

**ALSF SOVEREIGN
DEBT KNOWLEDGE PRODUCT
AND CAPACITY BUILDING
PROJECT:
DEBT SWAPS DEBT GUIDE**



**Baker
McKenzie.**

CONTRIBUTING AUTHORS

JAMES TANNER

at Baker McKenzie

RAJNEESH SEERAS

at the Green Climate Fund

SAFAA BARGOUCHI

at the African Legal Support Facility

Disclaimer

This Debt Guide is the product of its author(s). None of the views expressed in this Debt Guide necessarily represent the views of any of the institutions and organisations (or their respective governors, directors, managers, partners, associates, and/or clients) where each author works. This Debt Guide is intended as an initial guide and does not contain definitive financial or legal advice. Readers considering any of the issues discussed in this Debt Guide should seek advice at an early stage from their respective advisors.

TABLE OF CONTENTS

Acronyms	4
Executive summary	5
I. Introduction	6
II. “Traditional” Debt Exchanges and Liability Management Exercises	7
Rationales and Motivations	7
Technical Considerations	7
III. Exchanges in Distressed Situations	11
IV. Project Based Swaps	12
History of Debt-for-Nature Swaps	12
Resurgence in interest	12
Recent Debt-for-Nature Swaps	13
Monetising natural resources	13
“Bilateral” swaps	15
“Trilateral” swaps	16
Recent Case Studies and Structures	18
Eligibility and Considerations for Project Based Swaps	20
V. Potential Downsides to Project Based Swaps	22
Use in distressed scenarios	22
Democratic / consultation issues	22
Governance and Monitoring	22
Friction with “Debt Justice” concept	22
VI. Related Swaps and Similar Initiatives	24
VII. Practical Considerations and Conclusion	27
Conclusion	28
Glossary	29
References and Further Reading	30

Acronyms	Meaning Relevant
AfDB	African Development Bank
ANRC	African Natural Resources Management and Investment Centre
C2D	Contrat de Désendettement et Développement
CAC	Collective Action Clause
CAFI	Central African Forest Initiative
DAF	Development Assistance Fund
DFC	United States Development Finance Corporation
DSA	Debt Sustainability Analysis
DSF	IMF/World Bank debt sustainability framework
FPIC	“free, prior, and informed consent”
GEF	Global Environmental Facility
GLF	Galápagos Life Fund
IADB	Inter-American Development Bank
IMF	International Monetary Fund
KPIs	Key Performance Indicators
NGO	Non-Governmental Organization
NPV	Net present value
OECD	Organization for Economic Cooperation and Development
OFC	Ocean Finance Corporation
OSI	Official Sector Involvement
RfP	Request for proposal
RMC	Regional Member Country
RWF	Rwandan Francs
SAI	Supreme Audit Institutions
SCDIs	State Contingent Debt Instrument
SDDS	Special Data Dissemination Standard (IMF)
SDGs	Sustainable Development Goals
SPV	Special purpose vehicle
TEs	Tax Expenditures
TNC	The Nature Conservancy
UNESCO	United Nations Educational, Scientific and Cultural Organization
WHO	World Health Organization



Executive Summary

ALSF Sovereign Debt Knowledge Product and Capacity Building Project: Debt Swaps Debt Guide

Prepared by James Tanner at Baker McKenzie, Safaa Bargouchi at the African Legal Support Facility and Rajneesh Seeras at the Green Climate Fund

For the African Legal Support Facility (ALSF)

In this guide, we explore the many ways that African sovereigns can use debt swaps to improve their fiscal position while also in some cases receiving debt relief and/or raising funding for key development or conservation projects.

We explore the pros and cons of various types of «traditional» debt swaps, and outline the steps and considerations that a sovereign should bear in mind when embarking on one. Whether a sovereign is in a «distressed» situation (i.e. potentially unable to service its debts as they fall due) or not, there are good reasons for a sovereign to regularly explore whether its existing debt has the best possible composition, and liability management exercises (as well as new issuances) are a key tool in any debt management office's toolbox. The guide describes various changes to outstanding debt that can be achieved through swaps (interest rate, term, principal, governing law) and how these can be achieved in practice (call options, open market purchases, tender offers).

The development and recent renaissance in debt-for-nature swaps generates further opportunities for sovereigns. This guide describes the history (from their 1980s Central and South American roots) and recent developments (such as the two swaps achieved in 2023 which increased the amounts involved in such swaps by an order of magnitude) in these innovative programmes. We set out the parties involved and their roles, including the project manager, credit support provider, financial advisor, SPV/trust fund and verification agent. Case studies are provided to illustrate what several developing nations, including an African sovereign, have achieved with their advisor teams by embarking on these types of swap, such as rainforest conservation and marine protection, as well as the amounts of debt reduction achieved.

We discuss the differences between «bilateral» (directly between creditor and debtor) and «trilateral» projects (involving an intermediary), as well as some of the considerations to be borne in mind when planning a debt-for-nature swap. The key role of credit

support providers (such as major development finance agencies through insurance provision and guarantees) is described, which explains how with their support sovereigns are able to get «something for nothing» by issuing new debt with a superior rating and superior terms than they would be able to do without such support, in exchange for funding development or conservation projects which the sovereign may already have planned to fund. Also examined are some of the traditional arguments against project-based debt swaps (that they are difficult to use in a distressed scenario; democratic / consultation concerns; governance and monitoring issues; and that they conflict with «debt justice» principles), and how these may be mitigated against through a well-planned and well-executed swap process.

While debt-for-nature swaps have generated a great deal of publicity, there is no reason why the same principles cannot be applied to other project-based swaps. This guide provides several examples of other project-based swaps (including debt-for-education, debt-for-health and debt-for-climate) as well as argues for sovereigns, investors and other market participants to explore further opportunities for such other swaps given the impetus of the United Nations Sustainable Development Goals.

Practical suggestions for sovereigns embarking on a debt swap are provided, including considering whether there are potential projects that could form the basis of a project-based swap; engaging with creditors either directly or with a financial advisor; appointing counsel and preparing key documentation; liaising with credit support providers and negotiating agreed projects; obtaining authorisations and executing the deal.

We hope that sovereigns consulting this guide will be encouraged to consider the use of debt swaps, in particular project-based swaps, in helping them to meet their fiscal goals.

I. INTRODUCTION

There is an old Wall Street urban myth of a powerful firm whose conference room's wood-panelled walls were decorated with the paper certificates of defaulted bonds, as an unsettling *memento mori* to those who sat at the table to negotiate new issuances. Remember, the implication was, that no matter how solid one's finances are today, one may lack funds tomorrow to pay back what one owes. The prudent borrower, be they an individual, corporate or sovereign, is one who thinks ahead to that day and contemplates its best options to avoid or ameliorate the consequences when it comes.

Some of the most important options for borrowers in such circumstances are debt swaps and related liability management operations. Flexible in form, a well-executed debt swap can lead to reduced debt service payments, longer maturity profiles or reduced principal amounts of outstanding debt. Recent innovations in the international financial markets have made debt swaps by sovereigns in particular an attractive option even when the borrower is not in a distressed situation (as described below), through the increased possibility of using non-traditional consideration in such swaps and the recognition of the value of certain assets or results beyond solely monetary terms.

This chapter sets out the key considerations for sovereign or quasi-sovereign borrowers thinking of embarking on debt exchange exercises, and some practical considerations related to traditional debt exchanges. It then discusses the crucial factors that distinguish debt exchanges undertaken by sovereigns from those undertaken by corporates, partnerships or individuals. Finally, it explores the exciting new market developments in the form of debt-for-nature, debt-for-climate, debt-for-health and debt-for-education swaps and related concepts, including structuring options, the developing field of other types of "debt for" swaps, and the relationship with the use of proceeds instruments considered in *[ALSF Debt Guide on Sustainability Financing]*.

Our aim in this chapter is for any borrower who reads it and subsequently walks into that mythical conference room to be less intimidated by the spectre of defaulted debtors past, knowing that debt exchanges and liability management exercises can provide a legitimate alternative to a default, sometimes even with strongly positive outcomes for borrowers and other stakeholders.

II. “TRADITIONAL” DEBT EXCHANGES AND LIABILITY MANAGEMENT EXERCISES

While this section deals principally with “traditional” liability management and debt swaps for sovereigns, the considerations discussed are nonetheless applicable to the more novel forms of debt swaps set out later in this chapter.

Technical Considerations

Rationales and Motivations

It is relatively self-evident why a sovereign which is unable to pay its debts would begin to think of ways to change its debt profile. Why, however, would a sovereign wish to engage in a debt exchange or liability management exercise prior to finding itself actually in or near default? Reasons can include the following considerations, several of which were identified in an IMF primer on the subject:



Interest payment management

This can include the switch from floating rate existing debt to fixed rate new debt (or amending existing debt accordingly). Floating interest rate debt is a risk for many sovereigns due to potential mismatches between revenues (i.e., tax and other income of the sovereign) in many cases not being linked to the floating interest rates based on prevailing market rates which tend to govern international debt issuances, and, as such, has become a less popular borrowing option for many developing country borrowers. Alternatively, in a falling interest rate environment, more expensive fixed rate debt can be swapped for debt with a cheaper prevailing interest rate.



Maturity profile management

Sovereigns may engage in liability management exercises or exchanges to alter the maturity structure of their existing debt to lengthen the average maturity of debt (buying back bonds or replacing them with bonds of a different maturity) to better match the government's anticipated revenues and avoid "bunching" of maturities of outstanding debt (or simply to defer maturities to a later date in the hopes of indefinite roll-overs or an improved ability in the future to repay principal). Shorter-term debt being by its nature more susceptible to market and rollover risk, pushing maturities out even in "good times" can benefit a sovereign seeking to protect itself from future risks. Correct re-profiling can even be viewed as a form of debt relief: in fact, a 2013 study by Cruces and Trebesch reported that "maturity extensions are a crucial component of overall debt relief" and that of 180 examined debt relief operations, 123 featured debt rescheduling only (as opposed to a reduction in face value) which indicates the importance sovereigns attach to maturity re-profiling (see further below regarding debt relief in distressed situations).



Profile-raising / increasing investor base

Emerging markets sovereigns in particular may use liability management exercises and swaps to improve their market profile and potentially their credit ratings, which can improve their ability to draw upon the international capital markets. This can also benefit local financial / corporate borrowers who rely on the sovereign for a benchmark. Swaps and liability management exercises serve to demonstrate to international investors that the sovereign is taking prudent steps to ensure its finances are in good order going forward, and in a world where "any publicity is good publicity", an issuer which is frequently in the market is continually exposed to potential new investors (which in turn can have a positive impact on debt pricing due to increased investor demand). This is dependant, of course, on the swap in question being successful and demonstrating sound financial thinking on the part of the sovereign and its advisors.



Governing law

From the point of view of investors, it has been noted that "it is particularly dangerous to have a loan agreement with a sovereign borrower governed by the law of the borrower because it is within its own power to change that law and frustrate the rights of the lender."

Accordingly, to generate sufficient appetite in the international capital markets, emerging markets sovereigns tend to issue debt in the governing laws of other jurisdictions (English or New York law being the most common) trusted and known by investors. However, in the event of a sovereign becoming seen as a better credit risk, or its legal system achieving improved international standing, a sovereign may wish to "flip" the governing law of its debt to that of its own jurisdiction, and may be able to find investors willing to do so (for a price).



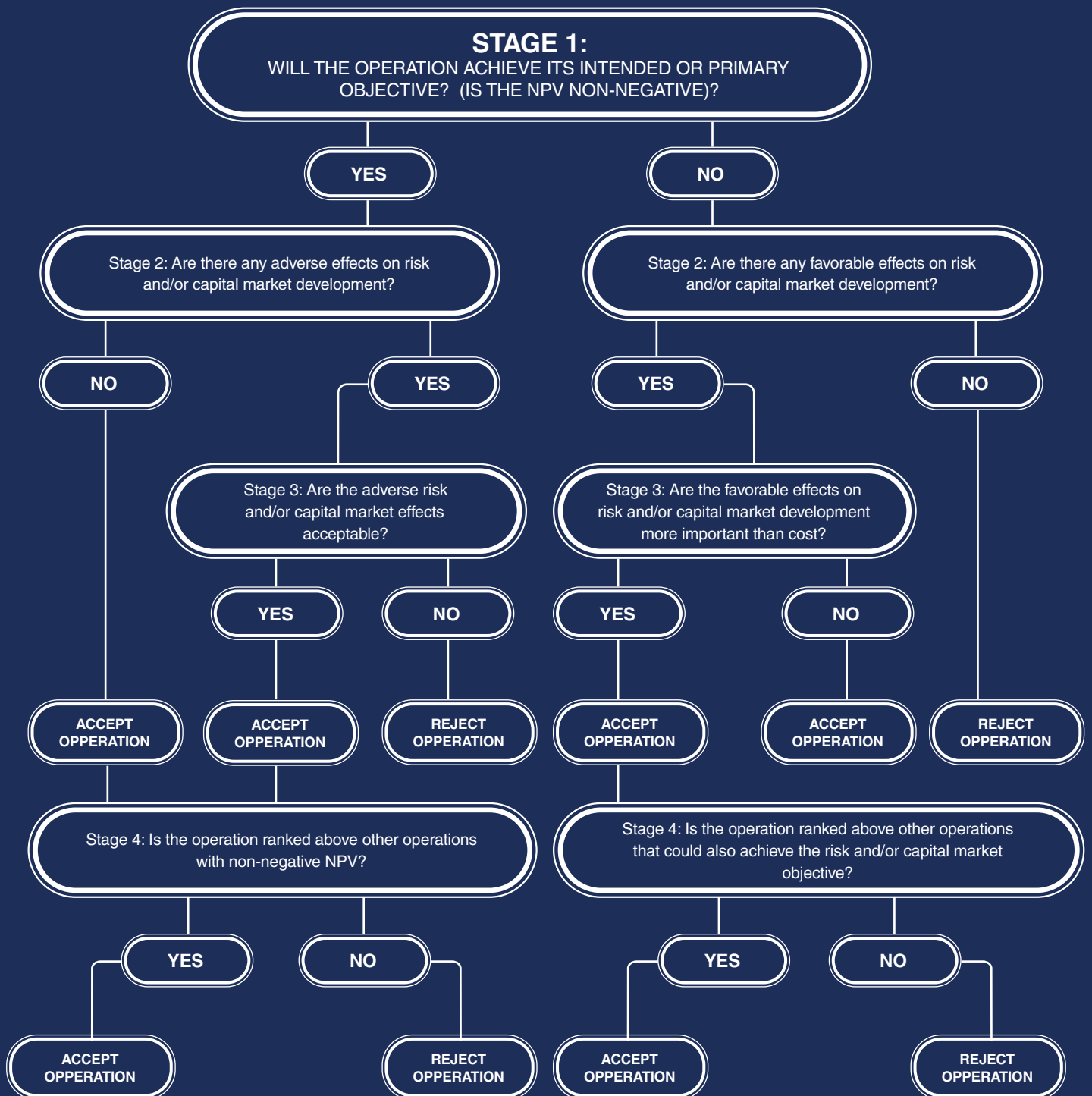
Currency

In order to avoid exchange rate risk, if it is financially viable, sovereigns may use swaps or liability management exercises to retire debt issued in foreign currencies (e.g., USD) and replace it with debt issued in local currency, which is more subject to the control and influence of the sovereign in question (and which may be the only option available for a sovereign with low foreign reserves). The ability for this to be done practically will of course depend on the local capital markets (for a local issuance) or the appetite of investors in the international capital markets for debt denominated in the currency in question. Alternatively, exchange rate risk can be managed and risk spread by swapping / amending debt denominated in one "international" currency to another (e.g., swapping some USD-denominated bonds for EUR-denominated bonds).

When assessing the potential benefits of a swap (or liability management exercise), there are several technical considerations to be taken into account. Without delving into the technical calculations which must be made to calculate exact financial impacts, a decision tree provided by the IMF for the assistance of sovereign borrowers shows the complexities inherent in deciding whether to embark on a given swap or management exercise:

While amendments to existing debt by way of a liability management exercise can usually only be accomplished in one way (i.e., by organising a vote of the debtholders in accordance with the terms of the underlying documentation for the relevant debt), once it has been decided to proceed with a swap operation, there are several mechanisms for a sovereign and its advisors to perform the swap. Which method is used will depend on the terms of the underlying debt, as well as the considerations set out below.

ILLUSTRATION OF THE DECISION-MAKING PROCESS





Call options.

If the debt (i.e., the sovereign bonds) contains a call option allowing the issuer to redeem the debt at a given price, exercising this right can be the best way for a sovereign to achieve the first half (i.e., removing the existing debt) of a swap, particularly if the market price of the debt in question is trading above par. However, not all sovereign bonds contain a call option, as investors (understandably) demand a premium for investing in debt with embedded call options as it increases their reinvestment risk and reduces their potential investment upside. Additionally, in a rising interest rate scenario (or a scenario in which the creditworthiness of the relevant sovereign declines leading to a drop in the market price of the debt in question) the cost of exercising a call option at a pre-fixed price may be more expensive to the sovereign than an open market or tender offer purchase (see below).



Open market.

In an open market operation, the issuer or a financial intermediary acting on its behalf buys back debt instruments at a price demanded by the seller or at the market price. If the market for the debt in question is liquid enough to achieve the goal of the operation (without the price being unduly moved by the operation itself) open market transactions will be an effective way to redeem existing debt as part of a swap. As the issuer and its advisors can carry this out in the timing they set (potentially in multiple “batches”) and may be done without alerting the market at large, a well-managed open market purchase operation can have a smaller impact on the price of the debt in question than a public tender offer (though even in the case of tender offers, it is important to maintain confidentiality prior to announcement to avoid price movements prior to the tender announcement which would increase the cost of the operation). Open market operations can also be less “all or nothing” than a tender offer operation which either succeeds or fails (as discussed below).



Tender offer.

In a tender offer, all sellers are treated equally and receive the same price, announced publicly by the sovereign and its advisors (e.g., via the press and over clearing systems / stock exchange messaging systems). For larger swaps (including the “trilateral” project-based debt swaps discussed below), a tender offer may be preferable as it sets a single price and timing for all investors, which can reduce individual transaction costs compared to negotiating multiple open-market purchases with individual sellers. The trade-offs for the lack of post-announcement confidentiality include transparency and predictability of costs, but these may be outweighed if the market moves or investors otherwise do not participate in the price setting, which can require the operation to be re-run at a new price or abandoned entirely.

III. EXCHANGES IN DISTRESSED SITUATIONS

While debt swaps are a tool that is available to sovereigns in the normal “course of business” on the rationales set out above, they may also form a key part of a restructuring agreed between a sovereign and some of its creditors when the sovereign is either in or near a default in respect of its debt (commonly referred to as a “distressed” situation). A debt swap in a distressed situation will have significantly different considerations in play than a debt swap when a sovereign is not nearing or following a default. While voluminous academic literature has been written on the subject of distressed sovereign debt restructurings, a few of the key points here particularly relevant to a swap include:

- *Unique legal position of sovereign restructurings. A sovereign, unlike a corporate entity, cannot be made bankrupt from a legal perspective. Accordingly, it could theoretically issue any new debt that it likes without fear of inability to honour its financial obligations rendering it insolvent. However, this is of course limited by the appetite of investors to invest in such debt in exchange for their existing holdings by means of swapping their debt.*
- *Domestic law vs foreign law. If the debt is governed by the law of the jurisdiction that issued it, the government will always be free (though it will face consequences in the pricing of future issuances) to change the law to avoid its obligations under the existing bonds. This could be substantially cheaper (in the short run, at least) than a government issuing another bond to swap for the existing bond which it cannot pay. Of course, the reputation of the issuer which does so would suffer in the capital markets, and there is often a substantial pricing differential between domestic and foreign law governed bonds of the same issuer to reflect this risk.*
- *Bargaining position of sovereigns / creditors. Ultimately, creditors will want to receive an instrument as similar as possible in a distressed exchange scenario to the instrument which they currently hold, without “haircuts” as to principal, reduction in interest payments or long extensions of maturity. Sovereigns, of course, would prefer the opposite. A debt sustainability analysis (DSA) - likely prepared by and in conjunction with the IMF and World Bank - will often be required to give an objective measure of what the sovereign can actually afford to pay its creditors, and, as such, will be both an early gating item to negotiations and provide a baseline for the terms of the new swapped debt.*
- *Creditor makeup. Negotiating the terms of a debt exchange in a restructuring scenario for a sovereign is much simpler if there is a single class of creditors (for example, one single existing bond). However, the makeup of creditors to most developing sovereigns will include bilateral (Paris Club and non-Paris Club) lenders as well as potentially domestic and international bondholders. See also [Chapter [X] – Key Considerations for Non-Traditional Debt]. Developing the correct new instrument(s) to offer to creditors with widely varying interests and priorities takes considerable time and expertise for the sovereign and its advisors.*
- *Issue of holdouts. Sovereigns need to adopt a “carrot and stick” approach, for example by offering incentives such as instruments that offer financial rewards for the stronger economic performance of the issuing sovereign (“GDP warrants”) or relatively favourable treatment on haircuts / interest rate / maturity, to ensure a sufficient number of creditors agree to the terms of the debt swap. The problem of holdouts who refuse to accept new debt and insist on keeping to the terms of the old debt (and the game theory considerations in the minds of creditors) can often be ameliorated in modern sovereign bonds via collective action clauses (CACs) which can operate across multiple series of bonds, and exit consents amending the terms of the debt by holders who agree to the terms of the proposed deal to make such debt less favourable to remaining holders. However, even with these, there are often high majority requirements to effect a mandatory swap that is binding on all creditors of the sovereign in question (a partial voluntary swap being much less useful to a sovereign in distressed circumstances than retiring a type or class of debt in its entirety pursuant to a full mandatory swap), and consenting creditors will need to be provided with an incentive to vote for a proposal to extinguish or modify their existing instruments.*

By way of timing, swaps for widely held debt can be a time-consuming process. It is not at all unusual for a debt swap to take a year or longer to negotiate and implement. It should be noted that even compared to other financing transactions, and other restructurings, a sovereign debt restructuring is a unique animal, and due to the many interested parties, the steps and timelines for one may not be indicative of the steps and timing for another. In particular, authorisations which may quickly be obtained for a corporate may require much more time for a sovereign (e.g., availability of ministers, authorisations of the legislative branch and political / diplomatic realities). In more complex sovereign debt swaps – for example, recent trilateral debt-for-nature swaps by Belize, Ecuador and Barbados – timelines of closer to two years from inception are common.

IV. PROJECT-BASED SWAPS

While in this section we deal most frequently with “debt-for-nature” swaps, we will frequently use the terminology “project based” swaps, and refer to “agreed projects” more generally rather than referring just to conservation and similar matters. This is to reflect our view that there is nothing inherently specific to nature-based projects which makes them uniquely suited on a legal or commercial basis to be the subject matter for the application of savings made by sovereigns in debt swaps with a use-of-proceeds component, and that these swaps have potentially far broader applicability (on which see further below).

History of Debt-for-Nature Swaps

Debt-for-nature swaps are financial transactions whereby a portion of the foreign debt owed by a developing nation is eliminated, decreased, or erased in return for locally supported conservation initiatives being funded by (at least in part) the reduced debt burden the nation will face after the swap. While sovereign debt swaps have existed as long as the sovereign debt market, the idea of some of the swap proceeds being subject to specific use-of-proceeds restrictions first surfaced in the 1980s, when the United States and its development finance agencies (as the debt-relieving parties) and South and Central American nations (as the relief-receiving parties) were the primary regions of concentration of such new transactions.

As non-governmental organisations and conservation groups began collaborating with developing nations to reduce their foreign debt burden while also safeguarding and maintaining their natural resources, smaller debt-for-nature swap agreements on more bespoke parameters depending on the priorities of the entities who would be “forgiving” the debt in question started to emerge. These initial agreements were mostly sponsored by the United States and its development agencies and concentrated on South America, where nations were dealing with high amounts of USD-denominated foreign debt and fast deforestation (the particular conservation goal that was the subject of the majority of the early debt-for-nature swaps, prior to the later involvement of other forms of conservation such as protection of oceans and aquatic life). This genesis, and the frequent involvement of nature conservation groups The Nature Conservancy (TNC) (a nonprofit environmental organisation founded in the United States in 1951) and The Global Environment Facility (a facility established by the World Bank in 1993 which provides money for environmental initiatives) in structuring and project management roles, is in large part responsible for debt-for-nature swaps being the most widely known and used project-based sovereign swaps to date.

To take a prominent example in size and subsequent publicity, the Bolivian government and TNC executed the first truly public and modern debt-for-nature swap in 1987 (albeit on a scale much smaller than many such swaps are performed now). In that transaction, TNC purchased USD 650,000 in face value of Bolivia’s foreign debt (USD-denominated Eurobonds) in the secondary market at a discounted price of USD 100,000 (reflecting the substantial discount such bonds were trading at in the secondary market at the time). In return, the Bolivian government designated three conservation areas totalling 3.7 million acres as buffer zones for the purposes of conservation. The groundwork for larger and more thorough debt-for-nature efforts in the 1990s and beyond was laid by this swap and those that followed it. As can be clearly seen, the key requirements for a swap of this kind would be (i) a substantial existing and freely trading stock of foreign-owned debt (ideally denominated in a major trading currency), (ii) such freely trading debt being traded at a substantial discount to its face value which would otherwise need to be paid in full at maturity (and, as it would naturally follow, no market existing for a refinancing at better terms) and (iii) potential development or nature-related outcomes in the country in question in respect of which international investors or public entities which have a mandate to intervene in such markets deem to be worthy of achieving. As will be discussed below, there are practical considerations which also would be important in any such swap, but these can be seen as the three real key pillars in the early development of the transaction.

Debt-for-nature swaps became more common in the 1990s as environmental issues grew in importance on the global agenda, becoming more popular among conservation organisations as a means of preserving the planet’s natural resources. Due to the hundreds of successful transactions that have been concluded in nations all over the world, debt-for-nature swaps are now a recognised and established mechanism for both debt reduction and conservation activities.

Debt-for-nature swaps were subject to criticism in the late 1990s and early 2000s despite their initial success. In particular, they have drawn criticism for not doing enough to address the underlying issues that led to unsustainable debt burdens and environmental deterioration. Others noted that agreements including debt-for-nature swaps were frequently insufficient and too narrowly oriented to have a major impact¹. See below for further discussion of the criticisms raised in respect of such swaps, and the counterarguments in respect thereof.

Resurgence in interest

¹ *Lessons Learnt from Experience with Debt-for-Environment Swaps in Economies in Transition*, Organisation for Economic Co-operation and Development, 2007.

After a burst of initial activity and academic interest (though low in nominal currency terms, numerous in terms of deals and projects funded) debt-for-nature swaps fell off the radar of the international capital markets for a substantial period following the bust of the dot-com bubble in the early 2000s and the subsequent lock-up of development funds in the years following the global financial crisis. While there was perhaps still interest in such swaps, and indeed The Global Fund continued to perform a number of project-based swaps (discussed further below), the culture of the financial markets following these events was perhaps not one conducive to innovation or to making investments other than to maximise returns.

However, in the years following the recovery from the fall of Lehman Brothers (and, in particular, following the Greek / Euro sovereign debt crisis), there has been an explosion of ESG (environmental / social / governance) related investing, such as green bonds and social development bonds (please also see the ALSF Debt Guide on Sustainability Financing) and their loan finance counterparts. Debt-for-nature swaps, which often include such instruments as part of their structure, in particular have seen a rise in popularity. This can be seen to be spurred on by the desire to discover novel solutions to the financial and environmental problems that many nations are currently confronting, and the mandate which many financial players have to achieve these without issuing fresh debt or sponsoring projects with “new money”.

The greater awareness of the significance of environmental conservation (and other sustainable development goals) has been one of the key factors behind the resurgence in interest in debt-for-nature and other project-based swaps. In particular, countries across the world have worked to include conservation in their economic and financial policies as they have grown more conscious of the environmental and financial benefits of protecting their ecosystems and biodiversity.

In addition, many developing nations find debt-for-nature swaps interesting because they offer a method to lower their foreign debt while aiding in conservation and sustainability efforts without using funds allocated to other priorities of the government. It is instead a portion of a nation's debt that is exchanged for investments in conservation projects and programs in this type of financial structure. These investments have the potential to themselves provide new revenue streams and job opportunities while protecting and preserving vital ecosystems and biodiversity².

Finally, a growing awareness of the importance of conservation for the long-term health and stability of the planet has led to a resurgence in the interest in debt-for-nature swaps. As the effects of climate change and environmental degradation are felt all over the world, many countries are seeking new and creative ways to protect ecosystems and biodiversity and respect for nature, with debt-for-nature swaps being one of the tools used to achieve this goal. Other projects relating to sustainable development outside of the purely nature / conservation space would also be relevant to address these concerns, for example the “debt for climate” swaps discussed further below.

The resurgence in interest in debt-for-nature and similar project-based swaps over the past decade has in summary

been driven by the increasing recognition of the importance of environmental conservation, the desire to reduce foreign debt and creditor exposure, the need to create new partnerships, and the growing awareness of the importance of conservation for the long-term health and stability of the planet. The particular focus on debt-for-nature, as opposed to other project-based debt swaps, may be explained by the (laudable) activism of certain organisations with the experience to organise such swaps who are primarily focused in the conservation sector as opposed to other types of developmental project.

Recent Debt-for-Nature Swaps

The above table's listing of a selection of recent debt-for-nature swap agreements demonstrates the variety of strategies for addressing environmental issues through debt reduction. As can be seen, in exchange for debt relief, each debtor country has agreed to achieve a specific set of environmental commitments, which are the focus of each agreement.

For instance, the Peru swap agreement places a strong emphasis on forest preservation and sustainable agriculture, whereas the Seychelles agreement concentrates on efforts to conserve the ocean. A variety of commitments are made as part of the Costa Rica agreement, including the creation of new national parks and protected areas, reforestation, and ecotourism. While the Indonesia agreement focuses on reducing greenhouse gas emissions through forest conservation and land-use planning, the Colombia agreement prioritises reforestation, sustainable agriculture, and the conservation of forests and other ecosystems. The newest and largest of such swaps, in Ecuador and Gabon, focus on ocean-based conservation.

The involvement of non-governmental organisations and international organisations in the debt-for-nature swaps process is a recurring theme in these agreements. For instance, the organisations Conservation International and TNC are parties to several of the debt-for-nature swap agreements listed in the table (in roles described further below). Many debt-for-nature swaps agreements also involve the Global Environmental Facility (GEF), which contributes to financial and technical support. Given their central role, these implementing partners will need to have a strong commitment to stay involved during the life of the project(s) funded by the swap in question.

Monetising natural resources

Other than the potential tourist-generated foreign currency inflows they may incite, the natural resources of developing nations have sometimes been (entirely fairly) viewed by the governments of such nations as “white elephants” - the colonial legacy of such term speaking volumes in and of itself. In short, there is a perception by some developing nations that there is an assumed duty of custodianship of natural resources in such nation, whether or not such nation has the resources to effectively manage such custodianship.

This double-bind is all the more difficult to break from when

² *Debt-for-Nature-Swaps: Feasibility and Policy Significance in Africa's Natural Resources Sector. AfDB report on 13 October 2022.*



INDONESIA

Creditor Nation/Organisation
NORWAY

Debt Relief Amount
USD 56 MILLION

Environmental Commitments
Reduction of greenhouse gas emissions through land-use planning and forest preservation

Year of Agreement **2016**



COLOMBIA

Creditor Nation/Organisation
CONSERVATION INTERNATIONAL/GEF

Debt Relief Amount
USD 36 MILLION

Environmental Commitments
Forest and other ecosystem preservation, sustainable agriculture, and reforestation

Year of Agreement **2016**



COSTA RICA

Creditor Nation/Organisation
US GOVERNMENT

Debt Relief Amount
USD 27.1 MILLION

Environmental Commitments
Reforestation, the creation of new national parks, the creation of other protected areas, and ecotourism

Year of Agreement **2017**



PERU

Creditor Nation/Organisation
CONSERVATION INTERNATIONAL/GEF

Debt Relief Amount
USD 25 MILLION

Environmental Commitments
Forest preservation and sustainable agriculture promotion

Year of Agreement **2018**



SEYCHELLES

Creditor Nation/Organisation
THE NATURE CONSERVANCY/GEF

Debt Relief Amount
USD 21.6 MILLION

Environmental Commitments
Expansion of current marine protected areas and creation of new ones

Year of Agreement **2019**



ECUADOR

Creditor Nation/Organisation
INTERNATIONAL BONDHOLDERS

Debt Relief Amount
USD 1.1 MILLION

Environmental Commitments
Ocean conservation in and around the Galapagos Islands, including research-based projects and observation

Year of Agreement **2023**



GABON

Creditor Nation/Organisation
INTERNATIONAL BONDHOLDERS/THE NATURE CONSERVANCY

Debt Relief Amount
USD 125 MILLION*

Environmental Commitments
Widening of marine reserves and strengthen fishing regulations

Year of Agreement

2023

* Refers to amount committed to conservation from \$500 million new debt issuance – precise debt relief not published.

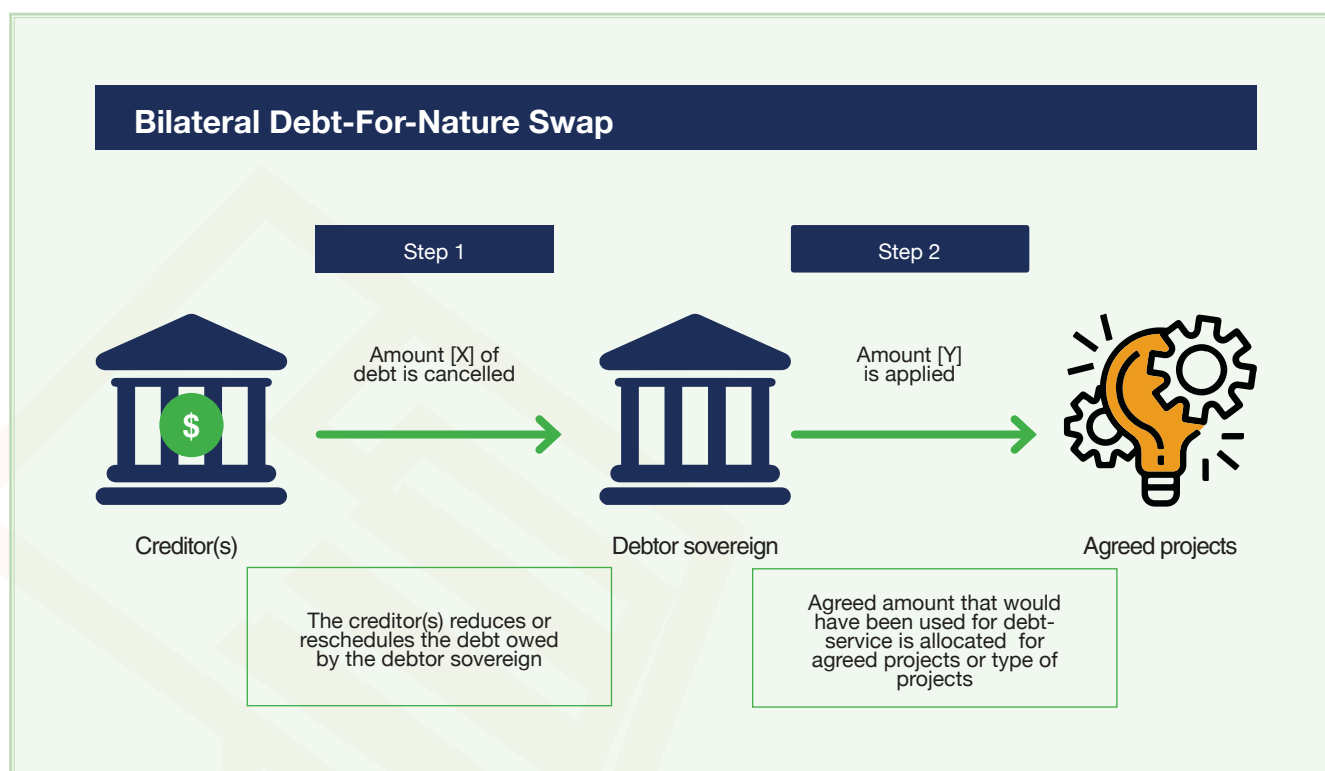
the erosion of these natural resources - be they geographic or animal (or even cultural, as will be discussed below regarding the potential expansion of these mechanics to relief targeted at other objectives) - is caused by an influx of tourism from more developed nations. An indebted nation may feel that if it is not able to fully convert its natural gifts into assets for its taxation base or economy generally that it has been left with a post-colonial legacy of stewardship without the post-colonial dividend allocated to the maintenance thereof.

A particular appeal, then, of a debt-for-nature swap (or similar swaps, as discussed below) is an ability - created seemingly out of nothing for those outside of a sovereign's debt management office - for a locally guided conservation or development effort to be funded without simultaneously adding to the upkeep costs of such natural or other assets which would inevitably follow from a pure addition to commercial exploitation (e.g., via tourism promotion or via opening otherwise protected areas to mineral extraction or other development). It is important, accordingly, for a sovereign to ensure that the implementing partners (often large intergovernmental organisations) involved

in the deal agree to adequate local/governmental involvement in the project, and that the project's parameters are clearly set out in the transaction documents to track agreed intentions. Sovereigns should therefore ensure that they receive independent advice to avoid (well-intentioned) implementing partners taking charge of the documentation and oversight process without sufficient representation of the sovereign.

As every nation's government, mindful of its duties to its population's needs, will be looking for ways to monetise its natural resources (or respond to its development needs) in as effective a way as possible, any sovereign which has a suitable pool of debt stock and natural resources or other development needs would be well advised to engage with advisors as to the possibility of a project based swap. While its advisors and implementing partners may be able to guide the sovereign as to what projects the market will have the most appetite for, ultimately the decision as to which sector or specific project should be the subject of the swap proceeds application must be a decision for the sovereign itself.

“Bilateral” swaps



Debt-for-nature (and, as will be discussed below, other “debt for...” swaps) may be structured in several different ways, depending on the interested and involved parties, the unique situation of the debtor and the goals of the swap.

The most simple, as the name would imply, is the “bilateral” form of swap. It should be noted at the outset that the name is misleading, in that one “side” of the swap may be actually composed of a number of creditors acting in concert. However, the name remains accurate in that fundamentally there are two interests represented in the

swap, being that of the debtor sovereign and that of the swapping party. The below chart demonstrates how the parties are positioned for these “bilateral” swaps.

As can be seen in the above, a bilateral debt-for-nature swap involves a government creditor and a (generally sovereign, supranational or public sector) debtor. While there can be third-party advisors assisting these parties, fundamentally there are only two “sides” to the trade. Accordingly, these swaps are typically negotiated directly between the creditor and debtor (and their

respective advisors, if any; simpler such swaps can be done without involving a large number of third parties).

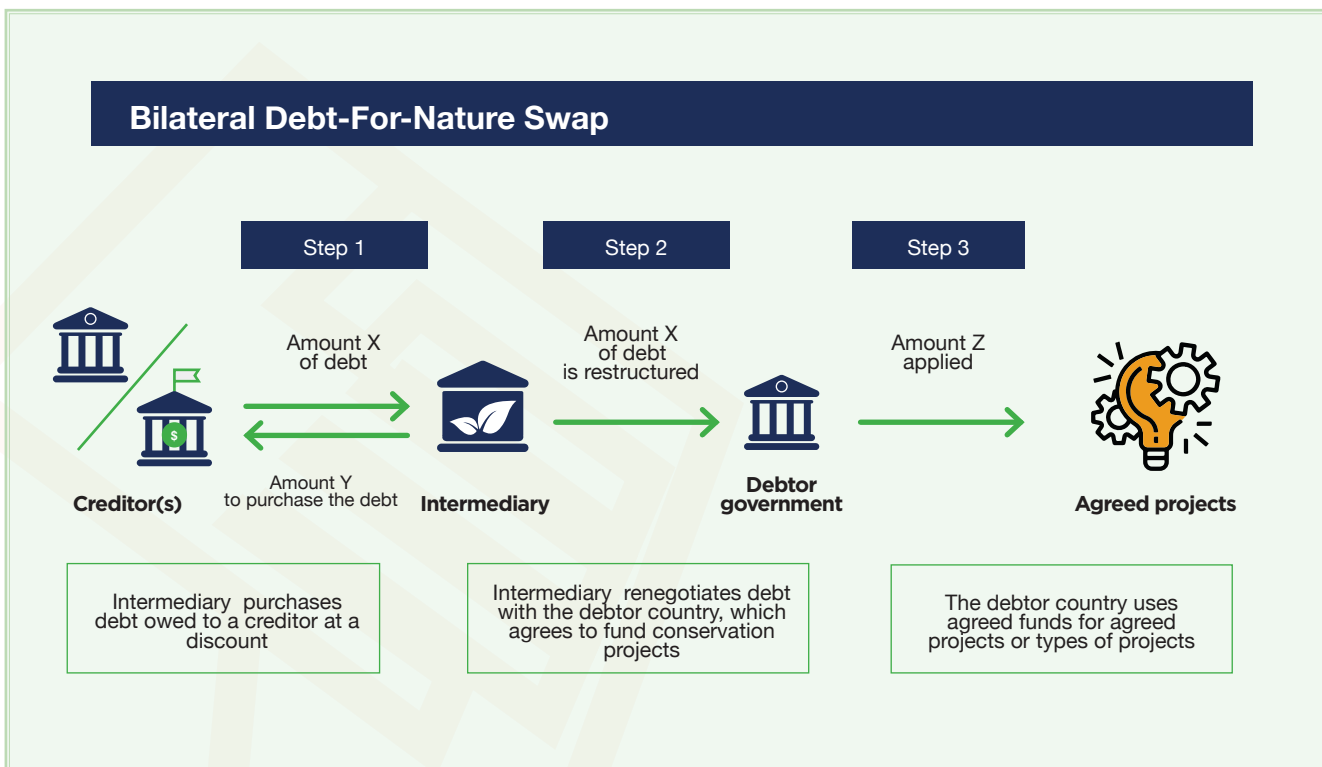
In bilateral debt swaps, in exchange for the creditor cancelling or discounting a debt owed by the debtor, the debtor agrees to invest a specified amount in a specific manner or in specific projects. For example, a creditor may agree to swap the USD 100 million in bonds that it holds for USD 75 million in bonds, provided that the debtor sovereign commits to investing USD 20 million in a project that supports the debtor’s and creditor’s conservation and/or environmental preservation objectives. The debtor achieves USD 5 million in pure savings, while also having another USD 20 million to invest in such project. In other cases, the net present value effects desired can be achieved by a discounting of the interest rate or a rescheduling of the payment of interest or principal.

To those with astute commercial instincts, an immediate “flaw” appears in the above structure: the bilateral creditors appear to walk away from the deal taking a pure financial loss, even if they do achieve the goal of having their debtor invest in a project of which they approve (and which in many cases the sovereign debtor is either the only or best-placed entity to achieve that project - charities, for example, cannot pass legislation to achieve their aims, no matter how well those charities may be capitalised, so sovereign involvement can be crucial). For this reason, the bilateral debt-for-nature market’s creditor side to date has been effectively solely public

sector, as private sector investors holding the debt of sovereigns will always struggle to explain to their stakeholders how this will lead to their turning a profit. Ultimately, a bilateral debt-for-nature swap relies on the willingness of a creditor to take a commercial loss in the form of debt forgiveness in order to effect a “good” result (and which they can consider and treat in their budgets in a similar way to grant-based support to the sovereign debtor). From the point of view of the debtor sovereign on the other hand, a bilateral debt-for-nature swap is an almost unambiguous “good” (subject to the concerns set out below), in that any amounts that they are obliged to apply towards agreed projects are smaller than the amounts that would otherwise have been used in debt service and they may have intended to perform the projects themselves in any case from their existing resources. Bilateral debt swaps are also, importantly, counted as “development aid” by the OECD, which is important to many creditor organisations (in particular creditor sovereigns).

Negotiation of bilateral debt swaps requires coordinated action among creditor and debtor agencies and the parties who will be involved in the implementation of the agreed projects (e.g., the trustees of trust funds which will be capitalised pursuant to the agreed projects). Accordingly, timelines for these transactions have many variables, but as a rule are quicker to negotiate and implement than trilateral swaps.

“Trilateral” swaps



A key downside of “bilateral” swaps is that the bilateral creditor will inevitably have to engage in a debt forgiveness exercise. As the market for debt-for-nature swaps (in particular) has developed, structures have developed to ameliorate this downside, as well as to create market-based opportunities for

interested debtor governments and advisors to create swaps transactions where there is no donor / guarantor forgiveness or “generosity” required.

A simple example chart for such a structure is below: As can be seen from the above, the difference between the “bilateral”

and “trilateral” swaps is the insertion of an intermediary (often but not necessarily a non-governmental organisation (“NGO”)) as a commercial actor within the transaction. While NGOs and similar entities may be and indeed often are involved in bilateral swaps, there they are in the position of advisors rather than actors. In a simple trilateral swap structure, the intermediary will purchase debt from a creditor or creditors, then renegotiate the terms of such debt (either through an amendment to its terms or a swap for alternative debt) to give the debtor sovereign a discount on the face value of the original debt, and/or a maturity extension or coupon reduction on the original debt leading to a reduction in the net present value of the sovereign’s outstanding debt. A portion of the discounted amount will then, as in a bilateral swap, be committed by the debtor government towards agreed projects such as nature conservation, improvement of healthcare systems or education.

Crucial to the economic viability of this structure is the ability of the intermediary to purchase the original debt at a discount to its face value, otherwise the economics will ultimately be similar to those of a bilateral debt swap, with the expenses of the intermediary and credit support provider if anything making the structure less attractive. In fact, in a well-structured trilateral swap, the unusual situation occurs where it is actually advantageous for a debtor sovereign for its debt to be trading at as deep a discount as possible.

Let us take as an example two sovereigns (A and B) which both have USD 1 billion of debt with identical maturities in the international capital markets, with Sovereign A’s trading at 90 cents on the dollar and Sovereign B’s at 10 cents. In such a scenario, an intermediary would be able to purchase the entirety of Sovereign A’s outstanding debt (assuming the market for such debt was not moved by its trading, on which see above on tender offers compared to open market purchases) for USD 900 million, and Sovereign B’s for USD 100 million. The intermediary would accordingly be able to offer up to USD 900 million in face value savings to Sovereign B by accepting USD 100 million in new bonds for its USD 1 billion face value original bonds, while for Sovereign A, the maximum such savings would be USD 100 million. The larger the face value savings given to the debtor sovereign, the more that can feasibly be carved out for the agreed projects: assuming that the amount required to be committed to the agreed projects would cost USD 50 million, for Sovereign A this would be equivalent to half the savings the government was making in the swap, while it would only be 5.5 per cent. of the savings made by Sovereign B. It does not take an astute political scholar to realise that governments will be far more eager to agree to commit funds to agreed projects if such funds represent only a small portion of savings made through the swap transaction as a whole.

The intermediary in such structures does not necessarily need to be an operating company or NGO. In certain structures, a special purpose vehicle can be used, funding the sovereign’s purchase of the original debt of the sovereign by means of another bond issuance the proceeds of which are passed on as a loan to the sovereign. Special purpose vehicles are useful in larger swaps as investors are often more comfortable being exposed to an entity created for the sole purpose of the deal, located in a jurisdiction offshore to the sovereign, rather than the exposure being to an intermediary which has pre-existing corporate history. As the intermediary sits in a central role to the structure of a trilateral debt swap, its independence and reliability are crucial, and will be looked at closely by rating agencies who assign a rating to the new debt issued as part of the process. See the diagram of the Ecuador

debt-for-nature swap below for an illustration of the centrality of the special purpose vehicle’s intermediary’s role.

With the increasing complexity of debt swaps, other transaction parties are now often seen. For example, the “new” debt issued in exchange for the old debt will likely have its credit position improved from the point of view of the “new” investors by means of an insurance wrapper (e.g., political risk insurance) and/or a guarantee. Such policies or guarantees may be provided by public entities like the United States Development Finance Corporation (DFC) (provided that the use of proceeds for the agreed projects aligns with the goals and policies of such public entities). These policies or guarantees can make the new debt offered as part of (or to fund) the tender offer for the existing debt far more attractive, thereby increasing the amount of original debt which can be exchanged (which in turn will lead to more savings amounts being available for the agreed projects).

Indeed, without such a guarantee or insurance being provided, it is unlikely that a large-scale trilateral debt swap could be achieved. For the reasons mentioned above, it is key that the debt of the debtor sovereign performing the swap is trading at a discount. However, if the discount is high, this means that yields upon any new issuance to fund repurchases of existing debt will be high, leaving the transaction in principle to be neutral for the sovereign in net present value terms and indeed likely would leave the sovereign in a worse position overall after transaction costs. The credit support provided by the guarantee and/or insurance is crucial to make the new issuance benefit from cheaper pricing (and, in a rated deal, a higher credit rating) to avoid the swap netting out economically – though if the fees charged by the credit support provider match or exceed the difference in net present value between the old debt and the debt issued to fund the swap, it is still possible that it could. It is accordingly important for these entities to be involved in the swap as soon as possible in the process to assess their interest and the potential costs of their involvement.

Other interested parties in a modern trilateral debt swap may include:

- *structuring and project manager of the transaction (historically a role performed by TNC but for which other entities such as Ocean Finance Corporation (OFC) have also begun to take an active role), which performs functions such as sourcing and negotiating credit support, structuring and constituting the fund which will manage the development/conservation funds and provide ongoing monitoring of the use of the funds generated by the swap;*
- *the financial institution entity that will manage the purchase (by open market or tender offer) of the outstanding original debt and sourcing of investors for, negotiating terms of and arranging for the settlement of the new debt. This will often be a large financial institution, such as an investment bank, experienced at managing such operations in the corporate and sovereign contexts generally;*
- *trustees or other professionals to manage the funds which are to be allocated to the agreed projects;*
- *verification agents employed by the project manager to ensure the ongoing use of funds in accordance*

with the parameters of the agreed projects;

- *corporate services providers for any special purpose vehicles involved in the transaction;*
- *agents/trustees for the “new” bonds issued pursuant to the swap;*
- *rating agencies for the “new” bonds;*
- *legal counsel for all relevant parties; and*
- *development finance banks and agencies which will provide the credit support needed to ensure differential pricing between the “new” and “old” debt.*

Any sovereign wishing to consider a debt swap should engage with advisors and other transaction parties as early in the process as possible to avoid delays. Crucial will be the participation of personnel from the finance ministry (in particular the debt management team, if any). Also important however will be the involvement of staff in departments relating to the project which will be the focus of the funds raised in the debt swap, for example the fisheries ministry and the environmental ministry if the swap is to be used for ocean conservation. While advisors may be able to guide the sovereign, ultimately the success or failure of a debt swap will come down to the active and enthusiastic participation of the sovereign government team. This will also have a direct impact on the timeline. As mentioned above, such swaps may take as long as two years from their initial conception, but this can be compressed if there is the political will and active participation of the government team to achieve the debt swap in a more abbreviated timeline (market conditions and delays based on governmental approvals being the chief gating factors to launching a successful debt swap).

Recent Case Studies and Structures

Central American Debt-for-Nature Swaps

The Mesoamerican Barrier Reef System, the Mayan Forests, and the Tapir Biological Corridor are a few of the Central American region’s most significant biodiversity hotspots. However, deforestation, agriculture, urbanisation, and climate change pose a threat to these ecosystems. Developing nations in Central America are utilising creative financing techniques like debt-for-nature swaps to preserve these natural resources.

Debt-for-nature swaps have been used in Central America since the 1980s and have shown to be a successful tool for conservation. The 2019 agreement between Costa Rica and the United States is one of the most recent instances of debt-for-nature swaps in Central America. The United States agreed to forgive USD 31 million of Costa Rica’s debt in return for commitments to safeguard the nation’s forests, which make up more than half of its total land area. Costa Rica promised to implement measures to stop deforestation, promote sustainable agriculture, and increase its forest cover from 54 per cent. To 60 per cent. By 2030.

Debt-for-nature swaps are encouraged in Central America through both bilateral and regional agreements. For instance, the Central American Biological Corridor Initiative combines debt-for-nature swaps, public-private partnerships, and other

financing methods to support the preservation and sustainable use of biodiversity in the area. Several international organisations, including the World Bank, the Inter-American Development Bank, and the Global Environment Facility, support this initiative. Similar initiatives could be established on the African continent and could receive similar levels of support from such and other relevant organisations.

Belize 2021

Belize has a barrier reef that stretches over 170 miles. It is known as the Western Hemisphere’s longest reef and is home to approximately 1400 species, including endangered hawksbill turtles and several types of threatened sharks. The country’s ecosystem is at risk, due to climate change and warming oceans as well as excessive fishing and unchecked coastal development, which challenges the government (like many other developing country governments) may not be capable of addressing alone.

The Government of Belize’s signed a debt-for-nature swap with TNC in November 2021, which was at the time the world’s largest debt refinancing for ocean conservation, amounting to a USD 364 million debt conversion for marine conservation (through the issuance of “blue bonds”) which reduced the country’s debt by 12 per cent. Of GDP. This debt-for-nature swap enabled Belize to create long-term sustainable financing for conservation and commitment to protect 30 per cent. Of its ocean (amongst other conservation measures).

Through this debt conversion, Belize was able to repurchase USD 553 million, a quarter of the country’s total outstanding public debt, from bondholders at 45 per cent. Face value discount through a “blue loan” arranged by TNC. This sale was arranged and underwritten by Credit Suisse, with the US government’s development bank, DFC providing the insurance wrapper (as discussed above). This enabled a lower interest rate on such bonds versus a straight Eurobond issuance by the government, as well as sovereign-friendly features in the debt including a 10-year grace period during which no principal is paid and a relatively long maturity of 19 years from issuance. Belize would not have been able to borrow the funds in the market to pay bondholders as the interest rate would have been too high to create savings. An innovative financial structure was arranged whereby the DFC insured the “Blue Loan” between the Belize Blue Investment Company and Belize, which enabled the country to repurchase USD 533 million in face value outstanding debt. The “debt conversion” resulted in a USD 189 million reduction in principal outstanding. The savings achieved through this refinancing enabled the Government of Belize to allocate approximately USD 180 million in conservation funding over 20 years.

Furthermore, Belize agreed to invest USD 4 million per year in marine conservation until 2041 which will assist in financing the planned increase in biodiversity protection zones from 15.9 per cent. to 30 per cent. of Belize’s waters by 2030, the strengthening of governance frameworks for domestic and high sea fisheries, and the creation of a Blue Carbon Framework for investment in blue carbon ecosystems (mangroves, tidal and salt marshes, and seagrasses that are noted for their ability to store carbon and which are, as UNESCO states, “a key component of nature-based solutions to climate change”). Many features from the Belize transaction have been repeated

in the Ecuador and Gabon swaps discussed below.

Ecuador 2023

The Ecuador debt-for-nature swap of 2023 is the world’s largest debt-for-nature swap to date by many metrics.

In April 2023, Ecuador converted USD 1.6 billion in existing commercial debt into a USD 656 million 18-year loan financed through a bond issued by a special purpose vehicle. In addition to repaying the loan, Ecuador provides approximately USD 17 million annually for conservation, being approximately USD 12 million for activities and about USD 5.4 million to seed a permanent endowment. The endowment assets, estimated to total about USD 227 million from the accumulated payments and investments over 18 years, are anticipated to be sufficient to continue financing conservation activities at the same level indefinitely. The swap saves the country more than USD 1 billion in borrowing costs and generates conservation resources totalling more than USD 450 million for the Galápagos Islands, plus more over the life of the endowment.

The debt support enabling these savings to be achieved (via the purchase of existing debt at discount funded by the issuance of new debt at par) and these projects to be performed was provided by a USD 656 million political risk insurance policy by DFC and a USD 85 million guarantee from the Inter-American Development Bank. Credit Suisse managed the tender offer and arranged the issuance of the

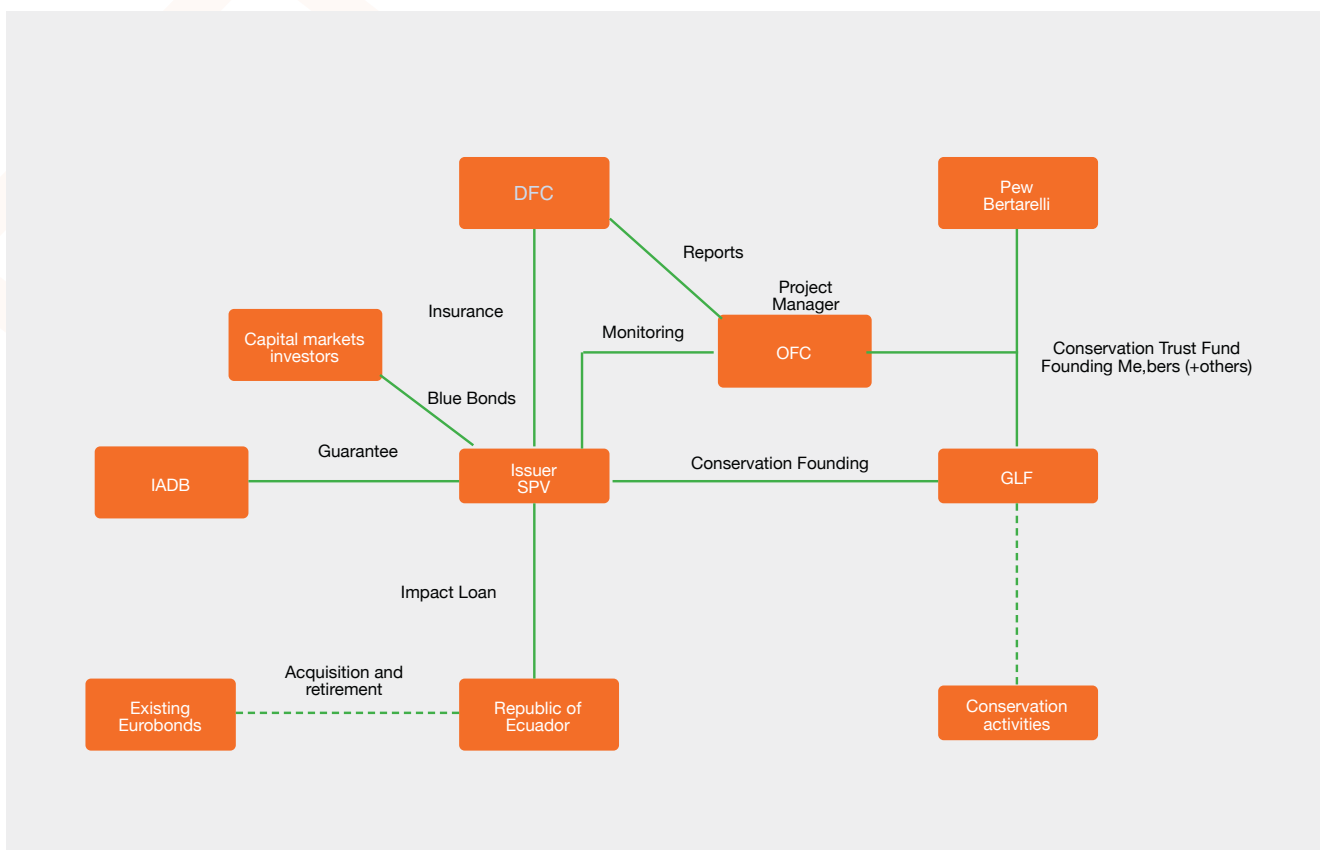
new debt, and OFC acted as the project manager, with Pew Bertarelli Ocean Legacy Project providing additional technical and financial support.

As part of the transaction, a Delaware charitable trust called the Galápagos Life Fund was established to oversee allocation of conservation funding. The fund has an 11-member board of directors composed of five government and six nongovernment representatives of the fishing, tourism, and academic communities.

The transaction documents provide that the funds generated by the swap can be used to strengthen management, monitoring, and enforcement in the Hermandad and Galápagos marine reserves. Funds can also support research-based efforts to achieve sustainable fisheries, climate resilience, and a sustainable blue economy.

The project documents also impose obligations on the relevant ministries of the government. Electronic monitoring device requirements are required to be established, monitored and enforced for industrial fishing vessels. Onboard fishing observer requirements will be implemented, and restrictions are to be placed on the use of fish aggregating devices for industrial fishing vessels. In respect of the aspects of the project which require participation of Ecuadorian government ministries to implement, failures to do so would in time result in financial consequences to Ecuador via the terms of the impact loan from the special purpose vehicle.

The diagram below sets out the key parties and roles in the Ecuador debt for nature swap.



Gabon 2023

In August 2023, the government of Gabon announced the first large-scale debt for nature swap in mainland Africa. The swap refinanced USD 500 million of Gabon's existing debt and generated an announced USD 163 million in new funding for ocean conservation, to be used in protection and management for 30 per cent. of its ocean (in line with the government's announced goal of protection for 30 per cent. of its territory).

The transaction terms provide for USD 5 million each year over the next 15 years for conservation and to create an endowment expected to grow to approximately USD 88 million by 2038 to fund ongoing conservation efforts in Gabon. Project funds will be used to finance a marine protection plan to increase the area of ocean under protection, improve management in currently and newly protected areas, and strengthen and enforce regulations in Gabon's fishing industry.

The political risk insurance to enable the favourable pricing terms of the new bonds required for the transaction was provided by DFC. As an illustration of the importance of such credit enhancement, the "blue bonds" issued by the master trust (effectively, the special purpose vehicle) benefitting from the political risk insurance were rated by Moody's at Aa2 at the time of issuance, compared to the long-term debt rating of Gabon at the time of CAA1, with a spread of only 200 basis points (i.e., 2 per cent.) above US treasuries. TNC acted as project manager.

Compared to the Ecuador 2023 swap, there was less scope for immediate headline net present value savings, as the outstanding debt of Gabon at the time of the swap was less heavily discounted (85 and 96.75 cents on the dollar, depending on the series) than that of Ecuador (relevant series trading in aggregate at approximately 60 cents on the dollar at the time). Sovereigns would be well advised in such cases to ensure that fees for advisors and credit support providers do not make the savings generated too small for the transaction to be worthwhile from a debt reduction standpoint.

The Gabon 2023 swap is by most metrics the second largest debt-for-nature swap to date. It is hoped that it will mark a watershed moment in bringing project-based swaps to mainland Africa.

Eligibility and considerations for Project Based Swaps

In assessing whether a debt-for-nature swap (or a similar project-based swap) may be a useful and appropriate tool for a particular sovereign's debt management strategy, two key metrics need to be considered: the debt profile and nature of its existing debt, and what agreed projects the sovereign would be willing to apply funds towards.

The standard starting point for an analysis of the debt profile of a sovereign is the IMF/World Bank debt sustainability framework (DSF) for that sovereign. However, not all sovereigns have DSFs already in place or in development, and DSFs are not created on a uniform basis. The African Development Bank

(AfDB), in its paper "*Debt-for-Nature-Swaps: Feasibility and Policy Significance in Africa's Natural Resources Sector*" has developed a set of metrics for assessing what it refers to as "debt affordability". Key components of the metric include the relevant sovereign's debt-to-GDP ratio, interest-to-revenue and population. The metric can be used by sovereigns to assign themselves a "score" on the affordability of their current debt.

A sovereign will also need to consider the composition of its external debt stock and the makeup of the creditors holding such debt. A sovereign with a small external debt amount could achieve proportionally outsized results by embarking on a debt swap which can lead towards long-term debt sustainability. Sovereigns with a larger stock of external debt could still benefit even from smaller swaps by moving debt service payments to conservation programmes or other agreed projects. Regarding creditor profiles, countries whose debt is primarily held by broad pools of commercial parties will have very different negotiations to those whose debt is primarily held on a bilateral basis; in the former, the involvement of a third party and adoption of the "trilateral" approach may be a better approach, while in the latter a potentially quicker and more beneficial (to the sovereign) "bilateral" structure for a potential debt swap could be more appropriate.

"Debt-for-Nature-Swaps: Feasibility and Policy Significance in Africa's Natural Resources Sector"

As mentioned above, the AfDB recently published a report paper titled "*Debt-for-Nature-Swaps: Feasibility and Policy Significance in Africa's Natural Resources Sector*", which is recommended reading for any reader interested in the potential for such swaps to play a transformative role in the financing of conservation in Africa, as well as developing the toolkits for sovereign liability management in the continent.

The aim of this research was to assist the AfDB's African Natural Resources Management and Investment Centre (ANRC) to meet its commitment to advise regional member countries (RMCs) on important aspects of natural resource management and to ensure nature fully supports Africa's future economic development objectives. The report explores ways that finance could be mobilised in an efficient manner for African countries whilst catering for climate and nature goals. Furthermore, it seeks to inform the AfDB's Debt Action Plan and Sustainable Borrowing Policy, including specific interventions on debt management and sustainability in African countries, while reducing the risks of debt crisis and distress, through "action-oriented advice on debt sustainability, climate resilience, and biodiversity conservation".³ The report highlights the aftermath of the COVID-19 pandemic as well as the war on Ukraine which is heavily impacting energy and food security, and suggests that an additional financing of USD 484.6 billion will be required over the next three years to support post COVID-19 recovery across Africa amongst other challenges such as climate and nature which are rapidly impacting least developed countries.

This report provides policy recommendations for sustainable financing options with a particular focus on debt-for-climate/nature swap transactions designed to exchange debt "forgiveness" for conservation action and highlights the opportunities to mobilize finance by leveraging a growing global recognition of the importance of nature. Lastly, the important

³ *Debt-for-Nature Swaps: Feasibility and Policy Significance in Africa's Natural Resources Sector*, African Development Bank, 2022

role that the AfDB can play for its member countries through advisory services, capacity building and collaborations with

relevant partners, in the post-COVID-19 era, amidst challenges posed by the war on Ukraine, global warming is highlighted.



V. POTENTIAL DOWNSIDES TO PROJECT-BASED SWAPS

Use in distressed scenarios

Critics have pointed out that to date debt-for-nature and similar project-based swaps have not formed part of the “toolbox” of options considered and used in sovereign debt restructurings (in a distressed scenario). Traditional arguments for why this has been the case tend to focus on the complexity of such swaps, their comparatively small scale and their potential to distract decision makers (both on the creditor side and the governmental side) whose capacity will already be strained by the existing workstreams of a “normal” sovereign restructuring. A counter-argument is that project based debt swaps are not intended to single-handedly solve any sovereign debt crisis. Additionally, as debt-for-nature and similar swaps have become increasingly common, they should no longer be seen by participants as an exotic financing option, and should be able to benefit from the experience that advisors (lawyers, bankers etc.) have garnered on previous transactions to ensure that these do not end up taking up too much bandwidth to be an effective part of a restructuring. In fact, by providing an additional option for creditors in a restructuring, a well-planned offer for a project-based debt swap could be used to provide an additional incentive for affected investors to participate in a restructuring offer. Finally, arguments based on scale are easily rebutted by the large-scale project swap operations recently undertaken by Ecuador and Gabon.

Democratic / consultation issues

Concerns have been raised on the exclusion of stakeholders, in particular indigenous peoples and local communities, in the implementation of debt-for-nature swaps, particularly those which were performed in the early years of the concept. For example, depending on the terms of the agreed projects, consequences have included the restricting of access to traditionally owned lands, and to the resource rights therefrom, which would otherwise have been enjoyed by indigenous people but in respect of which environmental protection was prioritised (a well-publicised example being the early swap in Bolivia, the terms of whose agreed project restricted the Tsimané people’s land rights). However, these concerns can be mitigated by ensuring a “free, prior, and informed consent” (FPIC) process takes place with relevant stakeholders early in the process of setting up the agreed projects, with a particular focus on land and land use rights. It can also be noted that project areas outside of nature conservation may be inherently less subject to such concerns, given that they may be less concerned with land, though of course in any swap the voices of all concerned must be listened to (and in a transparent

fashion) in order to preserve legitimacy.

Governance and monitoring

If there is a lack of support for the agreed projects, a debt swap transaction can fall apart due to a failure to meet targets or use the allocated funds correctly. For example, failure by governments to pass legislation required to achieve the agreed projects can leave a debt swap transaction effectively dead on arrival. Solutions to these issues include working within existing frameworks, as well as engaging with all necessary governmental and related parties early in the process. Ensuring that all parties are clearly made aware of the advantages of debt forgiveness, and that projects are being effectively funded with “free” money, is also necessary to ensure buy-in by officials on the ground. Additionally, ensuring a separate “ring-fenced” fund legally independent from the government’s budget ensures transparency and removes any incentive for the government to attempt to use the funds for other purposes.

Similarly, by their nature, whether the desired outcomes in respect of the agreed projects have been agreed upon is not always clear. In order to achieve buy-in from stakeholders (from investors to the population of the relevant country) accurate and transparent verification and assessment are key. Some critics have noted that in certain conservation-based swap transactions, monitoring and evaluation tend to privilege fiscal evaluations of protected areas over the direct outcomes of conservation measures. Accordingly, it should be ensured that a sufficient proportion of the funding of the agreed projects is allocated to verification and monitoring. Further, involving local stakeholders in the verification and monitoring process can both improve perceived legitimacy as well as yield more accurate data.

Friction with “Debt Justice” concept

The sovereign debt justice movement, though containing many different specific viewpoints within it, can broadly be summarised as the position that many wealthy lenders/investors (whether commercial or public) have unfairly benefitted from the developments that have created the current inequalities in wealth distribution as well as the climate crisis, and should accordingly forgive some or all debt owed to less fortunate borrowers in recognition of this fact, and to allow such borrowers to use funds which would otherwise be used on debt service to address urgent priorities. The Debt Justice Society noted that “*Countries in the global south are*

currently spending five times more on debt repayments than they are addressing the impact of the climate crisis".⁴ Some proponents of the debt justice movement argue that debt-for-nature and similar swaps serve as a distraction to this cause, with criticisms relating to the relatively small size of such swaps to date versus total debt levels; expensive negotiation periods and advisor fees; being a "greenwashing" exercise for creditors; undue control over sovereign use of funds by lenders in a privileged position; and fundamental criticisms of monetising the subjects of the projects (nature, education

etc.) and acknowledging the legitimacy of the original debt.

While ultimately the weight of these concerns will depend on the economic / political views of the individual, until the debt justice movement has achieved significantly more take-up amongst creditors, it would seem impractical for sovereigns to reject debt swaps as a tool (and the positive outcomes they are capable of creating) out of hand on the basis of this principle, in particular given the increasingly large sizes of recent project-based debt swaps.



⁴ "The debt and climate crises: Why climate justice must include debt justice", Debt Justice Society, 2022.

VI. RELATED SWAPS AND SIMILAR INITIATIVES

“Debt-for-Climate” vs “Debt-for-Nature”

The IMF has found a correlation of vulnerability to climate change and risk of financial crises, with potential debt downgrades rendering the financing of debt increasingly difficult for countries facing particular climate-based challenges. Debt-for-climate swaps, intended to address this issue, are similar in many ways to debt-for-nature swaps. Both debt-for-climate and debt-for-nature swaps offer a response to the triple crisis of growing debt, loss of biodiversity, and impacts from climate change faced by some developing nations. Both involve an exchange of an existing debt contract for a new debt contract and discounting the value of the original debt contract. However, the projects which can be the focus of some of the savings made by the sovereign in a debt-for-climate swap have a broader focus beyond nature conservation, extending to various adaptation activities with an emphasis on building resilience against sea level rise, flooding, droughts, and extreme heat.

Debt-for-climate swaps have yet to achieve the level of popularity in the financial markets as debt-for-nature swaps, and currently remain largely theoretical, with climate-based development financing to date taking the form of “climate conditional grants/loans” (i.e., new-money financing with conditions as to their use embedded in the terms of the financing).

However, a recent IMF paper⁵ argues that debt-for-climate swaps (as well as project-based swaps more generally) should be implemented and scaled up for two key reasons: (i) to strengthen climate finance as a whole (policies that support debt swaps involving commercial debt integrate much of the same monitoring and verification structures that also support climate-conditional lending instruments) and (ii) to incentivise bilateral official and commercial creditors to provide debt relief. The IMF argues that project-based swaps should focus on climate adaptation as well as nature conservation, and encourages this to be done for the countries most at-risk due to climate change. They note that developing standardised key performance indicators (“KPIs”) to set how the allocated funds will be used will be key (the European Union’s taxonomy for sustainable activities, for example, may be of assistance in this, as it has been for the new-money use-of-proceeds instruments discussed below). They also suggest the use of carbon credits in conjunction with debt swaps, as well as creating a multilateral initiative, grouping broad sets of donor countries and official bilateral creditors, to identify countries with the greatest gaps between climate-related investment needs and fiscal space to support a combination of bilateral debt swaps and trilateral debt swaps along with conditional grants.

⁵ *Debt-for-Climate Swaps: Analysis, Design, and Implementation*, IMF, 2022

⁶ <https://www.un.org/osaa/news/gabon-receives-payment-reducing-co2-emissions>

⁷ *Ibid.*

Carbon Trading - Case study: Gabon Initiative

While not technically a debt swap in and of itself, a carbon-trading initiative can have many similar features and be driven by many similar concerns from both sovereigns and investors. Carbon credits are market-based financing instruments which allow polluters to offset emissions through activities like planting trees or investing in renewable energy projects. Conceptually, they could feature in bespoke debt-for-nature swaps (or indeed other forms of project-based swaps) as carbon credits could form some of the consideration which a creditor could receive in exchange for participating in the swap.

In particular, the Gabon carbon-trading initiative (the “Initiative”), set up in 2019, is a breakthrough agreement between the state of Gabon and the multi-donor UN-hosted Central African Forest Initiative’s (CAFI) for a total of USD 150 million over 10 years.⁶ The CAFI more generally is partnered with six countries in central Africa to scale reform programmes, and also works on high-level policies to implement the Paris Agreement in its partner countries. Not only focusing on tackling rising emissions, the Initiative integrates fighting poverty in its goal for sustainable development. Upcoming projects for the CAFI include work on future emissions reduction in the Congo Basin Forest, focusing on rainforests in order to mitigate the ongoing global climate crisis. The Congo Basin Forest is the world’s second largest rainforest, taking out close to 1.5 billion tons of CO₂ from the atmosphere, which accounts for 4 per cent. of global emissions each year.⁷

The Initiative makes Gabon the first state in Africa to receive payment for reducing CO₂ emissions and follows previous work in Gabon to reduce emissions by extending sustainable forest management. The aim of the Initiative is to reduce deforestation and forest degradation by using new payment mechanisms to stabilise forests rather than simply slowing deforestation and degradation. The Initiative uses payments to invest into community forestry, scientific research, forest management practices, protected areas system and government capacity. The aim is for Gabon to finalise these systems that will be required to enable the country to formally sell carbon credits in the future.

Carbon credits may feature increasingly in similar transactions to debt-for-nature swaps in Africa. The Africa Carbon Markets Initiative (ACMI), an initiative to boost Africa’s carbon credit production 19-fold by 2030, was launched at Egypt’s COP27 summit in 2022, and in September 2023 drew hundreds of millions of dollars of pledges at Africa’s first climate summit, including a commitment by the United Arab Emirates (UAE) to buy USD 450 million of carbon credits from the African nations.

Debt-for-Education (and other projects)

While to date, the preponderance of project-based debt swaps has been focussed on environmental protection or climate change, from a technical perspective there is no reason why other “public good” projects cannot be the quid-pro-quo for the debt swap. The subject matter will, of course, need to be a project that is viewed by (in a bilateral swap) the creditor or (in a trilateral) the involved transaction parties (insurer, investors in new bonds, structurer) as being a desirable outcome from their own perspective.

Arguably, the market focus to date on debt-for-nature swaps rather than other project-based debt swaps is reflective of the predilections of creditors and the historical factors discussed above rather than the needs of emerging markets’ debtors. An indebted sovereign facing many domestic and international challenges may understandably wish to prioritise building strong health systems (for example) rather than protecting their wildlife or other natural resources. It is perhaps to be lamented that there has to date been relatively limited take-up of the opportunities provided by debt swaps with indebted sovereigns in developing regions. While a creditor (or another transaction party such as the insurance provider in a trilateral swap) has a right when providing “something for nothing” (debt relief, or risk exposure) to set their own requirements as to use of some of the “saved” money (they can, after all, walk away from any deal if they do not like how the savings will be used), it is hoped that the swap market will develop to be more debtor-lead as it matures and debtors become more familiar with the concept. In this model, debtors could pitch uses of proceeds to their creditors or the facilitative parties in a swap (and it is to be hoped that creditors will recognise that prima facie a local government may be better placed than they are to know the best projects towards which to apply swap-generated savings).

We would in particular note the opportunities raised by the publication of the Sustainable Development Goals (SDGs) by the United Nations in the debt swap context. Given the wide institutional buy-in to the SDGs by sovereigns, financial institutions and investors, provided that a debtor sovereign is able to identify a potential project or projects as furthering an SDG (which provides a clear and well-understood framework), there should be no reason why this could not form the subject matter of a debt swap’s agreed projects limb. While several of the SDGs (e.g., SGD 13 (Climate Action) and SDG 14 (Life Below Water)) do refer to nature and climate, a debt swap could just as easily serve to help achieve SDG 1 (No Poverty), 2 (Zero Hunger) or SDG 3 (Good Health and Well-Being), for example.

One area, that has already attracted a substantial amount of interest amongst commentators and a certain uptake in the real world is “debt-for-education” swaps. In these, the agreed project is, as the name would imply, an education-based one, rather than one relating to the natural world directly (debt-for-nature) or indirectly (debt-for-climate).

Case Study: Debt-For-Education Swap -

8 UNESCO Debt Swaps & Debt Conversion development bonds for education, 2011.

Cameroon / France

In 2000, the government of France created the *Contrat de Désendettement et Développement* (also known as the C2D: Contracts for Debt Relief and Development). In 2006, using this facility, France signed an agreement with Cameroon in respect of EUR 1.17 billion of debt to be used for education programs in Cameroon. Cameroon designed in that year a new 10-year education strategy focusing on universal primary enrolment, gender equity, and full graduation rates, with recruitment of the 37,200 contract teachers using USD 392 million over five years being the primary tool chosen to achieve these goals. 75 per cent. of the total cost of the program was to be funded by the government of Cameroon, with the remaining 25 per cent. (USD 103 million) to be part-funded by the C2D program in the amount of USD 55.3 million.

This was generally considered a successful program by relative constituents in both France and Cameroon. However, the C2D program has been subject to criticisms including high costs associated with its administration due to the complex conditions and requirements for the funding. Another criticism is that C2D did not actually provide debt relief as Cameroon was required to service its debts to France; however, this objection is perhaps more technical than substantive as France returned the debt service payments to Cameroon to use for development projects, making this a moot point (and in fact, C2D was not intended to improve debt sustainability but rather to assist governments which had achieved a sustainable level of external debt).⁸

Case Study: Debt-For-Education Swap - El Salvador / Spain

In 2005, El Salvador and Spain entered into a relatively small (USD 10 million over four years) debt swap whereby instead of making payments to Spain’s Development Assistance Fund (DAF), El Salvador deposited USD 2.5 million per year into a special account at the El Salvador Central Bank, with each such deposit commensurately reducing the amount owed to Spain. The deposited funds were managed by committees consisting of representatives of Spain and El Salvador, one for the debt swap execution and structure and the other for fund disbursement and project execution.

The funds were used to fund the Rural School Construction Program (in place already before the swap came into existence), which focused on building schools and stocking the libraries of deprived areas. Third-party audits provided transparency and ensured a lack of fund loss due to corruption. Reportedly 74 per cent. of the programme’s funds were spent on construction, 24 per cent. was used to stock libraries and less than 1 per cent. on administrative costs. All work other than the third-party audits was performed by existing public sector personnel and departments, and the programme continued despite a change in government administration mid-project.

Both Spain and El Salvador reported satisfaction with the programme. Spain was able to fund educational programmes without providing new funding, and improved working

relationships between officials of both governments.⁹ However, the relatively small scale of the project must be noted; systemic change is difficult to achieve on a budget of this size.

Debt for Education - Criticism

There have been criticisms of the debt-for-education concept which are, in the main, similar to those discussed above on project-based debt swaps more generally. Specifically, in the education context, there have been concerns raised¹⁰ that debt swap arrangements may potentially “crowd out”, from a bandwidth perspective, other aid intervention strategies such as direct financial support to a state’s education budget. The accounting rules binding on the foreign aid sector are, it has been argued, an inciting factor seems to treat debt-for-education swaps as an alternative for financial aid, rather than as an additional tool in the toolbox (for example the OECD Development Assistance Committee allows for the nominal value of debt relief to be counted as overseas development assistance, meaning debt-for-education swaps may be accounted for by providers as if they were pure financial assistance). It is accordingly important for debtor sovereigns to remind donors that debt-for-education swaps should not be viewed as a full substitute for education grants and other funding provided to assist with educational goals in developing countries (if for no other reason than that they are only possible where sovereigns have substantial international debt).

When entering into more debt-for-education agreements, policymakers should consider the issue of “brain drain” if the educational target involves educating selected students abroad since those students may not return to their home countries. Debt-for-education swaps must also be carefully reviewed for their opportunity costs, as such swaps may divert funds away from activities with higher returns (such as primary education) to activities of lower value to the population as a whole (such as financing a few expensive foreign exchange programmes).¹¹ Other arguments note that debt-for-education swaps do not automatically result in extra resources spent on education purposes within recipient countries as debtor governments can reduce their own education spending in line with the amounts provided pursuant to (or even more than the amount provided for) the swap. However, this is a potential criticism of all aid programmes related to items within a country’s general budget, and risks letting the perfect be the enemy of the good.

Debt2Health

In addition to education, there have been several prominent cases of the focus of a project-based swap being in the healthcare and anti-disease fields. The Debt2Health initiative of the Global Fund to Fight AIDS, Tuberculosis, and Malaria (the “Global Fund”) has used a debt swap mechanism since 2007 jointly with several creditor governments. It aims to improve health systems’ ability to address the health impacts caused by these diseases, which it has done to date in

⁹ *ibid.*

¹⁰ UNESCO *Debt Swaps for Education*, 2009.

¹¹ *An Economic Analysis of Debt Swaps and Case Study of the Harvard Debt for Education Swap*, 1993.

¹² https://www.theglobalfund.org/media/12284/publication_debt2health_overview_en.pdf

countries including Cameroon, the Democratic Republic of Congo, Côte d’Ivoire, Egypt, Ethiopia, Indonesia, and Pakistan. After being paused for several years after being founded, it was re-launched in 2017. Under the Debt2Health initiative, through individually negotiated swap agreements, a creditor nation foregoes repayment of a loan and the beneficiary nation agrees to invest part or all of the freed-up resources into a Global Fund-supported and monitored program. Debt2Health swap agreements have provided USD 226 million invested in health programs and USD 366 million in debt cancelled, with debt forgiveness provided by Australia, Germany and Spain to 10 debtor countries over 12 transactions¹².

As an example, under the Debt2Health initiative, in November 2017, the government of Spain agreed to waive debts owed by Cameroon, the Democratic Republic of Congo and Ethiopia amounting to EUR 37 million in exchange for investments in domestic health programs supported by the Global Fund totalling EUR 15.5 million (Cameroon: EUR 9.3 million in HIV programs; the Democratic Republic of Congo: USD 3.4 million in malaria programs; and Ethiopia: EUR 3.2 million to strengthen its health systems). By way of mechanics, the debtor sovereigns make their investments in the agreed sector or project by way of a contribution to the Global Fund (which is accounted for by the Global Fund as a contribution by the creditor sovereign), which the Global Fund applies as grants for the purposes agreed and assists the sovereign debtor to implement, monitor, audit and report results.

“Use of proceeds” instruments

When considering what form the “new” debt in any sovereign debt swap will be, it will be helpful for the issuer to consider the issues raised in the ALSF Debt Guide on Sustainability Financing. In particular, the new debt may have use of proceeds restrictions relating to the agreed projects - which make them similar in many respects to “green” or “blue” bonds. For example, the “new” bonds may contain events of default (or other consequences such as additional payment triggers) in the event of a failure to achieve the targets set in relation to the agreed projects. As such, if a sovereign issuer is considering the issuance of a new use-of-proceeds bonds, this would be a practical time to engage with its advisors and see if this new issuance could in fact form part of a swap for the existing debt of the sovereign. While as a rule to date, the use of proceeds targets in standalone use-of-proceeds instruments have been more general than the often very specific agreed projects requirements in debt-for-nature and similar swaps, these can nonetheless be considered as a continuum rather than completely distinct finance solutions.

VII. PRACTICAL CONSIDERATIONS AND CONCLUSION

Practical Considerations

It is the hope of the authors that this guide will have led members of sovereign governments or civil servants to consider whether a debt swap might be right for their country.

For those individuals, what would be the first steps, and what would be the potential process, for creating a successful debt swap?

- First, the sovereign should reach out to a project manager such as TNC or OFC to help it to consider whether there are potential projects that could form the basis of a project-based swap. While it is of course entirely possible for a sovereign to skip this step and instead proceed with a traditional liability management exercise without any project-based element, given the benefits outlined above, it would always be worth considering whether a bilateral or trilateral swap with a project element satisfactory to both creditor and debtor may be available.
- Following the engagement with a project manager, engagement with creditors would be the next logical step. In the case that one or more bilateral swaps are being considered, this can be done directly with creditors (with the assistance of the project manager), as these are (as has been explained above) substantially similar to negotiating grants or debt relief. However, if the creditor base for the swap is wider (for example, if it includes sovereign Eurobonds) it would make sense at this stage to engage a financial advisor (i.e., an investment bank). This can be done by way of a competitive request-for-proposals (“RfPs”) to leading institutions and to those with whom the sovereign already has relationships, for example those which assisted on the original issuance of the debt.
- Following the appointment of the financial advisor, legal counsel for all relevant parties will need to be instructed. The project manager can advise on this, and the sovereign may already have law firms it has relations with (as will the financial advisor). Ultimately, all fees for the advisors will be paid from the proceeds of the issuance of the new debt, so even the lawyers working for the financial advisor will be paid through the sovereign’s new debt incurrence.
- The project manager will, at this point, liaise with credit support providers, such as major development banks, to provide credit support (required from a practical perspective in the case of a trilateral swap). Legal counsel, the project manager and the financial advisor will assist the sovereign in negotiating the terms of any guarantee or insurance policy the credit support provider will grant. The negotiations will likely focus on the parameters of the agreed projects, their monitoring and the economic terms of the credit support.
- At the same time, the financial advisor and its counsel will be progressing the documentation relating to the new debt, as well as engaging with potential investors in order to help set the terms of the proposed swap. While this is taking place, the local legal advisors of the sovereign will work with the project team to ensure that all relevant approvals and authorisations are in place to enable due execution of the swap, and the project manager will coordinate the setup of the trust or charitable organisation to manage proceeds earmarked for the agreed projects.
- Upon agreement as to the terms of the documents, and on a favourable market window as advised by the financial advisor, the tender offer will be performed (as described above) and the transaction documents (for example, the indenture or loan agreements for the new debt, documents constituting the project trust or charity, agent appointments, insurance or guarantee agreements and project commitments) will be signed. As previously stated, this can sometimes be a significant time period following the original conception of the project but given the size that can now be achieved for certain swaps, it is an investment of time that can be very worthwhile for the sovereign. Throughout the process, the sovereign’s advisors will be able to answer questions and provide the benefit of their expertise, making any technical complexity that arises more straightforward and comprehensible.

VIII. CONCLUSION

The purpose of this guide has been to explain the key concepts surrounding debt swaps and demonstrate the many benefits that a sovereign can receive from them. In a world of high interest rates, debt burdens accumulated during the global pandemic and an increased focus on sustainable development, debt swaps (and in particular project-based debt swaps) present real opportunities for constructive engagement between all the stakeholders in the sovereign debt universe.

Whether or not they are having issues servicing their outstanding debt, sovereigns have much to gain and little to lose from exploring options to reduce the amount or improve the terms of their debt through swaps, particularly now that the market for large-scale trilateral swaps for developing nations has truly opened. It is to be hoped that this useful method of liability management for sovereigns continues to expand, particularly into areas beyond the purely natural world and into other types of development.

GLOSSARY

Bilateral Swap – a swap between two (sets of) parties, i.e. the debtor and the creditor (or a group of creditors)

Bonds – a tradable financial instrument representing a debt, issued by sovereigns, state-owned enterprises or corporates in the capital markets.

Call Option - an option to buy assets at an agreed price on or before a particular date, which can be included in the terms of a bond.

Carbon Trading - the buying and selling of credits that allow companies or other parties to emit a certain amount of carbon dioxide.

Debt for Education Swap – a project-based swap where the agreed projects / commitments are related to the provision of education or educational infrastructure.

Debt for Health Swap – a project-based swap where the agreed projects / commitments are related to healthcare, vaccines or similar fields.

Debt for Nature Swap – a project-based swap where the agreed projects / commitments are related to conservation or protection of natural or animal life.

DFC – the Development Finance Corporation, a US governmental development finance organisation that has provided support for project-based swaps.

Discounted – debt trading in the secondary market for less than its par value (e.g. 80 cents on the dollar represents a discount of 20 per cent.)

Distressed Debt – the debt of a company or sovereign that may be unable to fulfil its financial obligations.

Intermediary – the “middle” entity in a trilateral swap, a role often performed by an SPV.

Liability Management - a variety of procedures and techniques used by bond issuers for the purposes of buying back, exchanging or altering the terms of bonds

NPV – net present value, meaning the value in the present of a sum of money, in contrast to the future value it will have when it has been invested for a period of time (e.g. if interest rates are 10 per cent., 110 due in 12 months’ time has a present value of 100 today).

OFC – Ocean Finance Corporation, a project manager for debt swaps.

Open Market Purchase - the purchase and sale of securities in the open market, as opposed to via tender offer.

Project-Based Swap – a debt swap which includes as a condition for debt relief the performance of specific projects such as sustainability commitments.

Project Manager – entity which arranges and supervises the performance of commitments for project-based swaps.

SPV – special purpose vehicle, meaning a new company incorporated for one specific task in a transaction structure (often used as the intermediary in a trilateral swap)

Sustainability Commitment – the commitments in a debt for nature swap which the debtor agrees to perform in exchange for the debt relief provided.

Tender Offer – a public offer to buy securities (e.g. bonds) from every holder at a certain price at a certain time.

TNC – The Nature Conservancy, a global environmental organisation involved in project managing debt for nature swaps since the 1980s.

Trilateral Swap – a structure of project-based swaps where by an intermediary buys outstanding debt on a secondary market at discounted rates, funded by an issuance of new guaranteed or insured debt at par value.

REFERENCES AND FURTHER READING

International Monetary Fund, Debt-for-Climate Swaps: Analysis, Design, and Implementation 2022

<https://www.imf.org/en/Publications/WP/Issues/2022/08/11/Debt-for-Climate-Swaps-Analysis-Design-and-Implementation-522184>

African Development Bank Group, Debt-for-Nature-Swaps: Feasibility and Policy Significance in Africa's Natural Resources Sector 2022

<https://www.afdb.org/en/documents/debt-nature-swaps-feasibility-and-policy-significance-africas-natural-resources-sector>

IIED, Potomac Group LLC, UNECA, UNESCWA and UNDP, Linking sovereign debt to climate and nature outcomes. A guide for debt managers and environmental decision makers. 2021

<https://www.iied.org/20651iied>

Lee Buchheit, Guillaume Chabert, Chanda DeLong and Jeromin Zettelmeyer, The Sovereign Debt Restructuring Process 2018

<https://www.imf.org/-/media/Files/News/Seminars/2018/091318SovDebt-conference/chapter-8-the-debt-restructuring-process.ashx>

Patrick Bolton, Lee Buchheit, Mitu Gulati, Ugo Panizza, Beatrice Weder di Mauro, Jeromin Zettelmeyer, On Debt and climate, Oxford Open Economics , Volume 2, 2023, odad005

<https://doi.org/10.1093/ooec/odad005>

DEBT SWAPS

A COMPREHENSIVE
GUIDE FOR AFRICAN
SOVEREIGNS



ALSF

AFRICAN LEGAL SUPPORT FACILITY | FACILITÉ AFRICAINE DE SOUTIEN JURIDIQUE

Baker
McKenzie.

African Legal Support Facility | Facilité africaine de soutien juridique
Immeuble du Centre de commerce International d'Abidjan CCIA,
Avenue Jean-Paul II, 01 BP 1387 Abidjan 01, Côte d'Ivoire
www.alsf.int

© 2023