half of the number of Fund members, or a membership in excess of half of the Fund's total voting pool'.
- 3 Whether other official creditors (mainly the Paris Club) have exempted an MDB from restructuring in the past.

Institutions not meeting these criteria would be deemed 'plurilateral' institutions, a new term coined by IMF.

IMF directors did not accept the staff proposal as official IMF policy (IMF, 2022b), preferring instead to judge each case individually. The IMF followed up with revised and simplified guidelines that generally follow the 2022 staff proposal, but with language clarifying that each case will be decided by the IMF board (IMF, 2024).

Central to the IMF's proposed criteria is a focus on an MDB's governance arrangements. It is not immediately obvious what these attributes have to do with whether an MDB should or should not merit PCT. It would seem more intuitive to consider the financial terms by which an MDB has extended lending to the sovereign, and its ability to extend concessional financing going forward to help the sovereign regain debt sustainability. Such an approach would be more in line with the net positive flows criteria agreed at the GSDR.

The capacity of an MDB to provide low-cost financing is certainly linked to its governance. MDBs with wealthier country shareholders tend to have higher bond ratings, lower funding costs and therefore lower loan rates. But it is not determinative. Some MDBs that do not meet the IMF shareholding criteria, such as Development Bank of Latin America and the Caribbean (CAF) and the Central American Bank for Economic Integration (CABEI), have higher bond ratings than any of their shareholders and can provide low-cost financing to members, especially in emergency situations.

The use of shareholding criteria by the IMF could fuel suspicion that it is protecting the interests of the creditor governments that dominate IMF and World Bank governance. The more debt that is excluded

from restructuring due to PCT, the more financial losses need to be borne by other creditors (official and commercial) to get a country's external debt back to what the IMF deems sustainable. It is therefore in the interests of creditor governments to limit the amount of MDB debt benefiting from PCT.

In background discussions for this project, Paris Club officials indicated that the most important criteria within the Common Framework are twofold. First, the MDB must be a non-profit institution. Second, MDB lending must be at concessional or quasi-concessional rates and contribute to net positive flows to the debtor country, to help return the country's debt to a sustainable trajectory.⁸

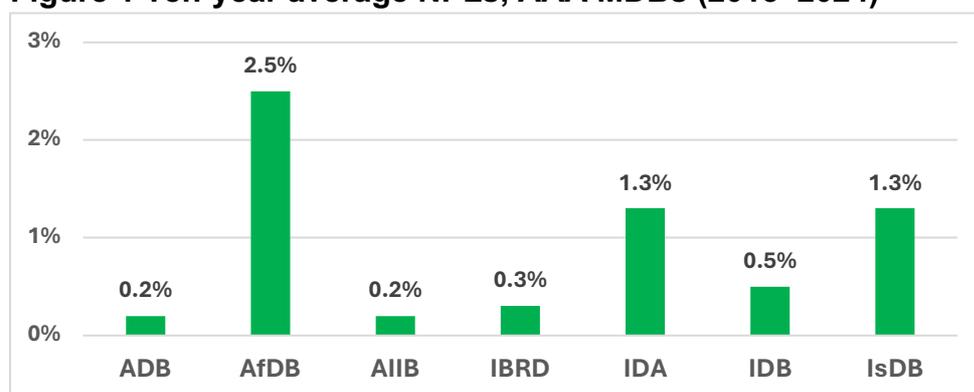
How the IMF and other creditors assess the PCT of different MDBs would benefit from clarification and alignment among the main stakeholders. The GSDR – which includes debtor nations as well as the Paris Club, the G20, the IMF, the World Bank and commercial creditors – may be the most appropriate forum to address the issue.

⁸ The concessionality definition of the OECD's Development Assistance Committee is taken into account as a benchmark by official creditors, although it is not the sole criterion.

3 What is PCT worth to MDB financial strength?

The benefits of PCT to MDB sovereign loan portfolio performance can be seen in the very low levels of non-performing loans (NPLs) over the past decade across the major MDBs that lend entirely or mostly to sovereign borrowers (Figure 1). Some MDBs with lower bond ratings also have strong NPL records, suggesting that PCT is not exclusive to AAA-rated MDBs (Figure 2).

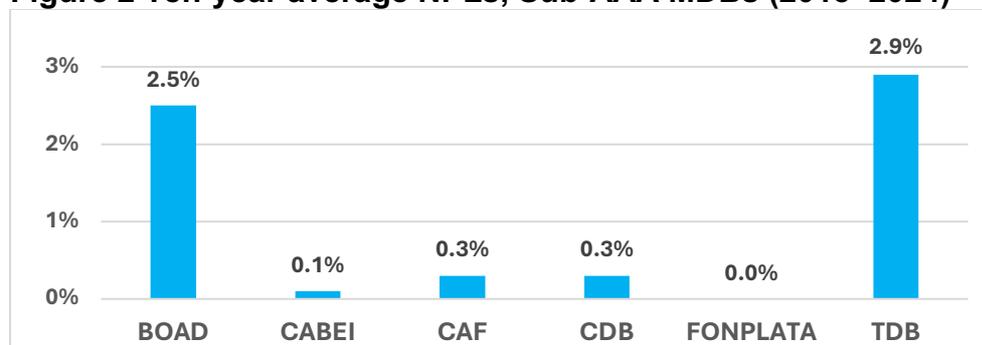
Figure 1 Ten-year average NPLs, AAA MDBs (2015–2024)



Source: Moody's (2025)

Note: Measured as non-performing assets as share of development-related assets. All sovereign loans for IBRD, IDA, IDB and Islamic Development Bank; includes non-sovereign loans for ADB (7%), AfDB (15%) and AIIB (15%). IDA is concessional loans; other MDBs are non-concessional loans.

Figure 2 Ten-year average NPLs, Sub-AAA MDBs (2015–2024)



Source: Moody's (2025)

Note: Measured as non-performing assets as share of development-related assets. All sovereign loans for FONPLATA; includes a share of non-sovereign loans for BOAD (23%), CABEI (10%), CAF (9%), CDB (6%), TDB (36%).

In 2024 IBRD, ADB and IDB reported historical statistics on default and recovery performance for sovereign borrowers, providing detailed evidence for the impact of PCT (Table 1). IBRD and IDB had zero sovereign loan non-accruals⁹ for the first several decades of their operations until the 1980s, and since then non-accrual events have been few for all three MDBs. All loans and interest have been eventually repaid in every case,¹⁰ with the only losses to MDBs coming from foregone interest on delayed interest payments.¹¹

Table 1 Default and recovery statistics for IBRD, ADB and IDB

	IBRD	ADB	IDB
Number of Non-Accrual Events	27	10	8
Average Annual Default Rate	0.7%	0.9%	0.5%
Average Loss Given Default	9.6%	3.8%	2.0%

Source: World Bank (2024b); ADB (2024); IDB (2024)

Note: Sovereign loans only. IBRD 1947–2023, although average default rate is from 1981 to 2023 (zero defaults prior to 1981); ADB 1990–2023 concessional and non-concessional lending; IBRD and IDB non-concessional only.

For perspective, S&P data shows that non-MDB creditors to sovereign borrowers in the ‘B’ rating range (roughly in line with the average borrower rating of IBRD, ADB and IDB) experienced a default rate of 2.6% between 1975 and 2024 – four to five times that faced by these MDBs (S&P, 2025a). MDB loss given default levels – the amount an MDB fails to eventually recover when a borrower goes into arrears – are 2–10%, far below the 45% that the Basel guidelines recommend commercial banks use for sovereign exposures (BCBS, 2023) and the 47–52% estimated by Moody’s (2022).¹²

Risk Control, an independent consultancy firm with experience in MDB finances, analysed PCT using data from 1991 to 2020 (Risk Control, 2022; 2023). The studies found that MDBs were 3.5 times less likely to face a default compared to commercial lenders exposed to the same sovereign borrower and experienced total economic losses 14 times lower than commercial lenders. Another Risk Control study shows that, using standard banking industry approaches, MDBs should require three to four times less equity capital compared to when not accounting for PCT (Risk Control, 2025).

⁹ Because MDBs all have a policy of not writing off sovereign loans, they do not use the term ‘default’ but rather ‘non-accrual’, indicating that the borrower is past-due on loan payments for a certain length of time (90 or 180 days).

¹⁰ Apart from the Highly-Indebted Poor Countries and Multilateral Debt Relief Initiative international debt relief efforts.

¹¹ ‘IBRD has a policy of not charging interest on overdue interest. The late payment of overdue principal and interest therefore leads to an economic loss for IBRD due to the present value of the payments IBRD receives at the time of arrears clearance being lower than the present value of the contractual cashflows, i.e. if the non-accrual did not occur. The magnitude of the present value loss depends on the length of time the loan stays in non-accrual and the prevailing interest rates’ (World Bank, 2024).

¹² IBRD losses relate mainly to a few fixed-rate loans issued during a period of high interest rates.

4 How do credit rating agencies evaluate PCT?

The ‘Big Three’ credit rating agencies – Standard & Poor’s (S&P), Moody’s and Fitch – factor PCT into their MDB rating methodologies in very different ways and with sharply different results. A more standardised approach to PCT across MDBs and greater information sharing – partly motivated by the G20 Independent Review of MDB Capital Adequacy Frameworks (G20, 2022) – has led to changes in rating agency accounting for PCT, notably in S&P’s recent MDB methodology revision (S&P, 2025b). Nonetheless, divergence on PCT across rating methodologies remains an important restriction on MDB capital adequacy headroom. This section briefly compares the way the three agencies account for PCT in their methodologies.

4.1 S&P

S&P (2025b) builds MDB ratings from two components: the Financial Risk Profile (capital adequacy and liquidity), and the Enterprise Risk Profile (governance, management and policy importance).

PCT impacts both components. S&P calculates PCT by reviewing the arrears status of every sovereign to which an MDB lends. These calculations are used to reduce the risk weightings of each sovereign exposure for an MDB. The exposures are then summed up to arrive at the total value for an MDB’s risk-weighted assets (RWA). The revised 2025 S&P methodology reduces the amount of RWA by 40–54% for 10 major MDBs in 2024, due to increased benefit accorded to PCT as well as a reduced penalty for portfolio concentration (S&P, 2025c).

RWA serves as the denominator to calculate S&P’s Risk-Adjusted Capital (RAC) ratio, the benchmark MDB capital adequacy metric:

$$RAC = \frac{\text{Total equity}}{RWA}$$

The RAC score is ranked in seven categories (‘Excellent’ to ‘Very Weak’). This ranking is adjusted according to various risk factors to arrive at the final capital adequacy assessment. S&P’s approach to factoring both lower probability of default as well as lower loss given default into each country exposure making up an MDB’s portfolio has a substantial positive impact on the capital adequacy metric, especially following the 2025 revision. The RAC is combined with a

liquidity assessment (which tends to be strong and stable across all major MDBs) to arrive at the overall Financial Risk profile.

To assess an MDB's policy importance, S&P aggregates the arrears of all sovereign borrowers into an overall arrears level. Depending on the percentage of the loan portfolio in arrears, each MDB is ranked in one of five categories ('Very Strong' to 'Weak'). This ranking is one of several factors that determine an MDB's policy importance. The arrears level required to be either 'Very Strong' or 'Strong' is relatively easy to achieve, meaning all major MDBs benefit from PCT in this part of the rating assessment.

The financial and policy metrics are combined in a single matrix to arrive at an MDB's standalone credit rating, which can then be adjusted further by other factors (notably callable capital). Hence, PCT plays an important role in supporting both sides of the standalone evaluation by S&P.

4.2 Moody's

The main building block of Moody's MDB methodology is the financial profile, broken down into capital adequacy and liquidity (Moody's, 2024). This core financial profile is adjusted with assessments of MDB management, policy importance and membership support to arrive at the final rating.

Capital adequacy has three sub-factors. The first (40% of capital adequacy) is an unweighted ratio between an MDB's assets and equity. Assets are not weighted by their risk, which differs from the other two agencies and has been a cause of complaint from MDBs.¹³ Hence, it is not possible to use PCT to modify the risks of individual loan exposures, as done by S&P (and Fitch, as described below).

The second factor, NPLs, accounts for 40% of capital adequacy. Because NPLs reflect the lower probability of default of MDBs, it automatically reflects PCT. However, the NPL ratio does not reflect MDBs' much lower loss given default compared to commercial creditors, since MDBs do not restructure their loans, which is a critical aspect of the value of PCT to MDB financial strength.

PCT is also included in the asset quality assessment, which is the third factor (20%) of the capital adequacy score. Should an MDB have a sufficiently strong repayment record (no cut-off levels are defined), an MDB will get a one letter-notch uplift in the average rating of the asset portfolio. This is a binary measure: either MDBs receive the one-notch benefit, or they do not. Most major MDBs focused on sovereign lending receive the benefit, according to the

¹³ Unweighted asset ratios have largely been supplanted by risk-based approaches inspired by the Basel guidelines for commercial banks. Among other issues posed by this unweighted metric, MDBs highlight that the benefits of risk transfer techniques (like portfolio guarantees, credit insurance or synthetic securitisations) are weakened by not taking repayment risk into account.

latest Moody's data (Moody's, 2025). This sub-factor includes lower loss given default as well as lower probability of default.

The Moody's approach of not risk-weighting exposures to incorporate PCT is not inherently problematic, since PCT still lifts the overall portfolio quality assessment. However, the cap on degree of PCT uplift, the mechanics of how the portfolio quality component is weighted and feeds into the overall financial assessment, and the relatively lower benefit given for loss given defaults mean that PCT does not play as significant a role compared to S&P.

This can be seen in the scoring. None of the major MDBs gets more than an A1 rating for their capital adequacy (four notches below Aaa), and none has an Aaa stand-alone financial profile. All are awarded an Aaa final issuer rating only with an assessment of membership support uplift. This final assessment combines quantitative and subjective components. MDBs have complained that the demonstrated strength of their loan portfolios should mean they are able to achieve a higher rating without needing an uplift awarded by credit analysts over which they have limited visibility.

4.3 Fitch

Fitch uses a financial assessment as the core building block, subsequently modified with management and political factors, similar to Moody's. Fitch evaluates capital adequacy and liquidity and uses the lowest of these as the financial assessment score. Due to the generally very high and little-changing liquidity scores of the major MDBs, capital adequacy is in most cases the decisive factor.

The benchmark capital metric is the Fitch Risk Weighted Asset ratio. PCT can modify the risk rating of each country exposure by up to three notches from the normal weighting for a commercial lender. In a separate calculation, PCT is used to calculate the weighted average risk of the loan portfolio as a whole. Here again, PCT can lift the entire portfolio's risk assessment by up to three notches. The capital and risk metrics fall into one of four categories, which are then matched in a matrix to arrive at the overall solvency rating.

The main measure of PCT is the default rate of sovereigns to MDBs (i.e. the number of sovereigns in default to a supranational entity in a given year divided by the total number of sovereign borrowers to this entity) compared with the default rate of the same pool of sovereigns to private creditors (Fitch, 2025). This differs from how S&P measures PCT, which looks at how MDB sovereign loans perform without comparison to sovereign loans from other creditors. The timeframe over which Fitch calculates PCT is unclear, but MDB officials have said they believe it to be up to 20 years, meaning non-accrual events can weigh down MDB PCT benefits long after they are resolved.

After finalising an MDB's financial assessment, Fitch evaluates its business environment, the results of which can increase or decrease the financial assessment by up to three notches. PCT can play a role in the 'importance of the public policy mandate' sub-factor, which has a 10% weight in the business environment score. The 'credit quality' score (12.5% weight) does not include PCT, and can be important (for example, in weighing down AfDB's rating currently). In sum, PCT is a relatively minor factor in the business environment assessment.

In its revised 2024 methodology, Fitch shifted to a more risk-based approach to capital adequacy, which is a positive change. However, the weight given to PCT does not appear sufficient to overcome other aspects of the Fitch methodology, limiting the capacity of the major MDBs. For example, AfDB recently reported that it had refined its approach to PCT, releasing 23% more lending capacity under its own capital adequacy framework, but it could not use that capacity due to constraints imposed by Fitch's methodology (G20, 2025: 19).

4.4 Overall comparisons

A detailed analysis of whether the uplift granted to PCT in rating agency methodologies is aligned with the empirical impact of PCT on MDB financial performance is beyond the scope of this paper.¹⁴ That said, a few points are worth noting.

First, each agency measures PCT differently. S&P looks at sovereign arrears over 10 years and places each exposure in one of three categories based on its track record with the MDB. Fitch looks at each sovereign's arrears to an MDB compared to commercial creditors to the same sovereign, over an undefined time period. Moody's combines the two approaches by considering sovereign arrears to an MDB in themselves, as well as sovereign arrears to an MDB compared to other creditors. Both S&P and Fitch define arrears as 180 days overdue, while Moody's uses a stricter 90 days.

Second, the way S&P and Fitch use PCT to modify risk weightings of each sovereign exposure includes both the lower probability of a default as well as the lower level of financial losses in the event of a default. Moody's, by contrast, only accounts for probability of default in its NPL metric in capital adequacy, thus missing the very important fact that MDBs eventually recover almost all of the money they are owed. Low losses are included in Moody's' assessment of portfolio quality, but only in 20% of the capital adequacy score.

Third, S&P's methodology includes PCT once in the capital adequacy metric and again in the policy importance of an MDB. The way each of those metrics is structured gives PCT considerable weight. Fitch also includes PCT twice, although Fitch gives less PCT benefit than S&P in both the risk-weighted asset and policy importance metrics. Moody's includes PCT in one metric, using cut-off levels that make it

¹⁴ See Risk Control (2022; 2025) for a technical discussion.

difficult for an MDB to achieve a high ranking.¹⁵ Moody's also implicitly includes PCT in its non-performing asset metric, although that does not include the low loss rates experienced by MDBs.

Fourth, S&P grants PCT uplift to MDBs that have up to 75% of their lending to non-sovereign borrowers, which in principle do not benefit from PCT. Moody's, by contrast, grants PCT uplift to MDBs with a maximum 25% non-sovereign lending, although it can offer benefit beyond that level in certain cases (for example, EBRD). Fitch has a sliding scale approach offering different levels of benefit according to the share of sovereign lending in the portfolio.

Greater standardisation of how MDBs themselves incorporate PCT into capital adequacy frameworks would encourage the agencies to take a more aligned approach, as proposed in a recent G20 report (G20, 2022). As Fitch notes, 'given the unregulated nature of MDBs, and the various ways that each MDB reports capital adequacy, the reports by MDBs and GEMs do not provide guidance on how to reflect the stronger loan performance in MDBs' capital adequacy' (Fitch, 2025: 3).

MDBs themselves recognise the value of a more harmonised approach to PCT in promoting convergence in rating agency methodologies, as expressed in a recent report by a collective of MDBs: 'Greater consistency of definitions across MDBs would enable the sector to present a unified voice when engaging with CRAs ... certain elements are critical and common across all MDBs, such as their reliance on PCT (for sovereign-guaranteed lending)' (MDBs, 2025: 16).

¹⁵ The highest 'bucket' for overall PCS ranking for S&P is 0.5% arrears or less, and the second is 5% arrears or less. For Moody's, the highest bucket is 0.5% arrears or less, and the second is 0.5–1% arrears. S&P's second bucket (out of five) of 5% or less would be equivalent to Moody's fifth out of eight buckets.

5 MDB mobilisation instruments and PCT

As MDBs explore new ways to mobilise private capital, protecting PCT is a central policy concern due to its importance in MDB financial strength and credit ratings. This section considers the implications that new mobilisation techniques might have for PCT and MDB sovereign lending. Risk transfers of sovereign loans to external counterparties are the main focus. The section also addresses MDB guarantees on sovereign loans and investments in MDB share capital.

5.1 Risk transfers

MDBs have increasingly sought to manage their balance sheets and catalyse new investment through risk transfers. These allow MDBs to shift the risk of their loans not being repaid to third parties – private insurers, investors or official donors – in return for a fee. This risk transfer frees up scarce risk capital to be redeployed for more development lending.

Risk transfers with commercial investors have picked up pace in recent years through credit insurance and securitisation deals, although they have mainly involved non-sovereign MDB loans (see Humphrey and McHugh, 2026). In part this is for financial reasons: non-sovereign loans are close to market terms, making it possible to attract investors to take on repayment risk at a financial cost that makes sense to the MDB.

However, the appeal of risk transfers is especially strong for MDB sovereign loans. These loans tend to be very long maturity, locking up MDB risk capital for two decades or more in some cases. Shifting the repayment risk of those loans off MDB balance sheets after loan project disbursement could open up substantial new lending capacity.

The problem is that sovereign loan risk transfers to an external party – especially a commercial investor – could impact PCT. If done at scale, borrower governments could start to feel that their loans are not with the MDB, but rather with anonymous investors to which they have no particular allegiance. That could weaken their willingness to prioritise repaying the loans in a time of financial stress. Other creditors (including, potentially, official creditors) might not agree that an MDB loan should be exempt from restructuring in a sovereign debt crisis if they feel that the exemption is benefiting investors rather

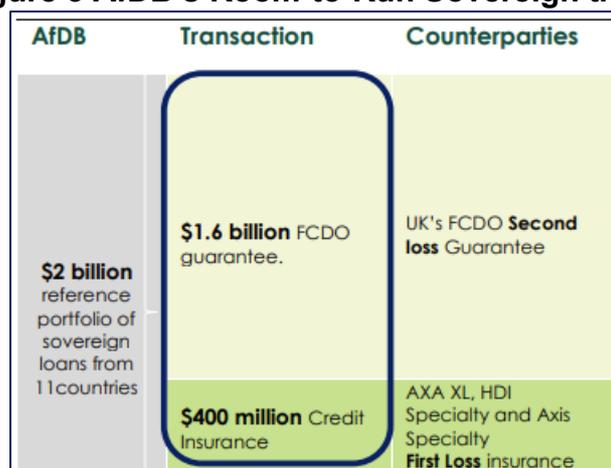
than the originating MDB. Concern about PCT has limited risk transfers on MDB sovereign loans.

5.1.1 Commercial risk transfers

Thus far, two major MDBs have undertaken a total of three commercial risk transfer transactions with their sovereign loan book, in all cases with insurance firms. A third, smaller MDB has done a sovereign loan securitisation.

The first was AfDB's Room-to-Run Sovereign transaction in 2022 (AfDB, 2022; Humphrey, 2022), which transferred a portion of the loan risk from 11 sovereign borrowers to private insurers and the UK government (Figure 3) in return for an undisclosed fee. The transaction allowed AfDB to expand lending headroom by up to \$2 billion.¹⁶ The UK accepted a below-market return to subsidise the pricing of the risk transfer (MOBILIST, 2025). Without UK government support, the deal would not likely have been financially viable for AfDB, as it would have had to pay investors a return well above what it earns on its sovereign loans.

Figure 3 AfDB's Room-to-Run Sovereign transaction (2022)



Source: AfDB, 2022

In 2023 and 2024, the IDB paid for credit risk insurance coverage on its sovereign loan portfolio, the first on a \$300 million portion of its exposure to one country and the second on \$300 million in loans to two countries. In the first transaction, the risk was distributed across 14 private insurance firms, while the second involved seven firms. These transactions were done on a purely commercial basis. The cost of the deals (relative to what IDB earned on the loans) may have been offset by the financial benefits to IDB of reducing loan portfolio concentration, helping its bond rating metrics and freeing more lending space for large borrower countries.

In all three transactions, IDB and AfDB remained the lender of record in charge of pursuing recoveries for the private insurance firms

¹⁶ The actual amount depends on the assessed risk of the new loans offered by AfDB. If the new loans are less risky than those in the Room2Run deal, more than \$2 billion could in principle be committed.

should any loans go into non-accrual or be caught in a sovereign restructuring. This was essential to ensure that pricing adequately reflected the low risk facing investors. Without PCT, the investors would have demanded a higher return to take on repayment risk, making the transactions financially unattractive to the MDB.

Sources at AfDB and IDB indicated that PCT concerns were alleviated mainly because of the small scale of the transactions involved. One of the MDBs sought confirmation ahead of time that the Paris Club would respect the PCT attached to these loans, despite the risk transfer, and not demand their restructuring in the event of a sovereign default. The other MDB felt that Paris Club confirmation was not necessary. Both suggested that they would think carefully about any future transactions to ensure no threat to their PCT.

The West African Development Bank (BOAD) executed a securitisation deal in 2023 (BOAD, 2023), shifting 24 sovereign BOAD loans with a face value of \$264 million to a BOAD-controlled subsidiary, which issued bonds based on the cash flow from the loans. The seven-year bonds paid 6.1% interest¹⁷ and were marketed mainly to regional pension funds and insurance companies as well as some impact-oriented international investors. BOAD staff said in an interview that the implications for the bank's PCT were carefully considered in structuring the deal. Pricing was less problematic for BOAD because it charges sovereign borrowers financial terms closer to market rates, unlike the AAA-rated MDBs.

Are MDBs being overly cautious? According to Galizia et al. (2021), correctly structured sovereign risk transfers should not compromise PCT. The authors argue that scale is relevant: at a very large scale, such operations could threaten the credibility of PCT. They also acknowledge a potential concern that countries might selectively default on loans whose risk has been transferred to third parties, but conclude that this risk can be prevented by structuring the arrangements correctly, with the MDB remaining lender of record.

Staff of two major MDBs consulted for this paper said that they view sovereign risk transfers as not viable at scale, due to the need to avoid any threat to their PCT, as well as pricing considerations. They agreed that sovereign risk transfers may be helpful at the margins, especially for regional MDBs facing concentration risk, but in the current policy environment are not a realistic option to address MDB sovereign lending capacity at scale.

Moving forward with commercial risk transfers at a higher volume and on a regular basis – along the lines of the 'originate-to-share' approach of IDB Invest and IFC for non-sovereign loans (see Humphrey and McHugh, 2026) – would only be possible if official creditors were to give clear signals of support. Absent such clarity, MDBs would be endangering the exclusion of their loans from

¹⁷ BOAD staff noted that pricing was set to ensure that BOAD did not pay more for the transfer than it earned on the loans.

restructuring in the event of a sovereign default. Even with greater clarity from official creditors, MDBs would need to ensure that risk transfers do not undermine the commitment of borrower countries to repay MDB loans. They would also have to address the financial mismatch between MDB sovereign loan pricing and the cost demanded by commercial counterparties for risk transfers.

5.1.2 Official risk transfers from member governments

Risk transfers with official counterparties – whereby a highly rated member government guarantees a portion of an MDB’s loan portfolio, thus freeing up risk capital – have become increasingly common in recent years due to their financial efficiency.¹⁸ Sweden pioneered the technique with its 2016 guarantee to ADB on loans to India (ADB, 2016), and it has since been replicated in support of lending to individual countries. More recently, MDBs have scaled this up on a portfolio basis (ADB, 2023; Government of Canada, 2025; World Bank, 2024d).

Official risk transfers could pose issues for PCT if creditor governments offer a guarantee on an MDB loan (which would be exempt from restructuring in a default scenario) instead of making the loan directly themselves (not exempt from restructuring). Guarantees on individual World Bank loans stipulate that the guarantor country – rather than the World Bank – is responsible for seeking recoveries in the event of a default, to mitigate this concern.

According to the management of three MDBs as well as Paris Club officials, official portfolio guarantees do not pose a problem because they represent broad, ex-ante support for overall MDB capacity and risk sharing. A more uniform approach to the terms of portfolio guarantees, particularly in relation to recoveries, would be useful to avoid problems in the event of a sovereign restructuring.

5.2 MDB Sovereign Bond Guarantees

PCT questions could also arise when an MDB provides a guarantee to assist a recipient government borrow from commercial lenders. The issue was highlighted by the experiences of World Bank guarantees to support government bonds of Argentina and Ghana. When those governments defaulted, in 2001 and 2022 respectively, investors called on the guarantees and the World Bank paid out. The payments were then automatically converted into loans by the World Bank to Argentina and Ghana, which were protected by PCT during the sovereign debt restructurings.

The World Bank guarantees effectively transformed a private claim of bondholders into a PCT-protected multilateral claim. Investors were

¹⁸ For example, the US government required budgetary provisioning for about 1/12th of the guarantee amount for its investment in ADB’s IF/CAP, and the guarantee can be leveraged at the same level as paid-in capital (about 1:5), translating into about 60 times’ leverage for each dollar of budgetary provisioning.

repaid, while the World Bank became a new creditor sitting above others in the repayment hierarchy.

These arrangements pose questions about the appropriate role of the PCT of the World Bank and other MDBs offering sovereign guarantees, potentially distorting commercial markets and disrupting the comparability of treatment principle during a sovereign restructuring. As with portfolio guarantees discussed above, the main concern is recoveries in the event of a default, and how this is perceived by other creditors.

Greater clarity on the PCT implications of sovereign guarantees would be helpful in light of a strong push for MDBs to make greater use of the instrument (G20/OECD, 2025). The World Bank recently undertook debt-for-development swaps in Benin (2024) and Côte d'Ivoire (2025) using guarantees to support commercial borrowing by the sovereigns and plans to scale these up further (Global Markets, 2025).¹⁹ Other MDBs have also offered sovereign guarantees in recent years, although they are a very small share of the loan portfolios (Table 2).

Table 2 MDB Sovereign Guarantee Portfolios (2024*)

	ADB	AfDB	IBRD	IDA	IDB
Guarantees (billions US\$)	0.3	1.2	3.8	1.6	1.4
Guarantees (% of portfolio)	0.2%	4.5%	1.3%	0.7%	1.2%

Source: MDB financial statements, 2024

* IBRD and IDA are as of end-June 2025 (World Bank fiscal year).

World Bank sources stated that sovereign guarantees do not pose a challenge to PCT in the same way as risk transfers to commercial counterparties. The Bank views these guarantees as sharing its AAA rating with the borrower, just as it does with regular World Bank bond investors. Making investors whole when a guarantee is triggered is thus a defence of its AAA, rather than sharing its PCT with investors. To avoid complications like those arising in the cases of Argentina and Ghana, and to facilitate restructuring negotiations, Bank staff indicated that they will be cautious in structuring sovereign guarantees and only use them for bank loans rather than sovereign bond issues.

The distinction between how PCT benefits MDB bond buyers and other types of commercial investors is a fine one. Establishing

¹⁹ The World Bank's Multilateral Insurance Guarantee Agency (MIGA) has also ramped up its coverage of sovereign debt in recent years, with \$5.9 billion in sovereign exposure and another \$9.3 billion to state-owned enterprises as of June 2025 (MIGA, 2025). However, in the event of a default, MIGA's coverage does not convert into a loan, and MIGA must seek recoveries on its own, hence this may not pose PCT issues.

guidelines supported by official creditors would help inform policy and operational decisions by MDBs, borrowers and investors.

5.3 MDB Capital Structure

MDBs could also mobilise commercial investors by inviting them as shareholders. This would be financially powerful, as every dollar in share capital is leveraged several times. However, accepting commercial shareholders could weaken the non-profit, developmental nature of MDBs, since commercial shareholders would expect a financial return.

This issue arose with two Southern-led MDBs. Afreximbank has accepted dividend-earning shareholders since its inception in 1993. It has four share classes. Class A shares (around 65% of total as of end-2024) are controlled by African sovereigns and the AfDB. Classes B and C are owned by a mix of African and international official and commercial investors, and D shares are open to retail investors and traded on a public exchange. Dividends have risen in recent years from \$28 million in 2015 to \$88 million in 2020 and \$300 million in 2024 (Afreximbank, 2024).

Trade and Development Bank (TDB) in southern and eastern Africa was originally purely government-owned but opened its share structure to institutional investors in 2013. By 2023 TDB had 19 non-sovereign shareholders accounting for 27% of total shareholding, with 27 sovereign governments (and AfDB) accounting for the remaining shares. Dividend payouts have been modest, at about \$2–5 million per year, with remaining net income retained in the bank.

Both TDB and Afreximbank were caught in a complex negotiation related to sovereign restructurings in Ghana, Malawi and Zambia. IMF and official creditor sources highlight their dividend-earning shareholders as a key reason to deny them PCT and require that their loans be restructured (Humphrey, 2025). In part because of this, TDB reorganised its shareholding structure to eliminate dividend-earning shareholders. Afreximbank has not changed its shareholding.

Only two other MDBs that the authors are aware of have non-sovereign shareholders. At CAF in Latin America, a group of 13 commercial banks from the region have a tiny (0.05%) shareholding stake. Similarly, a group of commercial banks accounts for about 0.5% of shareholding of the EADB. Both MDBs have statutory provisions permitting dividends (as do almost all MDBs, including the World Bank) but have never issued them.

According to the IMF proposed policy discussed in Chapter 2 (IMF, 2022a), the existence of non-sovereign shareholders is an automatic reason to consider an MDB like other commercial creditors. Presumably the reason for IMF's criteria is not the mere existence of non-sovereign shareholders, but rather as a sign that the MDB is operating as a for-profit institution. That does not seem to be the

case for either CAF or EADB, suggesting that the IMF might consider refining the criteria to focus on dividend payments.

Discussions with creditor government officials and MDB management suggest that it may be possible to create a non-voting share class for MDBs that does not pose a threat to PCT. Financial returns would need to be restricted to more like a fixed-income investment, rather than normal equity dividend, and may only be relevant for philanthropic or impact-first investors. Governance implications and tradability of shares, among other issues, would also need to be addressed.

Hybrid capital instruments, recently launched by AfDB, CAF and BOAD and under consideration at several other MDBs, bolster MDB capital and pay a return to investors. At the margins, the investor return is paid for by higher charges on MDB development loans, which could be perceived as profit similar to a dividend. According to Paris Club sources, the fact that hybrids are a fixed-income instrument and investor return does not vary dependent on annual net income (as is the case with share dividends) is a key reason why hybrids are not seen as problematic for PCT.

6 Conclusions and policy implications

PCT is a central pillar of the MDB financial model, underpinning superlative sovereign loan portfolio performance, high credit ratings and low funding costs. However, PCT is a customary practice with uncertain parameters and no accepted legal basis. The growing diversity of multilateral lenders and the efforts of MDBs to mobilise external investors are posing new questions about PCT.

The broad conclusion of this paper is that mobilisation of sovereign MDB loans should be undertaken with caution. With careful deal structuring around issues like financial benefits to borrowers, responsibility for recoveries and the non-profit nature of MDBs, sovereign mobilisation can be done safely via risk transfers, sovereign guarantees or non-voting share classes. However, undertaking mobilisation on sovereign loans at scale is not realistic in the current policy framework, as it could undermine the fragile consensus that underpins PCT.

A more systematic and broadly agreed approach to PCT would help MDBs, borrower governments and private sector actors better understand when, how and to what extent MDBs can mobilise in relation to sovereign lending. The Paris Club will discuss the implications of MDB mobilisation techniques for PCT with its membership, and it may be useful to take this up in the Global Sovereign Debt Roundtable.

6.1 Policy options to improve clarity on PCT

The main issues to be considered by policy-makers are threefold.

First, MDBs would benefit from more guidance on how mobilisation techniques linked to sovereign loans might affect their PCT. This relates principally to risk transfer transactions with commercial counterparties, but is also relevant to official risk transfers and sovereign guarantees.

The criteria used to evaluate whether loans involving external partners (commercial or official) would be exempt from restructuring should be made more explicit. The key issues revolve around recoveries in the event of sovereign defaults. It would be best to address this in advance rather than during a restructuring, to give MDBs greater clarity on appropriate avenues to explore.

It could be possible for official actors to arrive at a new consensus on the need for MDBs to mobilise commercial investment at greater scale on sovereign loans. This would require clear signals that MDB loans would be protected in a sovereign default, and guidelines for how mobilisation arrangements should be structured to avoid challenges to PCT. Discussions with policy-makers for this paper have not indicated that such a change is being contemplated, but that could change in light of development needs and restricted MDB sovereign lending capacity.

Second, greater clarity is needed on deciding which MDBs should benefit from PCT, and in which circumstances, particularly in light of the growing number of MDBs active in many developing regions. A systematic review of the key criteria used to decide how other creditors would treat an MDB's loans in a restructuring event would be useful to orient MDBs, borrower governments, the IMF and other creditors.

The focus should be on the financial terms of the loans in question and the commitment and capacity of the MDB to continue providing net positive financial flows going forward. As part of this effort, the IMF should consider revising its staff guidelines on lending into arrears to move away from a focus on MDB shareholding structure. The GSDR might be an appropriate forum to address the issue, as it includes the IMF, Paris Club creditors, G20, other official creditors (including China), commercial creditors and borrower country representatives.

Third, credit rating agency methodologies give widely divergent benefits for PCT in their evaluation of MDB creditworthiness. S&P give substantial uplift, while Fitch and Moody's are less generous. Neither Fitch nor Moody's appears to value the lower likelihood of default or the much lower loss given default due to PCT in their methodologies to the degree suggested by the empirical evidence.

Rating agencies should ensure that their MDB methodologies adequately reflect the financial value of PCT to MDB creditworthiness, based on empirical evidence. MDBs can help by continuing to work towards a more uniform and transparent method for incorporating PCT into their own capital adequacy calculations.

6.2 Options to mobilise on sovereign MDB lending without impacting PCT

MDBs can consider other innovations to mobilise external resources for sovereign lending capacity that do not negatively impact PCT.

Option 1: Develop other techniques to recycle sovereign-guaranteed loans. The World Bank recently undertook an innovative operation to shift a sovereign-backed loan to a state-owned bank off its balance sheet (World Bank, 2024c). The borrower repaid the IBRD loan early and refinanced the loan with a commercial lender.

The World Bank is now embedding ‘step-up’ clauses in certain loan contracts giving an incentive to refinance with commercial lenders, with World Bank support to identify lenders and structure the loan. This is a creative way to recycle MDB lending capacity more quickly, although it is mainly useful for revenue-generating infrastructure facilities that can appeal to commercial lenders.

Option 2: Small-scale sovereign risk transfers, including in blended structures. Smaller-scale risk transfers of sovereign loans may be feasible in the current policy framework and can have a substantial positive impact in managing exposures to high-risk countries, especially for regional MDBs. Risk transfer to commercial counterparties without any subsidy is possible, but pricing will be a challenge due to below-market financial terms on sovereign loans. One option could be to mix sovereign loans in a larger pool of non-sovereign loans in securitisation vehicles such as the Bayfront Capital initiative supported by the Asian Infrastructure Investment Bank (AIIB, 2023). Risk transfers at scale should only be considered if the Paris Club and other stakeholders reach a new consensus on MDB mobilisation and PCT.

Option 3: Blended syndication arrangements. It could be possible for the MDB to lend to a sovereign at its traditional policy rate and commercial lenders provide the parallel B loan at market terms, thus creating a larger financial package at blended financial terms. The MDB would lead interactions with the borrower, provide technical support and oversee project implementation (including procurement and safeguards). This could be useful for large-scale, transformative infrastructure projects that are too expensive for an MDB to fund on its own balance sheet. It can also help promote emerging market infrastructure as an investable asset class.

Option 4: Ring-fenced, non-voting share classes for impact investors. Bringing in commercial investors as return-seeking shareholders is problematic as it calls into question the non-profit nature of an MDB and could undermine PCT. However, it may be possible to create a special share class that has no voting power and earns a return in line with what MDBs normally generate – i.e. the net income mostly used to build equity reserves. This could be attractive to impact-first investors seeking to support development while earning only a modest return above capital preservation, such as philanthropies or even individual retail investors with ethical priorities.

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