

Essay series | Sri Lanka: from debt default to transformative growth

Lessons from bondholder restructurings

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About this publication

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Acronyms

CAC	collective action clause
CCRIF	Caribbean Catastrophe Risk Insurance Facility
CF	Common Framework
CRDC	climate-resilient debt clause
DFC	U.S. International Development Finance Corporation
DSA	Debt Sustainability Analysis
ECA	export credit agency
GDP	gross domestic product
GNI	gross national income
HIC	high-income country
IADB	Inter-American Development Bank
IMF	International Monetary Fund
LIC	low-income country
LIA	Lending into Arrears
LIOA	Lending into Official Arrears
LMIC	lower-middle-income country
MAC	market access country
NPV	net present value
OCC	Official Creditor Committee
PV	present value
SCDI	state-contingent debt instrument
TNC	The Nature Conservancy
UK	United Kingdom
UMIC	upper-middle-income country
VRI	value recovery instrument

Lessons from bondholder restructurings

Summary

Sri Lanka is restructuring \$13 billion in US dollar bonds, about 16% of its 2023 gross domestic product (GDP), following its 2022 default. Drawing from the recent experiences of emerging market restructurings over the last decade, this essay synthesizes across nine cases of bondholder restructurings, drawing lessons on the speed and scale of restructuring. It evaluates the utility and limitations of legal instruments like collective action clauses (CACs) and state-contingent debt instruments (SCDI) in facilitating successful restructuring, emphasizing long-term debt sustainability and climate resilience. We conclude with three policy lessons for Sri Lanka and other sovereigns facing similar challenges.

1.1 Introduction

Following its default in 2022, Sri Lanka is negotiating debt restructuring deals with its external creditors. The largest component of this comprises \$13 billion of US dollar bonds, equivalent to around 16% of 2023 GDP.¹ What can Sri Lanka learn from the recent experience of other emerging market economies that have restructured external bonds?

We focus particularly on eight bondholder restructurings that have taken place over the past decade, plus Greece's 2012 bond restructuring, the largest in history. These cases are summarised in Table 1.1.

¹ Apart from these bonds, Sri Lanka's external debt includes a further \$11 billion of debt to official bilateral creditors and \$3 billion to commercial creditors (almost all of which is to China Development Bank). A further \$12 billion of debt to multilateral creditors (e.g. the International Monetary Fund (IMF), the World Bank and the Asian Development Bank) is not restructured as these creditors benefit from so-called 'preferred creditor treatment'.

2 Lessons from bondholder restructurings

Table 1.1 Case studies of recent bondholder restructurings

Country	Income classification	Restructuring process			Debt composition		Debt reductions			
		Start date ¹	Default date ¹	End (exchange) date ¹	Duration (in years)	External debt/GDP (%)	Bondholder/external debt (%)	NPV haircut (%) ²	Market haircut (%) ²	Debt treated (\$ billion)
Greece	HIC	Jul-11		Mar-12	0.7	192	n/a	64.6	76.9	261.4
Barbados	HIC	Jun-18	Jun-18	Dec-19	1.5	34	22	24.3	26.5	0.8
Ecuador	UMIC	Mar-20		Aug-20	0.4	59.4	40	42.4	40.8	17.4
Argentina	UMIC	Dec-19	May-20	Sep-20	0.8	56.9	49	36.2	51.6	65.5
Suriname	UMIC	Jun-20	Apr-21	Nov-23	3.3	164	28			0.7
Belize	UMIC	Nov-16		Mar-17	0.3	68	46	19.7	29.9	0.5
Zambia	LMIC	May-20	Nov-20	Jun-24	4.1	67.1	19			3.3
Ghana	LMIC		Dec-22	Jun-24 ⁴	1.5	46	45			13
Mozambique	LIC	Oct-16	Jan-17	Sep-19	2.9	84.2	7	11	6.3	0.7

Source: Authors' compilation from Cruces and Trebesch (2013) 2014 updated dataset; Asonuma and Trebesch (2016) 2020 updated dataset; and IMF (2020). Debt composition data from IMF Country Reports and Debt Sustainability Analyses. Bondholder to debt ratio for Greece not available.

Notes:

1. Start and end of restructurings correspond to either the announcement or default, and completion of exchange, respectively. They do not necessarily correspond to the start of talks with private sector creditors. Source is IMF (2020) for 2014–2020 restructurings and Asonuma and Trebesch (2016) for 2005–2013.
2. NPV (net present value) haircut is 1 - (PV of new bonds/PV of old bonds) and market haircut is 1 - (PV of new bonds/face value of old bonds). Source is IMF (2020) for 2014–2020 restructurings and Cruces and Trebesch (2013) for 2005–13.
3. Participation rate is CACs of bonds were triggered.
4. Exchange date for Ghana is date of agreement in principle with bondholders as bond exchange not completed at the time of publication.
5. Since the exit yield for Ghana is still unavailable at time of writing, we base NPV calculations on market reports (Amobila, 2024).

Although an informal process for debt restructuring has emerged over several decades (see Box 1.1), these experiences teach us that there are no simple blueprints for how best to conduct debt restructuring with bondholders, and approaches inevitably vary case by case.

To understand what processes can increase the likelihood of a swift resolution of negotiations, and ensure a sustainable balance of debt reduction for long-term growth prospects, we first look at the speed and scale of restructurings, and the factors associated with this. We then examine the instruments that have been used to facilitate restructurings, including CACs and SCDI. Given the rising costs of climate change and the links between climate investment needs and fiscal capacity for external debt repayment, we look at how actions to increase climate resilience can be integrated into the restructuring process.

We conclude with three lessons:

- 1. Timely, proactive and transparent engagement with creditors and stakeholders is crucial** to minimise the risk of protracted restructurings, and sequencing negotiations when there is a complex creditor mix. While not bulletproof, CACs are effective tools in streamlining negotiations.
- 2. Careful design of debt restructuring terms is needed to maximise debt relief.** Considered use of state-contingent tools should provide liquidity relief to the sovereign if economic conditions worsen, as well as gains to creditors if economic conditions improve.
- 3. Ensure future economic recovery and debt sustainability is climate-resilient.** Explore innovations such as climate-resilient debt clauses (CRDCs) and debt-for-conservation swaps in future debt issuances, once immediate debt restructuring is resolved.

Box 1.1 Sequencing of debt negotiations

While debt restructuring negotiations and outcomes are not standardised and vary significantly on a case-by-case basis, an informal process for restructuring debt has developed, with the following steps:

- 1. Request to International Monetary Fund (IMF):** Country requests an emergency loan from the IMF.
- 2. IMF Debt Sustainability Analysis:** If the IMF finds that debt is unsustainable, it can lend to a country only if it has credible assurances from bilateral official creditors that they will undertake a restructuring to restore debt sustainability (so-called ‘financing assurances’) and if a credible restructuring process with private creditors is underway.² The DSA (whose methodology varies depending on whether the country is a low-income country (LIC) or a market access country (MAC)) also sets the available financing envelope for debt service payments, so setting the amount of debt relief that a country must obtain from its creditors.
- 3. Paris Club and official sector creditors:** This group historically consisted of Paris Club donors and official financing agencies (such as export credit agencies). The prominence and scale of new official creditors from China, which is not a Paris Club member, have complicated proceedings. Within the G20 Common Framework (CF), official creditors including China have been represented under a single Official Creditor Committee (OCC). For non-CF countries, there will be more than one group of official creditors to deal with. Paris Club debt relief is conditional on ‘comparable treatment’ of private creditors and other official creditors.
- 4. Private sector creditors:** During the 1980s debt crisis, this consisted of commercial banks; it is now increasingly made up of private sector bondholders. In recent restructurings, sequencing has tended to proceed first with bondholders and then with commercial lenders, including Chinese state-guaranteed commercial lending and non-Eximbank loans.

This informal regime is widely perceived to be struggling to deal with a sovereign debt landscape made up of a greater diversity of creditors, most notably non-Paris Club official lenders, as well as domestic and international private creditors. This is leading to many suggestions for reforms to the Common Framework process, including clarifying timelines, suspending debt service during negotiations, creating clarity on the parameters for comparability of treatment between official and private creditors, expanding eligibility to all middle-income countries (Georgieva and Pazarbasioglu, 2021), and moving to simultaneous, rather than sequential, information-sharing and negotiations with official and private creditors (Hagan, 2023).

Source: Based on Buchheit et al. (2018) and Corsetti et al. (2023, pp. 106–107)

² The IMF Lending into Arrears (LIA) and Lending into Official Arrears (LIOA) policy allows it to lend to countries unable to meet debt repayment obligations to private creditors and official creditors, respectively, conditional on receiving financing assurances, and the borrowing country making ‘good faith’ efforts to reach a restructuring agreement with creditors and to restore debt sustainability (see IMF, 2022). Recent (2024) reforms to the LIOA policy, widely viewed as a means to break issues of deadlock with Chinese creditors, mean that the Fund will be able to lend to countries where no debt agreement or financial assurances with bilateral creditors has been reached, as long as ‘additional safeguards’ have been provided (see Jones, 2024).

1.2 Debt restructuring outcomes: speed and scale of debt relief

Two key parameters in assessing debt restructuring are the speed of restructuring and the scale of debt relief obtained. A debt restructuring process that is slow, or that does not resolve an unsustainable level of debt, can depress growth, as Latin America experienced in its ‘lost decade’ of the 1980s. However, there may be a trade-off between the two, with bondholders able to agree more rapidly to a shallower restructuring, and external and structural factors can influence both of these outcomes. However, in ensuring speedy, smooth restructurings, governments have considerable agency in their strategic approach, and in the legal instruments they can deploy.

Speed

In recent decades, most sovereign restructurings have been relatively fast, with an average duration of one year between either default, or initiation of a pre-emptive restructuring, and completion of the restructuring. The use of minimum participation thresholds and legal tools such as exit consents³ and CACs (see below) has successfully ensured high creditor participation and reduced holdouts.⁴ Early, proactive and transparent actions by governments tend to pay off, with pre-emptive exchanges (before a default has occurred) being completed significantly faster than post-default exchanges. Between 1978

and 2010, the average duration of pre-emptive debt restructuring was one year, whereas post-default restructuring was five years (Asonuma and Trebesch, 2016). These ‘hard’ defaults tend to reflect breakdowns in relations and an adoption of a more ‘coercive’ stance by sovereigns, often leading to more confrontational protracted negotiations (Ferry, 2023a).

However, there are also cases that have taken significantly longer. Litigation from holdout creditors, as well as confrontational stances between government and creditors, prolonged Argentina’s 2005 restructuring for over three years (with legal disputes concluded only 15 years after the initial default, in 2016). More recently, the complex creditor composition and a larger number of fragmented creditors also influenced the prolonged restructurings in Suriname and Zambia, which both took over three years (see Table 1.1).⁵ Across our cases, a greater plurality and diversity of creditor types tends to correlate with more protracted negotiations, particularly when both Paris Club and non-Paris Club creditors are involved (Figure 1.1). The challenge of creditor coordination and integrating newer, non-Paris Club, creditors into multilateral arrangements, as in the case of Zambia’s restructuring under the CF, also entailed extremely protracted negotiations around creditor comparability of treatment.⁶ In the case of Ghana, another CF country, these issues were less salient. Ghana chose to focus first

3 Minimum participation thresholds are a condition in debt restructuring that requires a certain level of creditor participation for restructuring to proceed. Exit consents are formal agreements that allow a majority of creditors to change the non-financial terms of the loan, overriding minority holdouts and motivating them to accept a restructuring offer.

4 See Bi et al. (2016). However, the authors note that, in cases where exit consents are used to extract too high a haircut, small creditors have a strong incentive to coordinate and holdout.

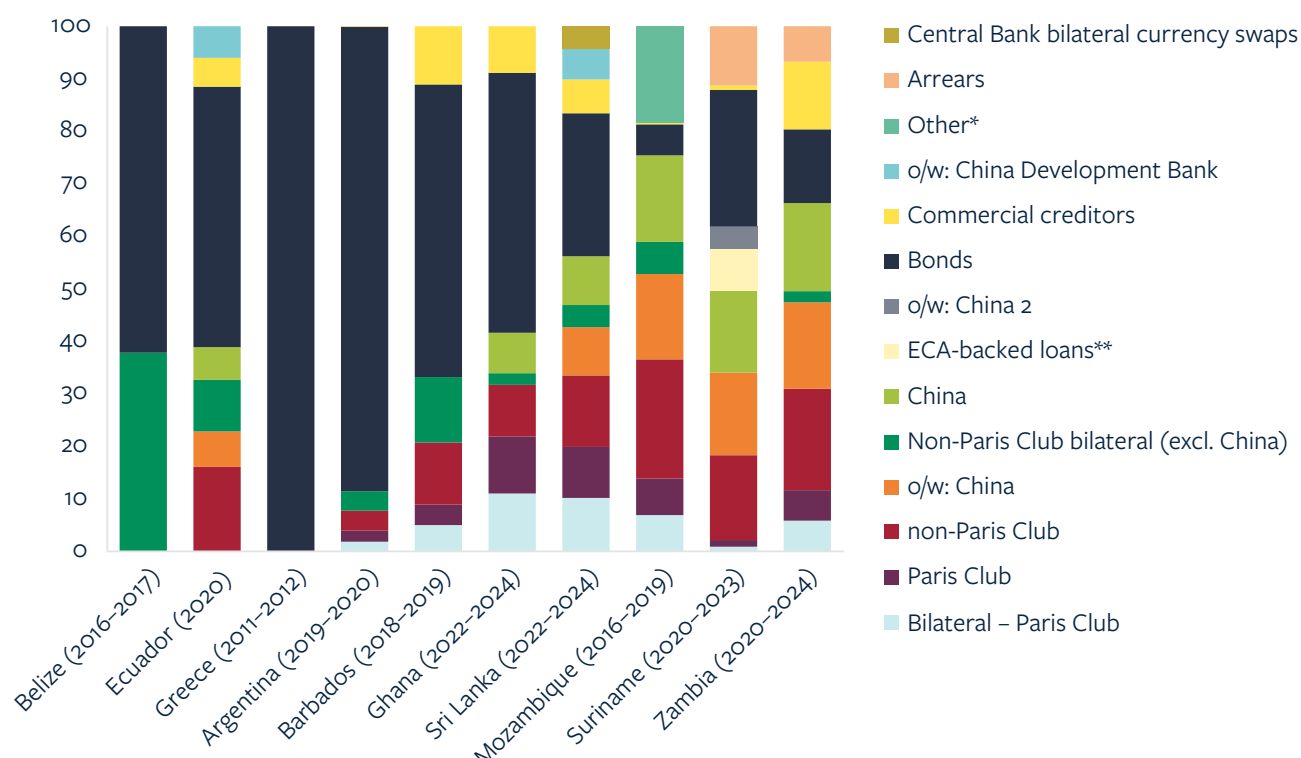
5 Zambia’s restructuring was agreed in principle in March 2024 but was not complete at the time of writing in May 2024.

6 Notably, the official creditors rejected a deal from bondholders in late 2023 over comparability of treatment concerns. Official creditors then accepted a revised agreement with bondholders, which offered slightly more debt relief, in March 2024.

on its domestic bond restructuring, while in its external restructuring non-Paris Club creditors were a smaller part of the creditor composition,

mitigating against some of the inter-creditor equity issues that had bogged down Zambia.

Figure 1.1 Creditor composition of external debt eligible for restructuring (%)



Source: Authors' compilation, based on IMF Country Reports and Debt Sustainability Analyses, Zettelmeyer et al. (2013), Bi et al. (2016) and Asonuma et al. (2018)

Notes:

Countries are ranked by duration of restructuring, shortest to longest. Debt to multilaterals is excluded.

* Mozambique's other private debt included \$2.8 billion in debt to its Liquefied Natural Gas Project partner ENG.

** Export credit agency (ECA)-backed loans in Suriname involve commercial lending guaranteed by official export credits and are classified under Paris Club as official sector lending, alongside bilateral loans. However, this norm has not applied to Zambia's ECA-covered loans from non-Paris Club lenders.

Meanwhile, Greece (2012), Belize (2016/17), Argentina (2020) and Ecuador (2020), where creditor diversity was lower and dominated by bondholders, managed to complete their restructurings in under a year. The use of CACs, and particularly of enhanced 'two-limb' CACs, contributed to the relative speed of Argentina

and Ecuador's 2020 restructurings. However, alongside legal instruments, transparency and proactive engagement by the government with the IMF and international creditors in the case of Ecuador was critical to a smooth and non-confrontational restructuring process. With non-Paris Club creditors,

Ecuador also leveraged high-level political meetings and sequenced them separately from other negotiations, two years following its bondholder restructuring.

Scale

Private bondholder restructurings from 2005 to 2020 averaged a 34% haircut in net present value (NPV) terms, with significant variation between Mozambique in 2019 with an 11% haircut, Ecuador in 2020 with 42% and Greece in 2012 with a massive 65%.

Factors influencing higher haircuts include pre-default external debt surges, being a low-income borrower, being a first-time bond issuance, having a prolonged debt crisis and severe post-default economic contractions (Graf von Luckner et al., 2023). Post-default restructurings are associated with deeper haircuts than are pre-emptive restructurings (48% vs 18%) (Asonuma and Trebesch, 2016), in part because a public declaration of default is a costly signal of a lower willingness to pay owing to domestic constraints (Ferry, 2023b).

In our cases, the largest haircuts, of above 35%, are associated with an external debt surge in the five years before default or start of restructuring, with external debt as a proportion of gross national income (GNI) (or debt to GDP for Greece) doubling on average in the five years before the crisis (from a 64% increase in Suriname to a 195% increase in Mozambique).⁷ In addition to experiencing a debt surge, Zambia is a lower-middle-income country and a first time

Eurobond issuer. Argentina, Ecuador, Greece and Suriname all suffered deep economic crises going into their default or restructuring, with GDP shrinking by an average of 14%. In Argentina, Ecuador and Suriname, this was related to the COVID-19 pandemic, and in Greece to the Eurozone financial crisis.

The international regime, or norms around debt restructuring, has also evolved: haircuts on private lending were higher in the 1990–2000s than in the 1970–1980s, as Brady deals and bond restructuring replaced the loan maturity extensions typical to the 1980s (Cruces and Trebesch, 2013). Newer bilateral creditors tend to prefer debt reprofiling (rescheduling and maturity extensions) over outright haircuts.⁸ In contrast, the Paris Club has progressively softened its terms, especially for International Development Association-eligible countries. As a result, official creditors received on average higher haircuts than did private creditors from 1978 to 2015, despite official debt typically being considered senior (Schlegl et al., 2019).

1.3 Debt restructuring instruments: legal tools and tactics

A key concern for governments in debt restructuring is that some bondholders will refuse to participate, and will hold out for full payment of their bond, perhaps even seeking to enforce this by means of litigation in the jurisdiction under which the bonds were issued (typically New York or England). Governments

7 Data are for external debt stocks (% of GNI) from the World Bank International Debt Statistics except for Barbados and Greece, which are high-income countries for which the World Bank does not collect this data. For these countries, general government gross debt as a percentage of GDP from the IMF's World Economic Outlook database is used instead.

8 For Chinese creditors, banks face institutional constraints against providing debt relief, and generally prefer to provide NPV-neutral debt treatment. See, for example, Rudyak and Chen (2021).

can use different ‘sticks’ and ‘carrots’ to compel or incentivise bondholder participation in restructuring arrangements.

Recent restructurings illustrate the utility of CACs as a ‘stick’ to gain full or near-full participation of creditors. These clauses provide a menu of different voting structures that allow a vote by a qualified majority of creditors to bind all creditors to a restructuring deal, thus preventing holdout creditors.

State-contingent debt instruments (SCDIs), and particularly value recovery instruments (VRIs), have been deployed as ‘carrots’ in cases such as Argentina (2005), Greece (2012), as well as in recent Common Framework cases of Ghana (2024) and Zambia (2024) to incentivise and reward creditor participation. However, the difficulties of pricing these instruments and their asymmetric impacts mean they may present little net benefit for sovereigns in the longer term, and should be carefully considered and designed.

Collective action clauses

Series-by-series CACs have been part of English law bonds since the 19th century, and of New York law since the early 2000s. These clauses, which generally require a 75% bondholder vote to enforce restructuring terms on all holders of a single bond series, aim to prevent minority holdouts from blocking restructuring efforts. Since 2015, CACs have been employed in all major restructurings except for in Mozambique (2016) and Mongolia (2017), where bonds did not contain these clauses. Successful cases include Belize (2016) and Barbados (2018), which achieved full bondholder participation.

However, series-by-series CACs still have limitations, as seen in Greece’s restructuring, when holdout creditors blocked restructuring in about half of Greece’s foreign law bond series, leaving €6.4 billion in non-restructured bonds. In contrast, for its domestic law bonds, Greece ‘retrofitted’ an aggregated CAC that allows for a single vote with a two-thirds threshold across all outstanding bonds, and that was crucial to its success in managing a speedy domestic bond restructuring with full participation.

Since 2014, ‘enhanced’ aggregated CACs that allow a single vote across the stock of bonds (as used by Greece) have become the standard under both New York and English law, after endorsement by the IMF, the US Treasury and the International Capital Markets Association. These enhanced clauses offer various voting methods: a single series vote with a 75% threshold, a ‘two-limb’ vote with a 50% threshold per series and 66 % in aggregate or a ‘single-limb’ aggregate vote with a 75% threshold (IMF, 2020).

These aggregated CACs were first utilised in Argentina and Ecuador’s 2020 restructurings. Unlike in Greece’s 2012 domestic law restructuring, both countries used the ‘two-limb’ voting procedure, rather than a single aggregated vote. This is because use of the aggregated vote requires a ‘uniformly applicable’ offer to all bondholders, and both Argentina and Ecuador decided that slightly different terms needed to be offered to holders of very short-term debt. The results were that Ecuador secured over 98% consent, leading to 100% participation after the use of CACs. Argentina obtained over 93% consent and a 99% participation rate. Two bond series with only single-series (rather than enhanced) CACs failed to meet the voting

threshold (IMF, 2020). Both restructurings introduced new legal strategies⁹ that proved controversial; ultimately, the countries and their bondholders negotiated safeguards on their use.¹⁰

Ultimately, CACs are not bulletproof but they remain an effective ‘stick’. As Greece’s experience shows, series-by-series CACs remain vulnerable to holdout creditors but enhanced CACs have proved essential for fairly rapid restructurings with private sector bondholders, and remain important instruments in minimising the proportion of holdout creditors.

State-contingent debt instruments

The evolution of the creditor landscape in recent decades has shifted how bond investors respond to default, opting to work through sovereign defaults rather than selling bonds at distressed values. This has brought SCDIs, particularly VRIs, to the forefront in facilitating and incentivising quicker debt workouts. VRIs, a subset of SCDIs, reward creditors during favourable economic periods (so-called ‘upside’ periods) with better payouts triggered by factors like higher GDP growth or commodity prices. In theory, they serve as incentives for creditors to agree to restructuring proposals and discourage holdouts; in practice, they have become a means for bondholders to compensate themselves for the cost of haircuts.

Notable uses of VRIs include Argentina in 2005, Greece in 2012 and Ukraine in 2015; all employed GDP-linked securities. Suriname’s 2023 exchange featured an oil-linked VRI to compensate bondholders. Zambia’s 2024 agreement in principle

includes an ‘upside case’ with higher interest rates and shorter maturities if exports and tax revenues exceed IMF projections. By linking payout to variables such as GDP or commodity prices that influence a sovereign’s debt service capacity, SCDIs can theoretically reduce conflicts over current valuations and potentially benefit sovereigns, allowing lower payouts during ‘bad’ times and higher payouts in ‘good’ times.

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9 Redesignation, changing the voting pool of bonds after votes have been cast and the so-called Pac-Man strategy of offering successive restructurings, offering slightly better terms each time, to gradually include holdouts.

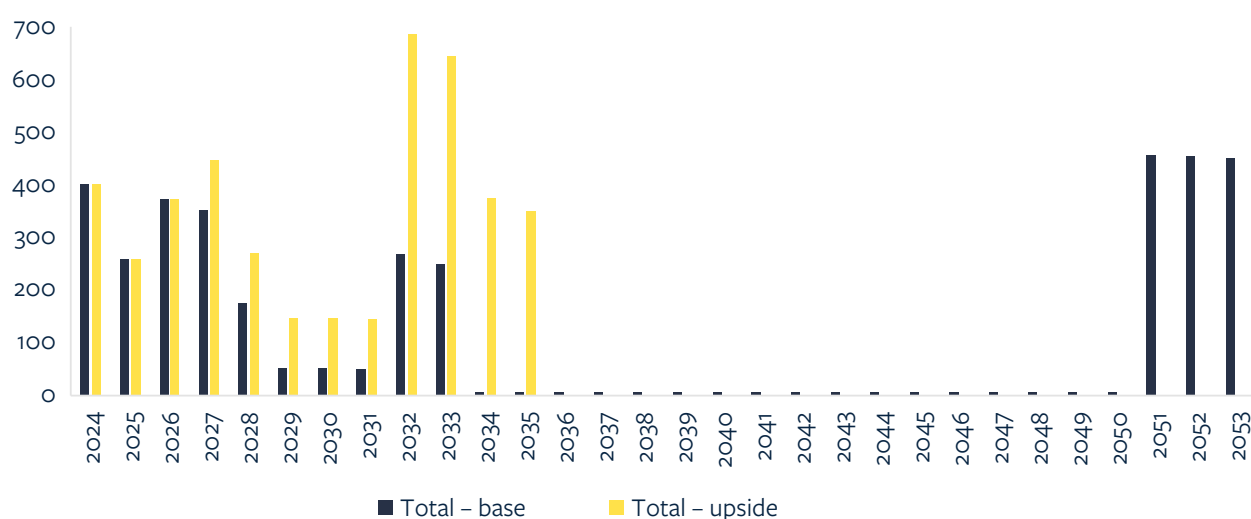
10 See IMF (2020) for a summary; for discussions, see Clark and Lyratzakis (2021) and de la Cruz and Lagos (2021).

valuations and potentially benefit sovereigns, allowing lower payouts during ‘bad’ times and higher payouts in ‘good’ times.

Despite theoretical advantages, SCDIs face practical challenges, including low liquidity, exclusion from key bond indices and trade at steep discounts in secondary markets. In Argentina, the GDP-linked warrant was detachable from the bond and separately traded, nullifying its purpose of rewarding original bondholders. These instruments also attract a high and persistent risk premium that is procyclical, and often higher than traditional bonds (Igan et al., 2021). While often attributed to novelty, this appears to be a permanent feature, owing to ‘distorted probabilities’ by which lenders price ambiguity and potential ‘downside’ scenarios, leading to systematic under-pricing (Roldán and Roch, 2021).

As such, SCDIs result in poor value for issuers in terms of debt relief, and it has proven difficult to structure them in a way that achieves their theoretical benefits of matching debt service

levels to the state of the economy without them becoming extremely complex. Ideally, SCDIs should be symmetric, offering better terms and liquidity relief during downturns. However, there is a trade-off, as added complexity reduces their market attractiveness and exacerbates market under-pricing, reducing their appeal as a ‘carrot’. Consequently, restructurings have favoured simpler, ‘upside-only,’ instruments, which can impose significant long-term costs for short-term performance gains. Argentina’s higher-than-expected growth from 2005 to 2011 entailed additional payments costing the country almost \$10 billion (Guzman, 2016). Upside-only GDP-linked and macro-linked instruments in Ukraine and Zambia also pose longer-term repayment burdens that are permanently higher even if economic conditions worsen, potentially pushing countries back into crisis. Zambia’s one-time trigger SCDI pushes its bond coupon from 0.5% to 7.5%, based on economic data over 2026–2028, entailing significantly higher repayments until 2035, even if economic conditions subsequently worsen, with the risk of pushing it back into debt distress.

Figure 1.2 Zambia's bond payments (principle and interest): base and upside scenarios (\$ million)

Source: Authors' calculation based on Government of Zambia (2024)

In contrast, Ghana's government pushed backed against bondholder proposals for a macro-linked bond opting and instead offered bondholders a choice of two restructured bonds, one with a face value haircut and a coupon of 5%, and a 'par' bond that does not have a face value haircut but that has a low coupon of 1.5% and a longer maturity, of 2037.

SCDIs need careful design to be beneficial in restructurings. This includes creating symmetric payouts that adjust for both good and bad times and standardising terms to improve liquidity (Cohen et al., 2020; Heller and Virketis, 2022). Official promotion and endorsement of standardised term sheets, drawing from the experiences of CACs and CRDCs, will be needed (Cohen et al., 2020). Financial sector representation and inclusion will also be crucial for market clarity around their inclusion in standard bond indices, and in credit default swap contracts (Heller and Virketis, 2022).

1.4 Aligning debt with climate goals: building long-term resilience

Debt relief and climate change are increasingly intertwined. Onerous external debt repayment limits a country's fiscal capacity to invest in climate mitigation and adaptation. Meanwhile, worsening climate risks and natural disasters can severely affect these countries' future debt service capabilities and creditworthiness. The push to adapt DSAs to better account for these fiscal costs of climate-related expenditures, and to integrate climate objectives into new innovative debt instruments like sustainability-linked bonds (SLBs), reflects broader recognition of the need to ensure debt sustainability is also resilient to future climate risks (Bolton et al., 2022).

While issued separately to SCDIs, climate-shock buffers in the form of CRDCs are becoming widely adopted by official lenders, including the UK, the Inter-American Development Bank (IADB) and the

World Bank. CRDCs can suspend debt repayment in the event of hurricanes or natural disasters, and thus provide liquidity relief in ‘downside’ events; however, their coverage remains limited to climate-related shocks. Barbados used another example of this in the form of parametric insurance from Munich RE and the Caribbean Catastrophe Risk Insurance Facility (CCRIF) to manage natural disaster risks as part of its debt restructuring, allowing for capitalisation of interest and deferral of scheduled amortisation over two years following a natural disaster. As of July 2024, the first CRDC, in Grenada’s 2030 bonds, may be activated for the first time, which would allow it to defer both principal and interest payments. The trigger is tied to payouts from the CCRIF, which, in the wake of damage from Hurricane Beryl in July 2024, has made its largest payout, of \$44 million, in 2024 (CCRIF, 2024).

Debt-for-nature swaps are another instrument that has been employed in several recent restructurings with private creditors, as part of a multilateral arrangement. Debt-for-nature swaps have been

attractive as dual-purpose instruments, to reduce debt service and redirect fiscal resources to climate and conservation needs by using the reduced interest savings from bond buybacks to finance concrete conservation projects.

Barbados, Belize and Ecuador utilised ‘blue’ bond issuances linked to marine conservation as part of debt-for-nature swap transactions (see Table 1.2). Ecuador’s 2023 debt swap reduced debt service by \$1.1 billion, generating \$450 million for conservation activities. Belize’s debt swap of its single ‘superbond’ significantly reduced its debt service (around 9% of GDP). A more recent debt swap in Gabon provided minimal relief in debt service costs but allowed for maturity extension that extended maturities, and crowded in other capital (Albinet et al., 2024). While they are not a panacea for debt distress, and should not be used as an instrument for debt relief, they can serve a purpose during periods of liquidity stress (in the case of Belize and Ecuador) and in supporting refinancing needs (Barbados and Gabon) (ibid.).

Table 1.2 Recent debt-for-nature swaps, key indicators

	Blue loan (\$ million)	Debt retired (\$ million)	Immediate debt reduction		Average repurchase price (cents per \$1)	Funds for marine conservation (\$ million)
			(\$ million)	(% of GDP)		
Barbados	146	150	4	0.1	96.2	50.178
Belize	364	580	216	8.7	55.0	450
Ecuador	656	1,628	972	0.8	41.0	

Source: IMF (2023)

As a second-best instrument, debt-for-nature swaps serve better as a pre-emptive measure than as a comprehensive solution to debt restructuring and default. Their impact for debt relief is generally modest relative to

the sizeable material and transaction costs involved via third-party fees for risk insurance (such as for the U.S. International Development Finance Corporation (DFC)), as well as costs in establishing conservation project structures.

Their use also does not avoid default: Belize and Ecuador's bond buybacks were still classed as 'distressed exchanges' by Moody's, due to their significant discounts (Nestmann, 2023).

While the case for debt swaps is narrow, they may be part of a menu of tools for long-term growth and conservation goals. Using them as 'fair-weather' instruments prior to default or following a successful restructuring can be a political signal of commitment to sustainable development, reduce the likelihood of further debt restructuring and ensure earmarked fiscal resources for climate investment over debt service.

1.5 Lessons

1. Timely, proactive and transparent engagement with stakeholders is crucial to minimise the risk of protracted restructurings. A cooperative and transparent stance, along with early engagement with creditor groups, can build goodwill, demonstrate good faith and be more likely to lead to a smoother and faster restructuring process. While larger haircuts may be possible through a post-default restructuring or a more confrontational stance, which may be necessary to restore debt sustainability, this is also likely to entail a more protracted restructuring process, with the prospect of higher future borrowing costs (Marchesi, 2015). Adapting different strategies with different
- creditors could avoid inter-creditor conflicts over comparability of treatment.
2. Design of debt restructuring should take care to maximise debt relief for the size of haircut possible, frontloading fiscal adjustment following a restructuring and ensuring that the repayment profile of restructured bonds matches future revenue streams, avoiding sharp increases in payments. While VRIs and SCDIs have a strong theoretical case, experience has not supported their utility as a debt relief instrument. Use and design of SCDIs should be carefully considered through market and sovereign consultations, to ensure they also provide liquidity relief if economic conditions worsen.
3. Future economic recovery and debt sustainability must also be climate-resilient, and debt relief should consider use of insurance or CRDC instruments to reduce the vulnerability of future debt repayment to the risk of external shocks. Debt-for-climate and debt-for-nature swaps can be a second-best tool, to help improve debt sustainability and redirect fiscal resources to long-term conservation investment need, only once the immediate crisis is resolved. Exploring options with third-party actors such as The Nature Conservancy (TNC) or bilateral creditors should begin with outlining the conservation rationale and investment structure, and focus on designing concrete conservation projects that can be supported in future under these structures.

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