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debt and development

Sleep now in the fire

Sovereign Bonds and the Covid-19 Debt Crisis



By Daniel Munevar • May 2021

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**"The world is my expense
The cost of my desire
Jesus blessed me with its future
And I protect it with fire
So raise your fists
And march around
Don't dare take what you need
I'll jail and bury those committed
And smother the rest in greed
Crawl with me into tomorrow
Or I'll drag you to your grave
To cost of my desire
Sleep now in the fire"**

Rage Against The Machine

Executive summary

Developing countries buckling under the weight of the pandemic are yet to receive debt relief from private creditors. Meanwhile hundreds of millions are suffering and investors have amassed record profits collecting public debt repayments throughout the pandemic. The outrageous nature of this situation is accurately portrayed by the band Rage Against The Machine in its song “Sleep now in the Fire”: those whose lives have been upended by the pandemic are being asked to “sleep in the fire” of deprivation to satiate the global financial system’s logic of profit and greed.

The first step towards addressing this unacceptable situation is a clear diagnosis of the problem. Unfortunately, a lack of transparency on public debt has turned this assessment into a challenging process. Sovereign bonds are a central part of this issue. This report sheds light on the market for these instruments. These are public listed securities issued by national governments of middle-and low-income countries under foreign currency and governing laws.

This report provides a breakdown of currencies, coupons, maturities, governing laws, presence of Collective Action Clauses (CACs), underwriters and identified bondholders across sovereign bonds. The analysis identifies a total of 549 sovereign bonds issued by 62 middle and low-income countries with an outstanding nominal value of US\$ 691 billion. This report finds that:

- Developing countries are required to pay US\$ 330 billion on debt service for these bonds over the next five years.
- The identified bond holders are composed of a group of 501 institutional investors from 31 countries. These firms have a total of US\$ 169 billion in sovereign bond holdings. The results of the analysis illustrate the power imbalance between creditors and debtors.
- The top 25 investors in sovereign bonds, led by US-based asset managers such as BlackRock, PIMCO and AllianceBernstein, have a total of US\$ 42.7 trillion in Assets Under Management. This figure is equivalent to four times the GDP of the 62 sovereign bond issuers that are covered in this report. This leads to an outsized disparity in the availability of financial, legal and technical resources that favours creditors to the detriment of sovereign debtors. The latter are at a structural disadvantage with respect to their creditors in the context of a debt restructuring.
- Policy initiatives, such as the G20 DSSI, aggravate this dynamic by enabling creditors to have their cake and eat it too. A lack of measures to ensure their participation in debt relief allows them to profit from risk while refusing to assume the losses once they materialise.

The costs of inaction on commercial creditor participation in debt relief are already unsustainable. Health, social, political and economic tensions heightened by the pandemic are stretching countries to breaking point across the world. The prioritisation of creditors’ rights over human rights is a short-sighted approach. People will not sleep in the fire for long.

To safeguard the lives and rights of people across developing countries, this report calls for concrete measures to improve transparency on sovereign bonds and ensure private creditor participation in debt relief. These include the following:

- The establishment of a public registry system for loan and debt data, including full disclosure of information on sovereign bonds.
- Improved regulations for disclosures of bond contracts and holdings by underwriters and investors such as investment banks and hedge funds.
- The adoption of a statutory approach for private creditor participation in debt relief under a multilateral sovereign debt workout mechanism. Such a mechanism is vital to address the structural power imbalance between creditors and debtors and provide a level playing field for equitable debt resolution that places human rights at the centre of the multilateral response.

Sleep now in the fire: Sovereign Bonds and the Covid-19 Debt Crisis

The human rights of hundreds of millions of people are being negatively affected by the most severe developmental crisis in recent history.¹ Debt is a central element in this situation. Public debt levels have been on the rise over the past decade. This dynamic has been exacerbated by the Covid-19 pandemic.

Growing debts are, in fact, a mirror of the evolving human catastrophe that is being witnessed across the developing world since the beginning of the pandemic: the number of people experiencing severe hunger has increased to 265 million;² an additional 236 million people have been pushed into extreme poverty;³ the equivalent of 212 million jobs have been lost;⁴ the number of children lacking basic literacy has increased to 584 million;⁵ and, in addition to the loss of 2.9 million lives to Covid-19, millions more people have seen their right to health being curtailed as a result of overstretched healthcare systems.⁶

While hundreds of millions are suffering, investors have amassed profits collecting public debt repayments throughout the pandemic. Investment banks,⁷ asset managers⁸ and hedge funds⁹ posted record revenues and profits in 2020. Multilateral efforts to involve such institutions in debt relief have been inadequate. On the one hand, creditors have been called to participate on a voluntary basis in the G20 Debt Service Suspension Initiative (DSSI).¹⁰ On the other hand, their participation is required under the Common Framework for Debt Treatments Beyond the DSSI.¹¹ Thus far, private creditors have not participated in either initiative. Developing countries buckling under the weight of the pandemic are yet to receive debt relief from their private creditors. The outrageous nature of this situation is accurately portrayed by the band Rage Against The Machine in its song "Sleep now in the Fire".¹² Those whose lives have been upended by the pandemic are being asked to "sleep in the fire" of deprivation to satiate the logic of profit and greed of the global financial system.

This situation is not sustainable. Prioritisation of creditors' rights over human rights is a short-sighted approach. This already is a catalyst for mass unrest across developing countries. They are at risk of a vicious cycle of instability and crisis.¹³ Urgent measures are required to avoid this outcome. The ongoing debt crisis must be tackled in a systematic, orderly and equitable manner. Active engagement of private creditors is required as part of this process. This will ensure fair burden sharing within creditors and between creditors and debtors. Without their participation in debt resolution efforts, developing countries face a protracted crisis. The most vulnerable will be saddled with unsustainable debt burdens. The achievement of the 2030 Agenda will definitely be put out of reach.¹⁴

Against this backdrop, the first step towards a solution is a clear diagnosis of the situation. Unfortunately, lack of transparency on public debt has turned this assessment into a challenging process.¹⁵ Sovereign bonds are a central part of this problem. These are public listed securities issued by sovereign governments under foreign currency and governing laws. They allow to raise external financing and can be bought and traded by investors across the world. Despite their status as public contracts, there is a substantial lack of transparency when it comes to the terms, clauses and participants in bond markets. Without a clear understanding of these crucial issues, efforts to ensure private creditor participation are bound to fail.

This report aims to shed light on the lack of transparency in the case of sovereign bonds of middle- and low-income countries¹⁶. The study includes a breakdown of currencies, coupons, maturities, governing laws, presence of Collective Action Clauses (CACs), underwriters and identified bondholders. The analysis identifies a total of 549 sovereign bonds issued by sovereign authorities under foreign currencies and governing laws.¹⁷ These instruments have an outstanding nominal value of US\$ 691 billion and have been issued by 62 middle- and low-income countries. Developing countries are required to pay US\$ 330 billion on debt service for these bonds over the next five years. The identified bond holders are composed by a group of 501 institutional investors from 31 countries. This group of investors, led by US-based asset managers such as BlackRock, PIMCO and AllianceBernstein, hold sovereign bonds with a nominal value of US\$ 169 billion as of January 2021. Policy measures, such as the G20 DSSI, are enabling these creditors to have their cake and eat it too. Lack of measures to ensure their participation in debt relief allows them to profit from risk while refusing to assume the losses once they materialise.

This analysis underscores the lack of transparency that surrounds sovereign bonds. It is an expensive and difficult process to retrieve information on a reliable and comprehensive basis for these instruments. This is problematic given the benefits that increased transparency can bring to debt management practices of sovereign issues, risk assessments by investors and design and implementation of multilateral debt relief initiatives.

The report is structured as follows. Section two provides a description of the data and methodology. Section three provides an overview of the distribution of sovereign bonds by issuers in 2021. Section four discusses the financial terms of the bonds, including currency, coupons and maturities. Section five analyses the legal terms of the contracts, with a focus on governing law and presence of Collective Action Clauses (CACs). Section six, identifies the main sovereign bond underwriters and bondholders, and provides an assessment of the relative cost of debt cancellation. Section seven concludes with policy recommendations.

Data and Methodology

Access to data on public debt is a surprisingly difficult exercise.¹⁸ Over recent decades there has been a proliferation of publicly accessible databases which have helped to improve our understanding of public debt. These include data provided by the United Nations (UN), International Monetary Fund (IMF), World Bank, Organisation for Economic Cooperation and Development (OECD), Bank of International Settlements (BIS) and the Paris Club, among others.¹⁹ Despite these efforts, lack of transparency remains one of the most problematic issues in the international architecture of sovereign debt.²⁰

Compilation and dissemination of public debt data follows the criteria established by the Inter-Agency Task Force on Finance Statistics (IATFFS). The IATFFS has developed a system of classification for the compilation of external debt statistics. External debt is defined as “liabilities that require payment(s) of principal and/or interest by the debtor at some point(s) in the future and that are owed to non-residents by residents of an economy.”²¹ This definition aims to capture the economic impact of resource transfers between residents and non-residents in an economy. Thus, the “external” character of the debt. These debts can be acquired by different sectors of the economy, using a variety of instruments and borrowing from different non-resident institutions.²²

The identification of what constitutes an external debt under this definition is an impossible task.²³ The residence of creditors is often obscured by active trading, layers of intermediaries and risk management strategies.²⁴ As a result, official statistics use a definition of external debt which actually relies on the place of issuance, jurisdiction and/or currency of the debt instrument.²⁵

An analysis of sovereign bonds has to deal with this methodological challenge. Sovereign bonds are debt securities negotiable in exchanges issued by a national government to borrow from non-residents.²⁶ However, determining the residency of the holders of these securities is one of the most difficult fields of work in external debt statistics compilation.²⁷ As a result, it is necessary to use an alternative set of criteria.²⁸ Sovereign bonds included in this analysis are public listed securities issued:

- By a national government of a middle or low-income country.²⁹
- In a G7 market under foreign governing law.³⁰
- In US dollars, Euros or Japanese yen.
- With a maturity date after January 1, 2021.

The identification of relevant public listed bonds falling under this classification was made through the Refinitiv fixed-income database.³¹ A preliminary list of bonds was then cross-referenced with the databases of the London Stock Exchange³², Luxembourg Stock Exchange³³ and EDGAR³⁴. This process yielded a total of 843 unique ISIN codes for bonds issued by a group of 62 middle- and low-income countries.³⁵ The data was further refined to account for duplicate listings of bonds issued under both Regulation S and Rule 144A.³⁶ Sovereign issuers make use of these different regulations to market the same bond to different types of investors. Bonds under Regulation S have less strict disclosure criteria. These are issued in the Eurobond market for international investors. Bonds under Rule 144A follow a stricter set of disclosure criteria. However, trading in these instruments is limited to private placements for qualified US institutional investors.³⁷ Excluding duplicates, the list of instruments narrows down to 549 bonds.³⁸

The analysis focuses on three sets of issues. First, the financial terms of the bonds, including currency, coupons and maturities. Second, the legal terms of the contracts, including governing law and presence of Collective Action Clauses (CACs). Third, the identification of the main sovereign bond underwriters and bondholders. The identification of bondholders is based on data reported by Refinitiv based on regulatory filings as of the end Q4 2020. The first two sets of issues are analysed using the list of bonds with 549 instruments. The last part of the analysis is conducted using the list of 843 instruments. This allows the inclusion of holdings of bonds under both Regulation S and Rule 144A.

The annex provides an overview of the countries and bonds included in this analysis. The complete dataset with all the information included in this report can be found online.³⁹

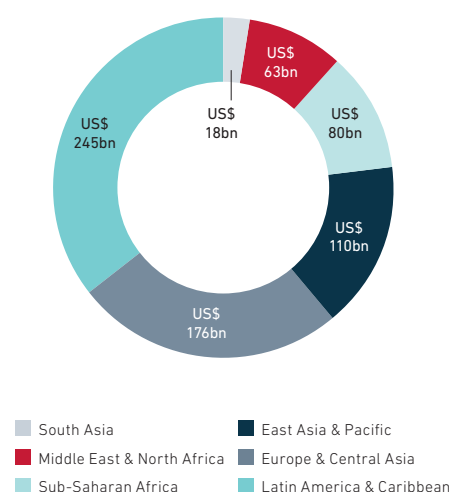
Overview of sovereign bonds in 2021

Developing countries have increasingly relied on bonds to meet borrowing requirements over recent decades.⁴⁰ In contrast to syndicated bank loans, bonds allow countries to access a wider network of investors across the world. This helps to increase liquidity at the expense of a higher degree of exposure to financial shocks and volatility. Annual issuance of bonds by national governments of developing countries has more than doubled from less than USD 1 trillion in 2000 to around USD 2.5 trillion in 2019. Cumulative issuance of this type of bonds reached a total of USD 37.4 trillion during this period.⁴¹ This dynamic has gone hand in hand with the development of local currency bond markets. On average, domestic currency issuance by national governments account for 90 per cent of total issuance.⁴² While most of the growth has taken place in bonds in domestic currency, high levels of liquidity in global financial markets have also caused a noticeable increase in foreign currency bonds since the financial crisis of 2008.⁴³

This report focuses on the later segment.⁴⁴ The analysis of sovereign bond data identified 549 sovereign bonds issued by 62 middle- and low-income countries.⁴⁵ The outstanding nominal value of these instruments is US\$ 691 billion as of January 2021. Figure 1 presents the distribution by value and number of instruments per region. It shows a high degree of concentration of sovereign bonds. Three regions, Latin America & the Caribbean (LAC), Europe & Central Asia (ECA) and East Asia & the Pacific (EAP) account for 76 per cent of the total nominal value with 390 sovereign bonds.

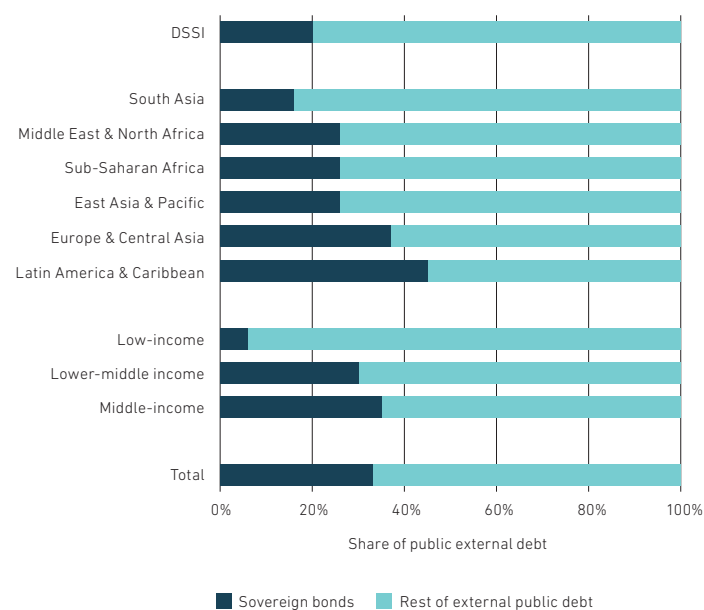
The group of 62 countries included in this study had a public external debt of US\$ 2.1 trillion in 2019. Identified sovereign bonds represent 33 per cent of this figure (Figure 2). However, there is a large degree of variation across country groups.⁴⁶ For 22 countries with sovereign bonds which are eligible to participate in the G20 DSSI, these instruments account for 20 per cent of public external debt.⁴⁷ From a regional perspective, the share of sovereign bonds varies from 16 per cent for countries in South Asia (SA) to 45 per cent in LAC. On an income basis, the share of sovereign bonds reflects the degree of integration of countries in global financial markets. Countries with lower levels of income are effectively shunned. This analysis identified that only four low-income countries have sovereign bonds: Ethiopia, Mozambique, Rwanda and Tajikistan. For these countries, bonds represent just six per cent of public external debt. This share increases to 30 and 35 per cent for lower-middle and middle-income countries, respectively.

Figure 1: Distribution of sovereign bonds – US\$ billions (2021)



Source: Author calculations based on Refinitiv data.

Figure 2: Share of sovereign bonds in public external debt (2021*)

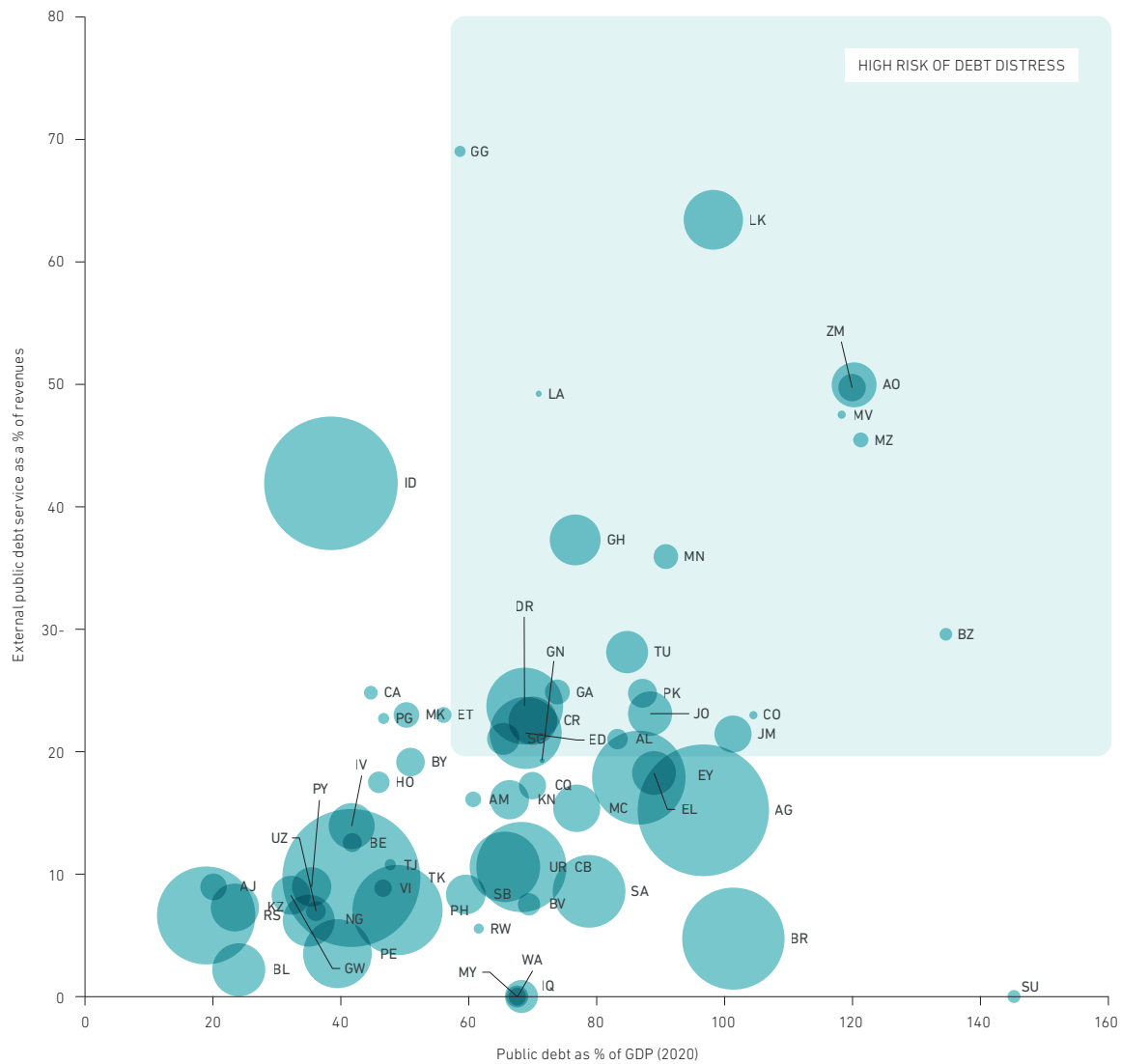


*Estimation compares nominal outstanding value of sovereign bonds as of January 2021 with data for public external debt for 2019 (latest available). The regional groups presented here only include the 62 countries with outstanding sovereign bonds.

Source: Author calculations based on Refinitiv and World Bank International Debt Statistics (IDS) (2020).

Figure 3: Sovereign bonds and public debt burdens (2020)

Size of the bubble indicates the size of sovereign bonds in billions of US dollars



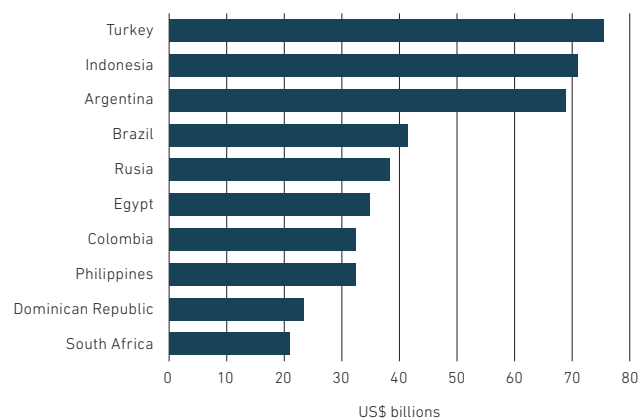
Source: Author calculations based on Refinitiv, IMF World Economic Outlook (WEO) (2020) and World Bank IDS (2020).

The size of sovereign bonds varies greatly between countries. Figure 3 shows the relation between total public debt, external public debt service as a share of government revenues and outstanding sovereign bonds in the aftermath of the Covid-19 pandemic. There are three elements worth highlighting in this figure:

- Countries with higher stocks of public debt as a share of Gross Domestic Product (GDP) tend to use a larger share of government revenues to pay debt service. The latter is an important indicator of the relative impact of debt on the availability of domestic resources. In addition, there is a large variation in the amount of outstanding nominal amounts of sovereign bonds as indicated by the size of the bubbles (Figure 3).
- Debt vulnerabilities are substantial in the aftermath of the pandemic. At least 26 countries allocated 20 per cent or more of government revenues to meet external debt service at the end of 2020.⁴⁸ The shaded upper right quadrant contains 20 of these countries, one third of the 62 nations covered by this report.⁴⁹ These can be considered at high risk of debt distress due to the combination of high levels of debt and servicing requirements. Sixteen of them already have an IMF program in place.⁵⁰ The remaining four (Belize, Laos, Sri Lanka and Zambia) are either already negotiating or rumoured to be in the process of entering into an IMF program.⁵¹ The countries with the largest outstanding stock of sovereign bonds in this group include the Dominican Republic, Ecuador, Sri Lanka, Ghana and Costa Rica.
- Most of the countries with large outstanding amounts of sovereign bonds allocate less than 20 per cent of government revenues to debt service.⁵² However, there is a group of countries with high levels of public debt and large amounts of sovereign bonds that are in a vulnerable position (lower right quadrant of Figure 3). These include Argentina, Brazil, Egypt, Colombia and South Africa. With the exception of Brazil, the remaining countries already have IMF programs in place.⁵³ The combination of a weak recovery and a tightening of international financial conditions could push these large issuers into the shaded quadrant.⁵⁴

The high degree of concentration of sovereign bond issuance poses a risk for global financial stability. The top 10 sovereign issuers have a total of US\$ 439 billion in bonds. This figure represents 63.5 per cent of the total for developing countries included in this analysis. The degree of concentration increases the risk of contagion in the event of a sudden stop in capital flows. This is especially the case in a context in which large outflows of benchmark-driven investments of institutional investors can be triggered by external factors unrelated to domestic conditions (See section six).⁵⁵ The risks of a systemic debt crisis remain substantial.⁵⁶

Figure 4: Top 10 issuers of sovereign bonds – US\$ billions (2021)



Source: Author calculations based on Refinitiv data.

The high degree of concentration of sovereign bond issuance poses a risk for global financial stability

Financial terms of sovereign bonds of developing countries

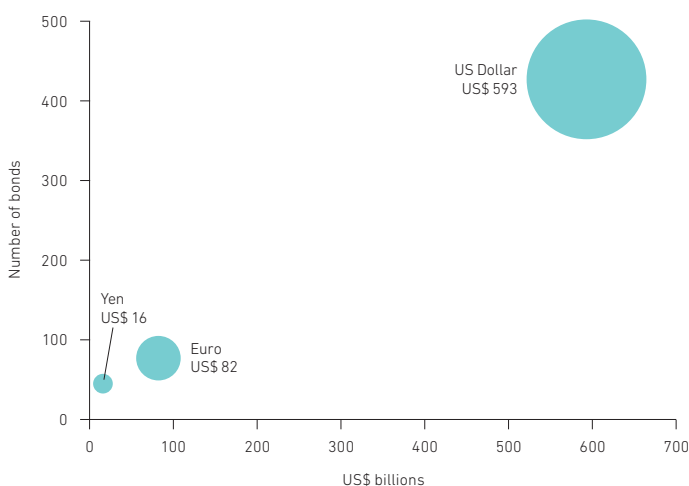
This section of the report turns its attention to the financial terms of sovereign bonds issued by developing countries. These include the currency, coupons and repayment profiles of outstanding bonds.

Currency distribution

The international financial architecture is a hierarchical system with the US dollar at its apex.⁵⁷ The US dollar plays a central role in the process of clearing transactions and contracts across time, currencies and legal jurisdictions. This dynamic is reflected in the distribution of currencies across sovereign bonds (Figures 5). A total of 427 sovereign bonds with a nominal outstanding value of US\$ 593 billion are denominated in US dollars. In terms of value, this is equivalent to 85.8 per cent of the total. The Euro and Japanese Yen represent the remaining 11.9 and 2.4 per cent, respectively.

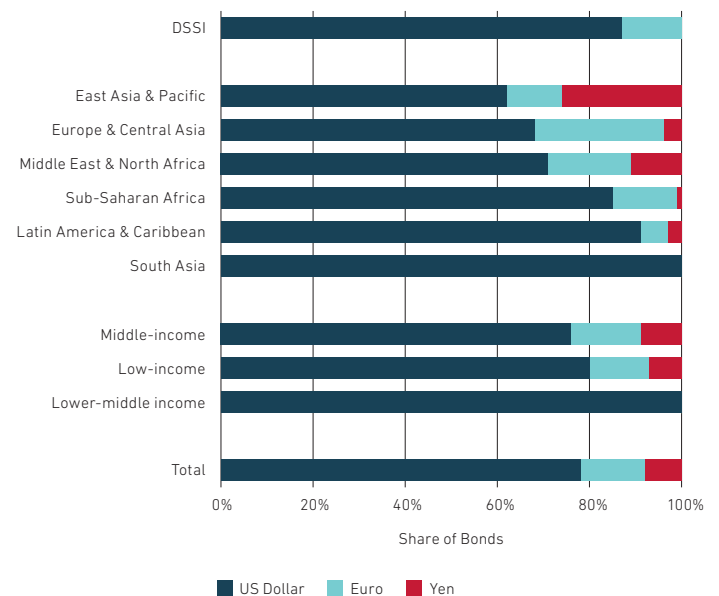
Figure 5: Currency of sovereign bonds – US\$ billions (2021)

Size of the bubble indicates the size of the category in billions of US dollars



Source: Author calculations based on Refinitiv data.

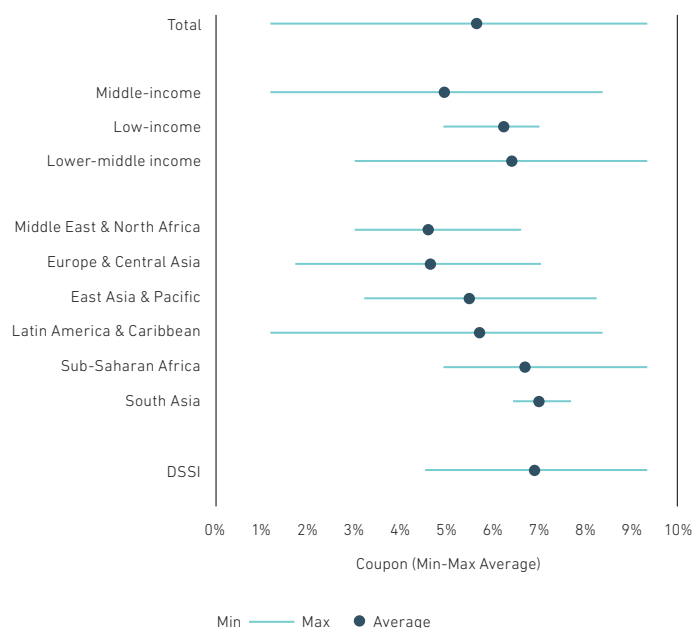
Figure 6: Currency distribution of sovereign bonds per country group (2021)



Source: Author calculations based on Refinitiv data.

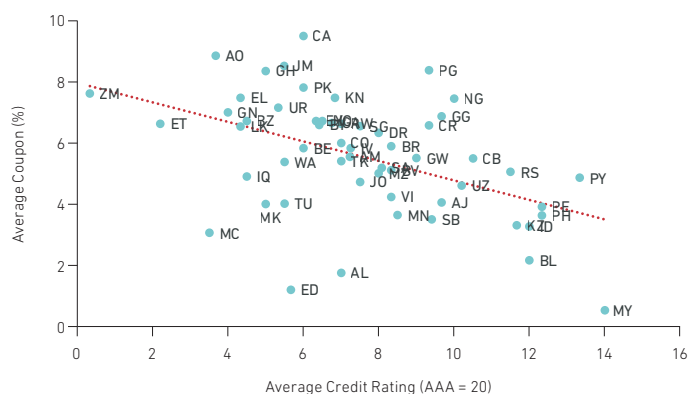
An analysis of the distribution of currencies across sovereign bonds and country groupings shows a slightly more diverse picture (Figure 6). Looking at individual bond contracts, the share of the US dollar drops to 78 per cent of the total. In one extreme, DSSI eligible countries issue bonds denominated only in US dollars and Euros. In the meantime, countries in Sub-Saharan Africa (SSA) issue bonds mostly in US dollars. This is noteworthy as some of them, including Benin, Ivory Coast, Senegal and the Republic of Congo are members of the CFA franc area. The CFA franc has a fixed exchange rate to the Euro. This currency has been dubbed Africa's last colonial currency due to the de-facto control of the currency by the Central Bank of France.⁵⁸ Despite these links to the Euro, a substantial share of their issuance takes place in US dollars. Finally, at the other extreme, for countries in EAP, bond contracts using the Japanese Yen represent 25.7 per cent of the total. This probably reflects the regional focus of investors from Japan.

Figure 7: Coupon distribution of sovereign bonds per country group – Maximum, minimum and average per country (2021)



Source: Author calculations based on Refinitiv data.

Figure 8: Average coupon of sovereign bonds and credit ratings (2021)



Source: Author calculations based on Refinitiv data.

Coupon distribution

The coupon of a sovereign bond is the interest rate paid by an issuer on its nominal outstanding value.⁵⁹ It effectively represents the cost of financing through sovereign bonds. Coupons can be structured in a variety of ways including fixed, floating and indexed interest rates.⁶⁰ 513 sovereign bonds, equivalent to 93.4 per cent of the total, have fixed coupons. This represents a marked improvement over the structure of financing observed in the past, where most of the sovereign debt was issued under floating structures.⁶¹ While a floating or indexed rate may allow for lower interest rates in the short term, they expose countries to large increases in borrowing costs in the event of a financial shock. In contrast, fixed rates may prove more expensive in the short term, but effectively provide insurance against volatility. The large share of fixed coupons in sovereign bonds likely played an important role in buffering the impact of the Covid-19 pandemic on borrowing costs of developing countries.⁶²

The coupon interest rate varies greatly within and between country groups (Figure 8). Developing countries have average coupon rates as low as 1.2 per cent and as high as 9.5 per cent. The average coupon rate at the country level for the entire group is 5.7 per cent. Middle-income countries in the Middle East & North Africa (MENA) and ECA tend to have lower coupons than lower-middle and low-income countries in SSA and SA.⁶³ DSSI eligible countries have an average coupon rate above the entire group, equivalent to seven per cent. The relatively high coupons attached to sovereign bonds of these countries must be factored into the analysis of the lack of participation of commercial creditors in the G20 DSSI.⁶⁴ In a context in which the amount of negative-yielding debt in the world has climbed to an all-time high of US\$ 17.5 trillion, sovereign bonds of DSSI countries represent a small but highly profitable source of returns to investors (See section 5).⁶⁵

At the country level, coupon rates are correlated with credit ratings (Figure 8). Credit ratings issued by agencies such as Standard & Poors, Fitch and Moody's indicate the capacity and willingness of rated governments to repay debt obligations in full and on time.⁶⁶ Countries with stronger macroeconomic fundamentals have higher credit ratings than countries at high risk of debt distress. While there is a high degree of dispersion, countries with higher credit ratings tend to have lower coupon rates than those with lower ratings. This dynamic highlights the importance of Credit Rating Agencies (CRAs) to influence the access and cost of credit of developing countries. Their role in the context of the pandemic has been criticised due to their insistence on pursuing a business-as-usual approach despite the nature and severity of the situation.⁶⁷ On the one hand, countries which responded to the crisis in a more decisive fashion to protect their populations were more likely to be downgraded. On the other hand, CRAs reviewed sovereign ratings when they were due for regulatory purposes rather than in response to the pandemic.⁶⁸ The negative impact of their actions on countries struggling to tackle the pandemic has triggered calls for a systemic reform of CRAs, including the establishment of independent and publicly owned CRAs.⁶⁹

A weak recovery combined with a high degree of volatility might push a large number of sovereign bond issuers into a situation of high risk of debt distress

Repayment profiles

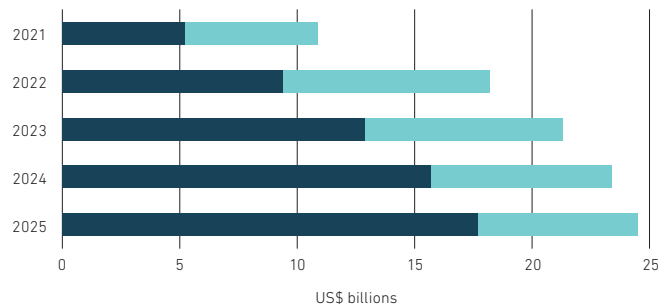
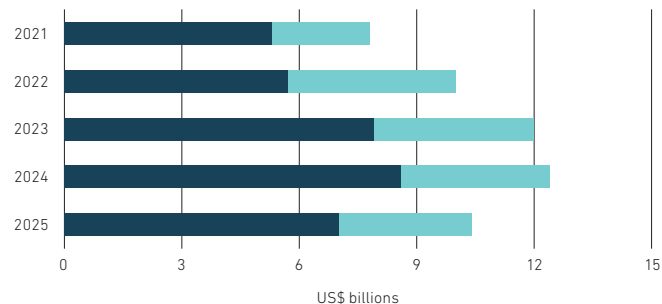
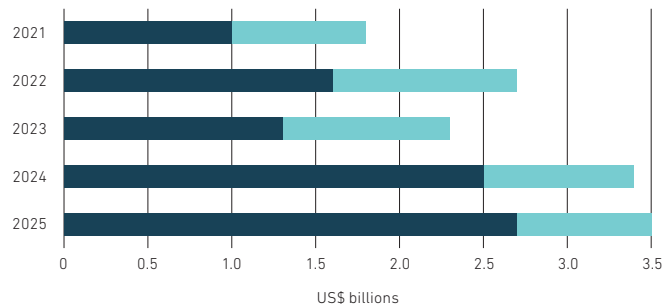
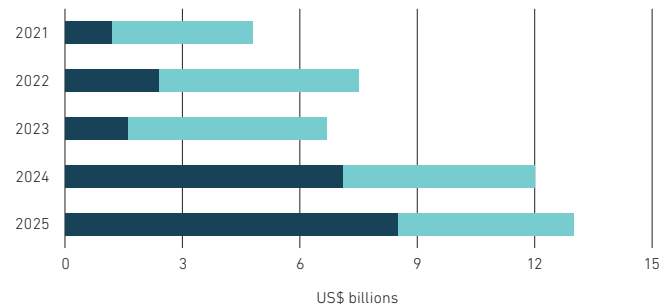
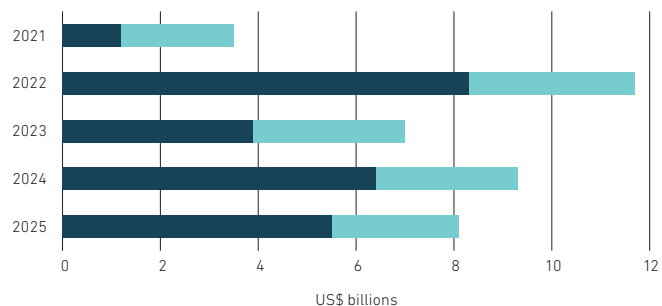
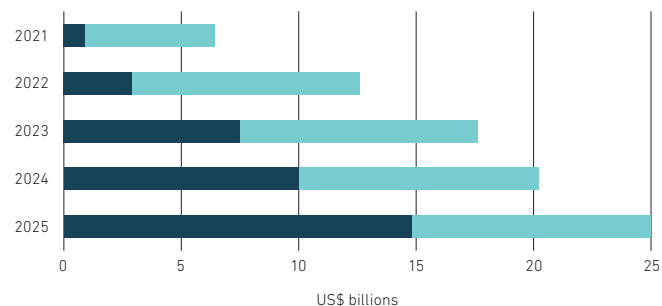
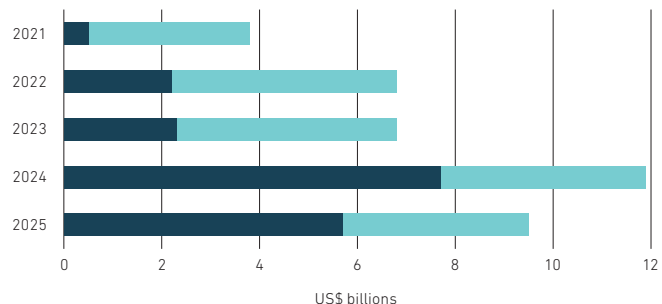
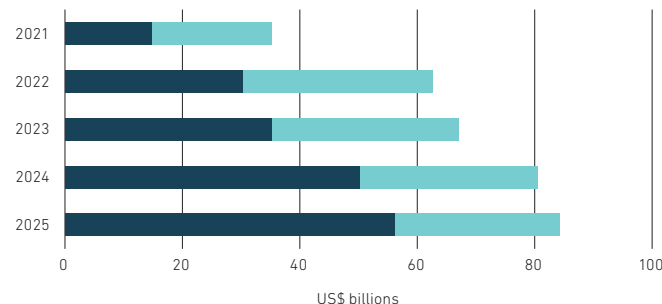
Developing countries issue sovereign bonds with a wide range of maturities. The maturity of a bond refers to the period of time during which the issuer must repay the original bond value to its holders. Structures of repayment follow "bullet" or amortisation schemes. In the case of the former, all the principal is paid at maturity, while interests are paid over the duration of the bond. In the case of the latter, principal payments take place over the duration of the bond. Investors usually favour a "bullet" structure for the redemption of bonds as the risks of rollover and default concentrate at maturity of the bond.⁷⁰

Against this background, outstanding sovereign bonds identified in this report have maturity dates ranging from 2021 to 2121. At least 470 bonds appear to be issued under a bullet structure.⁷¹ A substantial share of these will mature between 2021 and 2025 (Figure 9). Principal payments of maturing bonds are equivalent to US\$ 187 billion during this period. Adding coupon payments, debt service requirements on sovereign bonds will reach US\$ 330 billion over the next five years.

The strength of the recovery will play a key role in determining the capacity of developing countries to meet these payments. A weak recovery combined with a high degree of volatility might push a large number of sovereign bond issuers into a situation of high risk of debt distress (Figure 3). The profile of repayment of bonds is set to provide a certain margin of manoeuvre to manage this type of risk over the coming two years. However, it is important to note that some country groups are expected to experience a spike in repayments between 2024 and 2025. This is particularly noticeable for countries in ECA, SSA and LAC, as well as for DSSI eligible countries. For countries that received emergency financing from the IMF in 2020, this dynamic will create substantial financial pressures as a result of the combination of bond and IMF repayments between 2023 and 2025.⁷² For DSSI countries that participated in the initiative, the suspended payments to bilateral creditors will also need to be returned during this same period.⁷³ This lumping of payments represents a looming threat.⁷⁴ It highlights the need for debt relief measures to align servicing requirements with a reduced repayment capacity as a result of the pandemic.

Figure 9: Repayment profiles, principal and coupon payments, per country group – US\$ billions (2021-2025)

■ Principal ■ Coupon

Europe & Central Asia**East Asia & Pacific****South Asia****Sub-Saharan Africa****Middle East & North Africa****Latin America & Caribbean****DSSI****All countries**

Source: Author calculations based on Refinitiv data.

Legal terms of sovereign bonds of developing countries

This section of the report examines two key legal aspects of sovereign bonds issued by developing countries. They refer to the governing law of the contracts and presence of Collective Action Clauses (CACs).

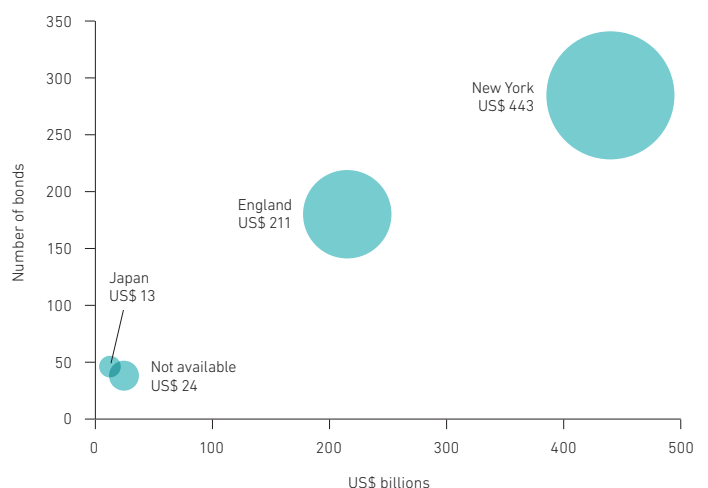
Governing law of sovereign bonds

The governing law of a sovereign bond refers to the jurisdiction that governs the contract.⁷⁵ Bonds under the jurisdiction of the issuing country allow a sovereign to unilaterally change the terms of the contract. As a result they are perceived to provide weak legal protections to investors.⁷⁶ In contrast, for bonds issued under a foreign jurisdiction, the sovereign agrees to be held accountable to a judicial process as a commercial entity in a foreign court. To do so it must waive its sovereign immunity and rights as part of the bond contract.⁷⁷ This gives creditors a powerful protection mechanism. On the one hand, they are insured from unilateral actions by a sovereign. On the other hand, they are able to challenge the sovereign in court in cases where the latter is found to be in breach of the terms of the contract, such as missing scheduled payments on coupons or principal. There is evidence that under normal circumstances, and for less vulnerable countries, investors don't tend to discriminate between bonds under domestic or foreign law. However, in periods of distress and for vulnerable countries, investors prefer bonds issued under foreign law to secure the protection given by a foreign court.⁷⁸

This dynamic has problematic implications for developing countries. A number of these are required to issue bonds under foreign law to access financing. This places them in a vulnerable position. In cases of default, creditors actively use the threat of litigation under a foreign court to improve their negotiating position against a sovereign debtor. The use of this type of threat is becoming increasingly popular. Over the last two decades, half of the events of sovereign default have been accompanied by litigation.⁷⁹ As the risk of default increases and the price of bonds decline, hedge-funds, and so-called "vulture funds" are able to buy the bonds at a big discount of their nominal value. They can then proceed to use a combination of threats and litigation to seek full repayment of bonds. These aggressive legal tactics are used to put pressure on countries and seek settlements that reward them with massive profits.⁸⁰ These come at the expense of the protection of the human rights of the population of countries in debt distress.⁸¹ Lack of a bankruptcy procedure for sovereigns, such as a multilateral debt workout mechanism, means that developing countries are effectively left helpless against this type of abusive behaviour.⁸²

Figure 10: Governing law of sovereign bonds – US\$ billions (2021)

Size of the bubble indicates the size of the category in billions of US dollars



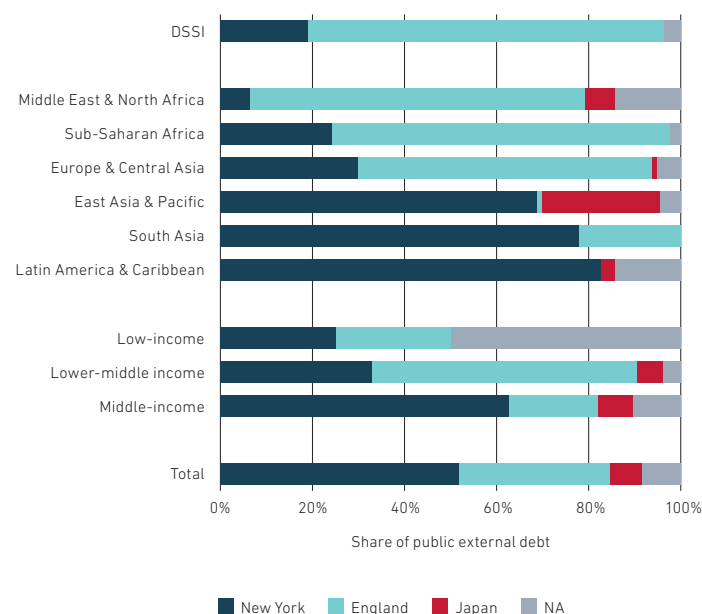
Source: Author calculations based on Refinitiv data.

The impact of the pandemic on debt sustainability of developing countries could potentially turn into a legal quagmire. All of the bonds included in this analysis are governed by foreign law and subject to the jurisdiction of foreign courts. The majority of sovereign bonds are issued under the law of the State of New York in the United States (US). A total of 284 bonds with a nominal outstanding value of US\$ 443 billion fall under this jurisdiction (Figure 10). In terms of nominal value, this is equivalent to 64.1 per cent of the total. Bonds under the English and Japanese laws represent 30.6 and 1.8 per cent, respectively. Finally, there is a group of 46 sovereign bonds with a nominal outstanding value of US\$ 24.3 billion for which it was not possible to identify the governing law of the contract.

An analysis of the distribution of the governing law of individual sovereign bond contracts shows large differences between country groups. This variation can be attributed to preferences in the choice of governing law. This choice is a result of a complex mix of historical, political and economic factors.⁸³ Due to large transaction costs, countries tend to use and maintain all their contracts under a single foreign jurisdiction. Most of the sovereign bonds issued by countries in MENA, SSA and ECA fall under English law. This is reflected in the high participation of English law bonds in the governing law distribution of DSSI eligible countries. In contrast, most of the bonds issued by countries in EAP, SA and LAC fall under New York law.

These patterns have important implications for statutory approaches to addressing debt distress. A statutory approach refers to the adoption of legal and administrative measures at either a national or multilateral level to improve debt crisis resolution.⁸⁴ Examples of this type of approach include the enactment of legislation to discourage disruptive litigation by vulture funds in Belgium, France and the United Kingdom (UK).⁸⁵ Adoption of measures discussed in the context of the UN Financing for the Development in the Era of COVID-19 and Beyond Initiative (FFDI) such as arbitration mechanisms, debt standstills, Article VIII Section 2(b) of the IMF Articles of Agreement or a sovereign debt authority would need to take into account the distribution of governing law in sovereign bonds.⁸⁶ Use of these measures could be required in the event of a systemic debt crisis in the aftermath of the pandemic.⁸⁷ In this context, actions focused on DSSI eligible countries would have to focus on the adoption of special legislation in the UK. Conversely, initiatives aimed at providing legal protection and support to middle-income countries would need to focus on the enactment of special legislation in the US.

Figure 11: Governing law distribution of sovereign bonds per country group (2021)



Source: Author calculations based on Refinitiv data

Collective Action Clauses (CACs)

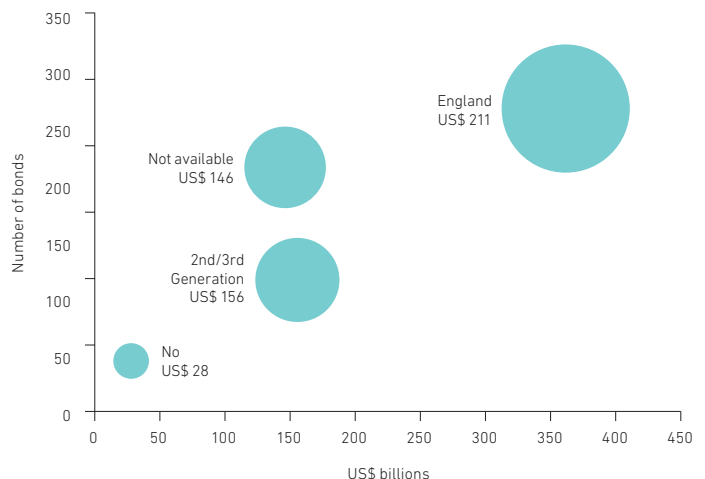
After the failure of the IMF to introduce a Sovereign Debt Restructuring Mechanism (SDRM) in 2002, multilateral policy efforts on debt crisis resolution shifted towards market-based solutions.⁸⁸ These refer to the use of financial incentives and contractual improvements to address gaps in the international sovereign debt architecture. Over the last two decades, CACs have been at the forefront of these efforts. CACs are contractual provisions that allow a majority of holders of a bond to make decisions that bind all holders of the instrument.⁸⁹ This provision allows the resolution of creditor coordination problems as they limit the capacity of a minority of holders to disrupt a debt restructuring process. Furthermore, they can help to diminish the threat of aggressive “hold-out” litigation strategies by hedge funds and vulture funds.⁹⁰

CACs have a long history. First generation CACs were introduced in 1879 and became commonplace in corporate bonds issued under English law.⁹¹ Following the Argentina debt crisis of 2001, a second generation of CACs began to be introduced into sovereign bonds issued under New York law. Second generation CACs allow a majority of bond holders within a single bond series to bind the minority to the terms of a restructuring. A binding agreement requires support by 75 per cent of the bond holders.⁹² Third generation CACs were introduced to address creditor coordination problems across a series of bonds in 2003. This generation of CACs included an additional mechanism called “two-tier” voting clauses. Under this provision, an agreement reached with 85 per cent of holders of all outstanding bonds and 66⅔ per cent of each individual bond series would be binding to all holders.⁹³ This system limited the capacity of investors to block a restructuring process of a single bond series. Finally, a fourth generation of CACs was established by the International Capital Markets Association (ICMA) in 2014. The last generation of CACs had the objective of providing standardised and improved terms across contracts under New York and English law. Fourth generation CACs allow the modification of the terms of a sovereign bond using three voting possibilities. First, a single bond series vote requiring 75 per cent of the holders of that specific series. Second, a “two-tier” vote, requiring 66⅔ per cent of holders of all outstanding bonds and 50 per cent of each individual bond series. Third, a single limb vote, requiring 75 per cent of all holders, if the modifications proposed can be uniformly applied across contracts.⁹⁴

The footprint of the evolution of CACs is clearly visible in sovereign bond contracts (Figure 12). At least 228 sovereign bonds with a nominal value of US\$ 362 billion, 52.3 per cent of the total, include fourth generation CACs. This is a result of the efforts by the IMF and ICMA to standardise these clauses across new sovereign bond issuances since 2014.⁹⁵ In the meantime, 22.5 and four per cent of bonds in terms of value have either older or no CAC clauses, respectively. For a group of 184 bonds with a nominal value of US\$ 146 billion, 21.2 per cent of the total, it was not possible to gain access to the bond prospectus to inspect for the presence of CACs.⁹⁶

Figure 12: CACs in sovereign bonds – US\$ Billion (2021)

Size of the bubble indicates the size of the category in billions of US dollars



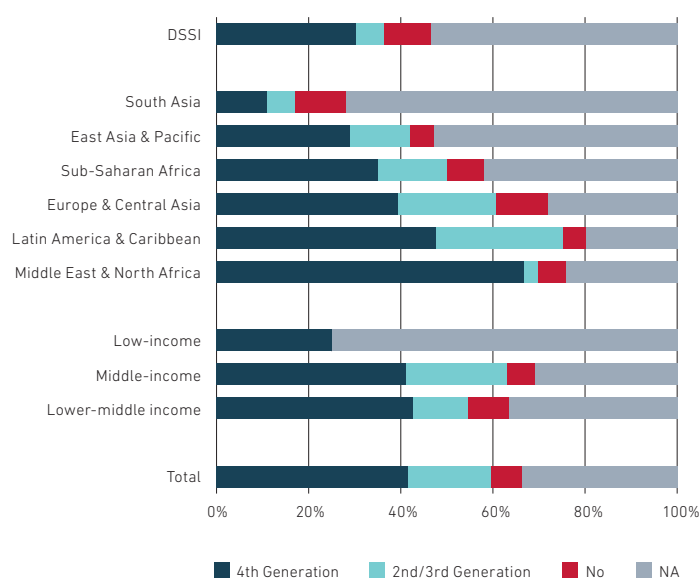
Source: Author calculations based on Refinitiv data.

The uneven distribution of CACs and lack of transparency in publicly listed bonds have important implications for developing countries. These can be discussed in the context of the analysis of the share of different types of CACs in individual bond contracts across country groups (Figure 13). Despite improvements in the share of bond contracts that include fourth generation CACs, many countries still have outstanding bonds with older or no CACs. The coexistence of different CACs across contracts introduces additional layers of complexity in the event of a default. Hedge funds and vulture funds remain in a position to exploit these gaps to their advantage. In the case of Venezuela, the price of bonds without CACs increased relative to those with CACs after the country started to experience a situation of debt distress in 2016.⁹⁷ Hold-out investors bought bonds without CACs under the premise that a debt restructuring involving other bonds won't limit their capacity to pursue aggressive litigation against the country.⁹⁸ In a less extreme scenario, coexistence of fourth generation CACs with older versions still poses challenges. Argentina's debt restructuring in 2020 is an example of this dynamic. The country was forced to provide additional financial and legal incentives to holders of bonds with older CACs in order to reach a binding agreement with its creditors.⁹⁹

Last but not least, even in a scenario where a debt restructuring can be secured in a short period of time through the use of fourth generation CACs, this may result in excessive concessions to commercial creditors in order to secure the required majority. This is the case of the debt restructuring of Ecuador in 2020. The country managed to reach an agreement with its creditors in less than six months. The negotiations involved the use of fourth generation CACs, which eliminated the risk of hold-outs. While the restructuring has been lauded as an example of the capacity of CACs to improve debt crisis resolution, there are serious concerns regarding debt sustainability.¹⁰⁰ The price of a swift agreement involved an insufficient reduction in the nominal value of the bonds held by creditors. As a result, “substantial challenges” remain for the country to achieve long-term debt sustainability.¹⁰¹ These involve the implementation of a large fiscal adjustment that is bound to have a negative impact on the human rights of the population of the country.¹⁰² Thus, while CACs can facilitate debt restructuring negotiations, they don't necessarily ensure sustainable outcomes.¹⁰³

With regards to transparency, there are glaring gaps in the availability of prospectuses of public listed bonds. For countries in SA, EAP and DSSI eligible countries, less than half of the prospectuses could be accessed. This is also reflected in the lack of availability of data on CACs for these country groups. This is both problematic and relevant for several reasons. First, despite being public contracts, these documents are gated behind expensive paywalls of commercial providers of such documents.¹⁰⁴ Even having a subscription to commercial databases does not guarantee access to the underlying contracts. As a result they are effectively hidden from public scrutiny and accountability from and to relevant actors such as citizens, parliaments, unions or civil society organisations (CSOs). Second, in addition to information on CACs, prospectuses incorporate other relevant contractual terms that become important in the event of a default.¹⁰⁵ These include presence of cross-default clauses, negative pledges and covenants, among others.¹⁰⁶ Uncertainty with regards to the legal terms of the contracts increases the complexity of investor decisions, debt management and crisis resolution. Third, the Institute of International Finance (IIF), the global association of the financial industry, developed a set “Voluntary Principles for Debt Transparency”. The principles were designed to enhance transparency in commercial sector lending, particularly to low-income countries.¹⁰⁷ However, there is a major data gap embedded in the IIF principles. Publicly listed bonds are explicitly excluded from reporting as it is considered that transparency in this area is “already good”.¹⁰⁸ The data shows that this is far from being the case for DSSI eligible countries. This is problematic as the IIF principles have been adopted as the basis of the OECD Debt Transparency Initiative launched by the G20 in October 2020.¹⁰⁹ Exclusion of public listed bonds from the OECD initiative severely limits its capacity to improve debt transparency in the context of the implementation of the G20 DSSI and Common Framework.¹¹⁰

Figure 13: Distribution of CACs in sovereign bonds per country group (2021)



Source: Author calculations based on Refinitiv data.

Underwriters and holders of sovereign bonds

The last section of this report focuses on identifying the key commercial actors in the sovereign debt market. These include bond underwriters, bond holders and an assessment of the relative impact of debt cancellation.

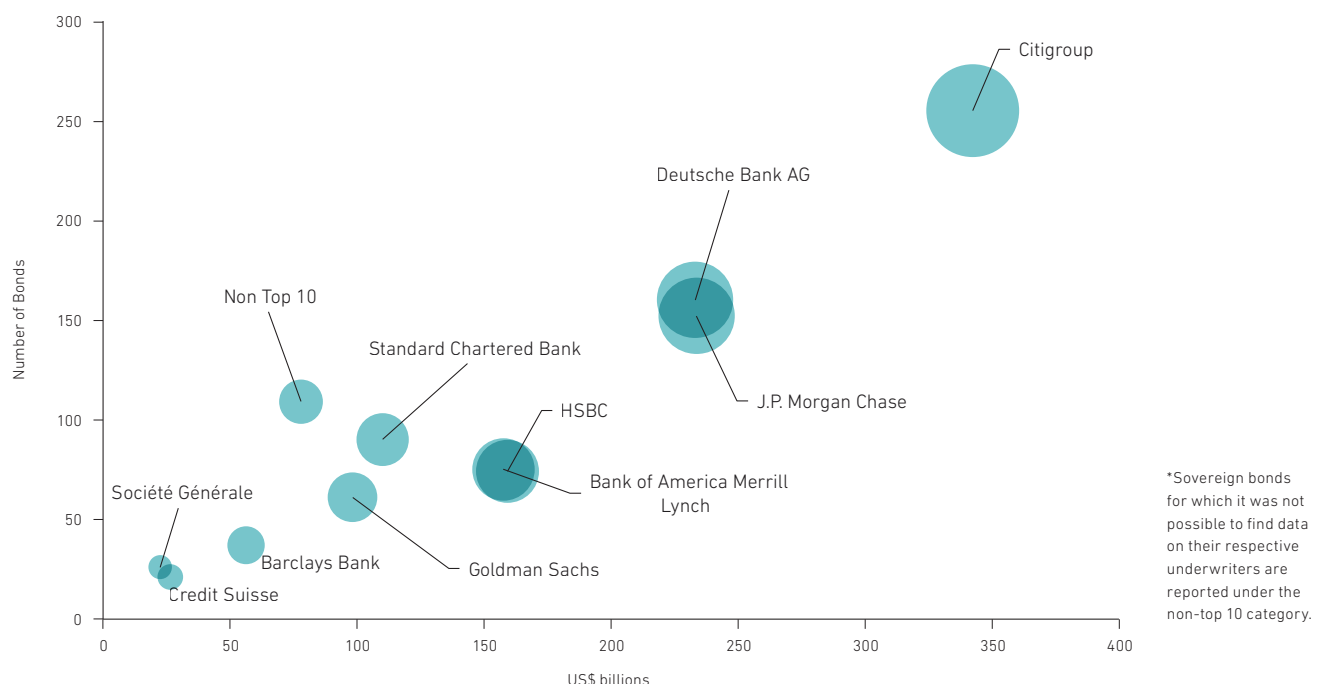
Sovereign bond underwriters

The issuance of a sovereign bond is a complex commercial process. Sovereign issuers traditionally hire investment banks to provide advice on and be responsible for its execution, which involves performing the tasks of underwriting, marketing, distribution and pricing of the instrument.¹¹¹ This means structuring the terms of the bond, including coupons and maturity dates, as well as finding prospective investors. The process is referred to as “bookbuilding” and it allows the underwriter to collect information regarding demand and adequate pricing for a bond.¹¹² Depending on its size, a bond issuance can be underwritten by one or several investment banks, who charge fees to a sovereign issuer for the provision of this service. While there is very little transparency on the fees charged by investment banks, they are estimated to represent between 0.05 to 0.225 per cent of the nominal value of the bond.¹¹³

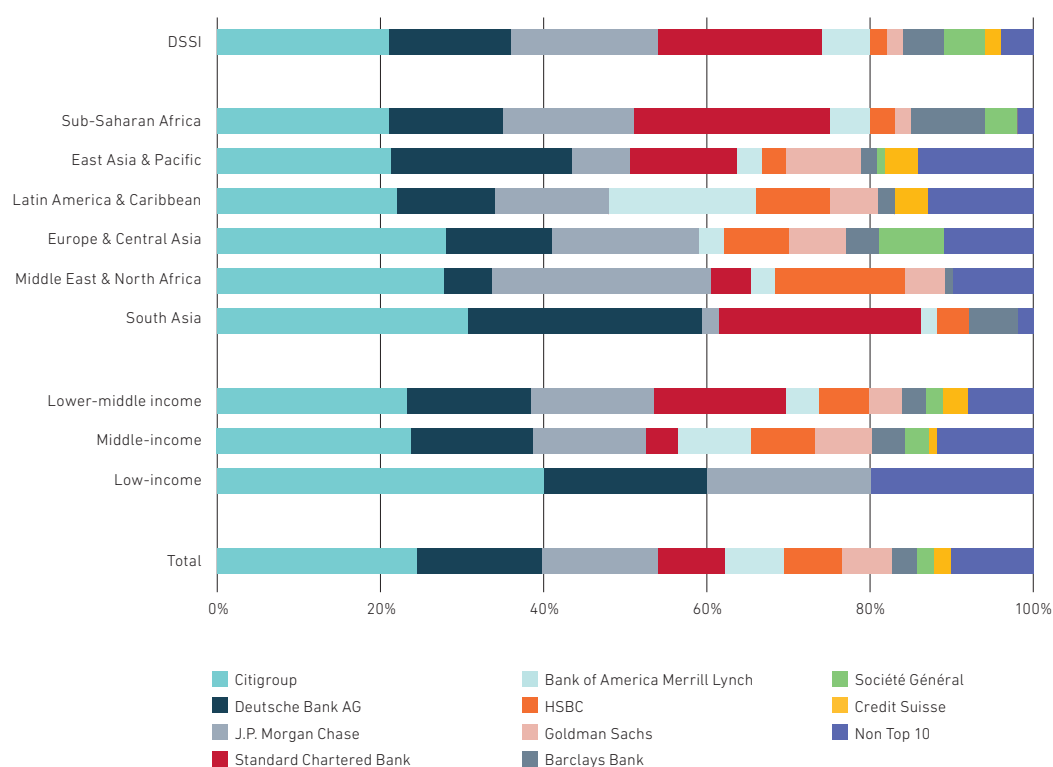
This report collected data on the top three underwriters per bond issuance.¹¹⁴ An overview of the results is shown in Figure 14. The top 10 bond underwriters are a group of investment banks based in the US, UK, Switzerland and the European Union (EU). They include Citigroup (US), Deutsche Bank (Germany), J.P. Morgan Chase (US), Standard Chartered Bank (UK), Bank of America (US), HSBC (UK), Goldman Sachs (US), Barclays (UK), Société Générale (France), and Credit Suisse (Switzerland) (Box 1). Taken together, these firms have participated in the issuance of 440 bonds, equivalent to 80.1 per cent of the total. There is a substantial degree of concentration within the largest underwriters. The top underwriter of sovereign bonds is Citigroup. The US investment bank has participated as an underwriter in the issuance of at least 255 bonds with a nominal value of US\$ 343 billion. It is followed by Deutsche Bank, with 160 bonds with a nominal value of US\$ 233 billion, and J.P. Morgan Chase, with 152 bonds with a nominal value of US\$ 234 billion. The dominance of these firms in sovereign bond underwriting can be traced back to the early 1990s.¹¹⁵

Figure 14: Sovereign bond underwriters* – US\$ Billion (2021)

Size of the bubble indicates the size of the underwriter in billions of US dollars



Source: Author calculations based on Refinitiv data.

Figure 15: Sovereign bond underwriters distribution per country group (2021)

Source: Author calculations based on Refinitiv data.

The market power of Citigroup, Deutsche Bank and J.P. Morgan Chase is reflected in the patterns of issuance of different country groups (Figure 15). Across country groups, the top three underwriters have consistently participated in at least 50 per cent of the bond issued. This can be attributed to a similar pattern observed in the case of governing law. As a result of the high transaction costs, countries tend to rely over time on the same investment firms to handle their bond issuance.¹¹⁶ This creates a self-reinforcing dynamic that increases the market power of large underwriters. Their ability to offer countries access to a wider network of investors and improved financial terms strengthens their capacity to further increase their market share.¹¹⁷

This exercise to identify bond underwriters is an important step in the process of improving data disclosure and transparency regarding sovereign debt. The UNCTAD *Principles on Promoting Responsible Sovereign Borrowing and Lending* establish the responsibility of commercial actors in the process of adopting informed credit decisions.¹¹⁸ The publication of bond prospectuses and relevant financial terms of public listed bonds is a basic step towards fulfilling this responsibility. Underwriters are in a unique position to support efforts towards establishing a publicly accessible registry of loan and debt data.¹¹⁹ The high degree of concentration in sovereign bond underwriting should facilitate the adoption of regulatory approaches for improved disclosures on public listed bonds under a publicly accessible registry. Efforts in this area would simultaneously benefit borrowing countries, investors and multilateral policy initiatives in the areas of debt management and crisis resolution, at little to no cost.

Box 1: Who are the main underwriters of sovereign bonds of developing countries?¹²⁰

1. Citigroup (255 bonds with a nominal value of US\$ 343 billion): A diversified financial services holding company based in the US. Its business segments include Global Consumer Banking (GCB), Institutional Clients Group (ICG) and Corporate/Other. Its ICG segment, in charge of bond underwriting, accounted for 88 per cent of total revenues in 2020. The company operates in over 160 countries and jurisdictions and has a market capitalisation of US\$ 148 billion.
2. Deutsche Bank (160 bonds with a nominal value of US\$ 233 billion): A Germany-based investment bank and financial services company that offers a range of investment, financial and related products and services to private individuals, corporate entities and institutional clients. Its business activities are divided into three segments: Corporate & Investment Bank (CIB), Private & Commercial Bank (PCB) and Asset Management (AM). The company has a market capitalisation of US\$ 24 billion.
3. J.P. Morgan Chase (152 bonds with a nominal value of US\$ 234 billion): A financial holding company based in the US. J.P. Morgan's activities are organised into four business segments. These include Consumer & Community Banking, Corporate & Investment Bank, Commercial Banking, and Asset & Wealth Management. Its Corporate & Investment Bank division, in charge of bond underwriting, accounted for 53 per cent of total revenues in 2020. The company has a market capitalisation of US\$ 466 billion.
4. Standard Chartered Bank (90 bonds with a nominal value of US\$ 110 billion): An international banking company based in the UK. The bank's segments include Corporate & Institutional Banking, Retail Banking, Commercial Banking and Private Banking. Its corporate and institutional banking, in charge of bond underwriting, accounted for 63 per cent of total revenues in 2020. The company has a market capitalisation of US\$ 23 billion.
5. Bank of America (75 bonds with a nominal value of US\$ 158 billion): A bank holding company (BHC) and a financial holding company based in the US. The company provides a range of banking and non-bank financial services and products through its business segments: Consumer Banking, Global Wealth & Investment Management, Global Banking, Global Markets and All Other. Its global banking division, in charge of bond underwriting, accounted for 22 per cent of total revenues. The company has a market capitalisation of US\$ 347 billion.
6. HSBC (75 bonds with a nominal value of US\$ 159 billion): A banking and financial services company based in the UK. The company manages its products and services through three businesses: Wealth and Personal Banking, Commercial Banking, and Global Banking and Markets. The company has a market capitalisation of US\$ 128 billion.
7. Goldman Sachs (61 bonds with a nominal value of US\$ 98 billion): An investment banking, securities and investment management company based in the US. The company operates in four business segments: Investment Banking, Institutional Client Services, Investing & Lending, and Investment Management. Its investment banking segment, in charge of bond underwriting, accounted for 21 per cent of total revenues in 2020. The company has a market capitalisation of US\$ 119 billion.
8. Barclays (37 bonds with a nominal value of US\$ 56 billion): A holding company based in the UK. The company is organised into two business divisions: the Barclays UK division (Barclays UK) and the Barclays International division (Barclays International). The company has a market capitalisation of US\$ 42 billion.
9. Société Générale (26 bonds with a nominal value of US\$ 23 billion): A France-based financial services group. It operates through three segments: French Retail Banking, International Retail Banking & Financial Services and Global Banking and Investor Solutions. The company has a market capitalisation of US\$ 25 billion.
10. Credit Suisse (21 bonds with a nominal value of US\$ 27 billion): A financial services company based in Switzerland. The company's segments include Swiss Universal Bank, International Wealth Management, Asia Pacific, Global Markets, Investment Banking & Capital Markets, Strategic Resolution Unit and Corporate Centre. The company has a market capitalisation of US\$ 26 billion.

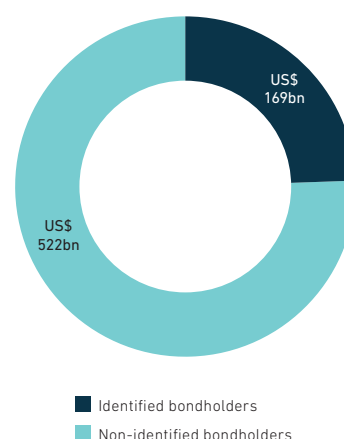
Sovereign bond holders

The identification of holders of securities can help to improve risk and debt management. Both countries and investors stand to benefit from greater transparency in at least three key respects. First, improved disclosures can help to identify debt vulnerabilities and power dynamics in the debtor–creditor relationship.¹²¹ Second, identifying changes in the investor base at times of debt distress can provide additional mechanisms to pre-empt hold-out strategies and reduce the costs of debt crisis resolution. Third, it can provide key insights for the design and implementation of effective statutory measures for commercial creditor participation in debt relief efforts in the aftermath of the pandemic, under either the G20 Common Framework or a multilateral debt workout mechanism under the UN.¹²²

However, the identification of sovereign bond holders is one of the most difficult areas of work for those compiling debt statistics.¹²³ Efforts to increase transparency face several obstacles. These include unregistered secondary market transactions, use of custodian and nominee accounts, off-market transactions, repo transactions and a lack of regulations to bind holders to disclose their positions.¹²⁴ All of which makes it extremely difficult to obtain a consistent overview of the creditor base of a country. As one veteran sovereign debt lawyer once joked; the only reliable way for a country to identify the holders of its bonds, is to stop paying. That way, they will all identify themselves to demand payment at a second's notice.

This report follows a less extreme approach. The analysis compiled bond holder data across a list of 843 instruments using Refinitiv. This allows it to include holdings of bonds under both Regulation S and Rule 144A. The outcome of this exercise is rather concerning. It was only possible to identify holders of bonds with a nominal value of US\$ 169 billion, equivalent to 24 per cent of the total. Identified bond holders refer exclusively to institutional investors, who disclose their positions quarterly via regulatory filings compiled by Refinitiv. No data, however, was available on the identity of the holders of the remaining 76 per cent. Holders in this second group include investment banks, hedge funds and other commercial investors, among others. These institutions are not required to disclose their positions and remain “under the radar.”¹²⁵

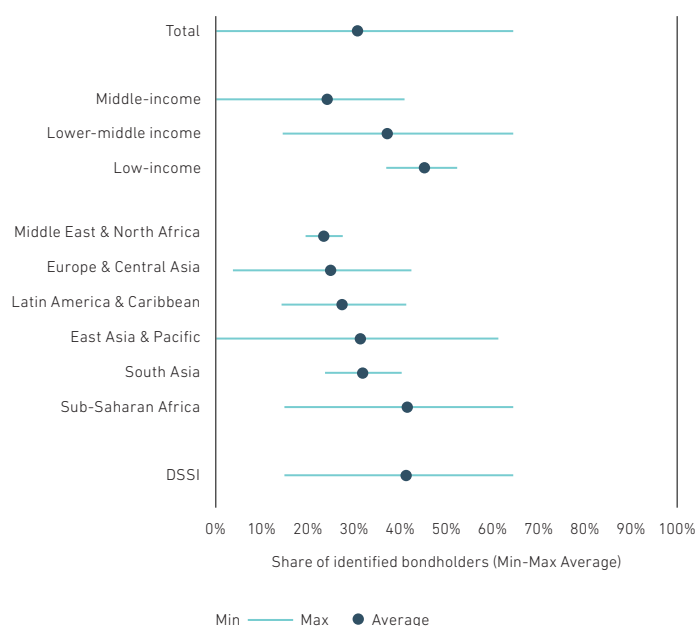
Figure 16: Share of identified holders of sovereign bonds – US\$ billion (2021)



Source: Author calculations based on Refinitiv data.

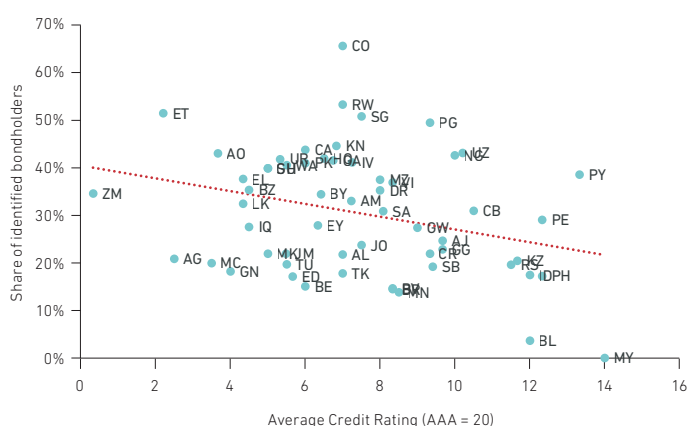
The share of identified holders varies greatly from case to case. It is possible to identify on average holders of 31 per cent of outstanding sovereign bonds at the country level (Figure 17). There are substantial variations across country groups. At the lower bound, it is possible to identify on average 24 and 25 per cent of bond holders in the MENA and ECA regions respectively. At the higher bound, it is possible to identify 32 per cent of the bond holders of countries in SSA and DSSI eligible countries. This is a rather unexpected finding given the lack of adequate disclosure on contracts for these country groups, as noted in the previous section. There seems to be a weak negative relationship between credit ratings and the presence of institutional investors, as reported by Refinitiv (Figure 18). In theory, countries with better ratings should be in a position to attract a higher share of institutional investors. However, the data shows otherwise. A plausible explanation for this dynamic is that the larger size of sovereign bond markets for countries with better credit ratings reduces the share of holdings by large institutional investors.¹²⁶

Figure 17: Share of identified holders of sovereign bonds per country – Maximum, minimum and average per country group (2021)



Source: Author calculations based on Refinitiv data.

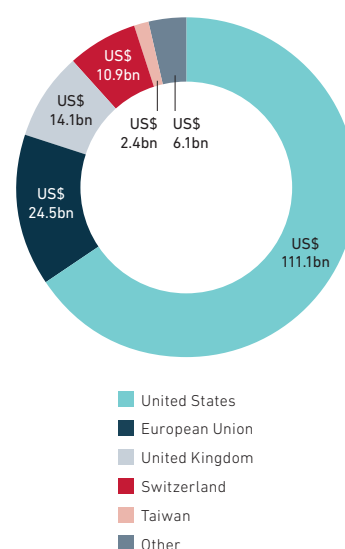
Figure 18: Share of identified holders of sovereign bonds and average credit rating – (2021)



Source: Author calculations based on Refinitiv data.

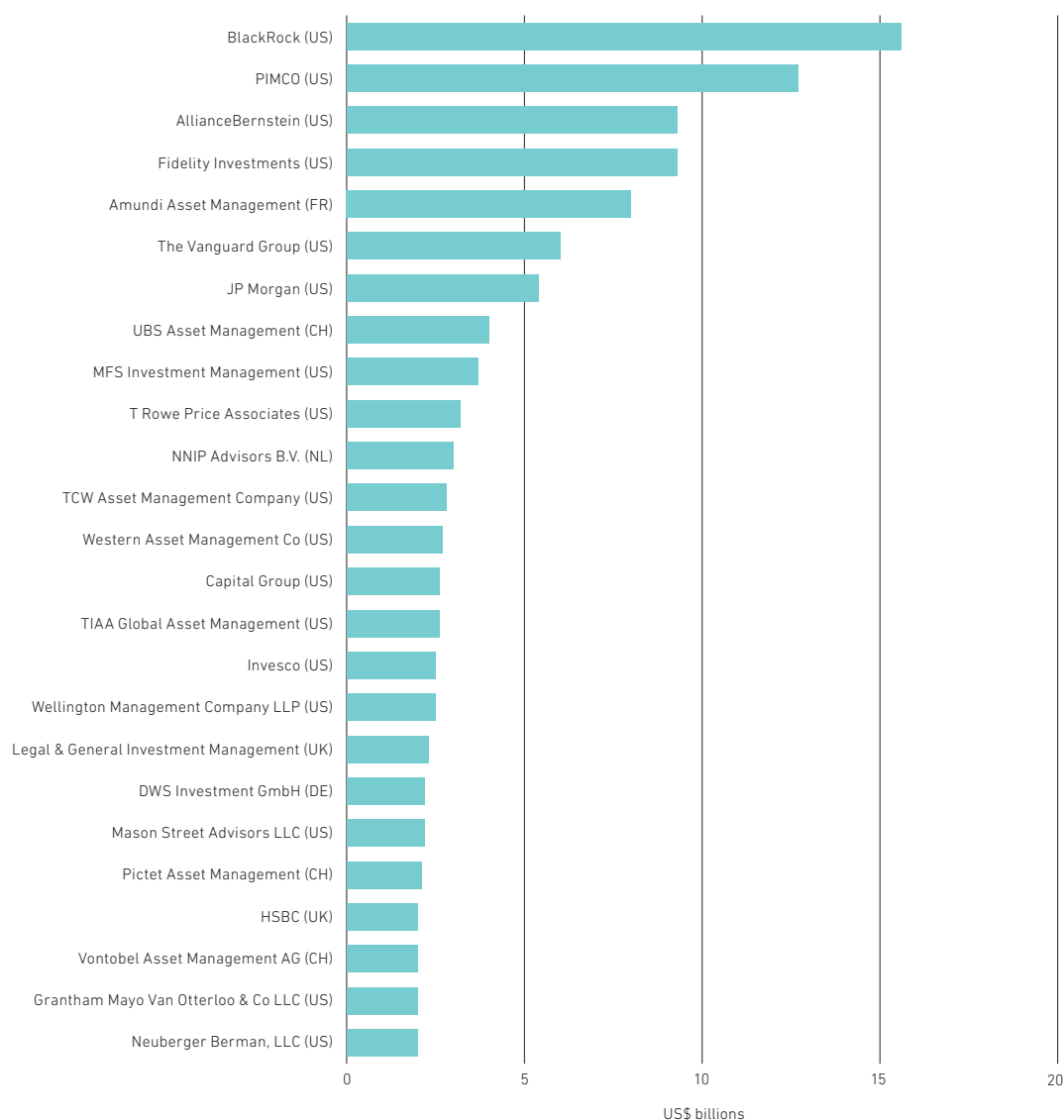
From a geographical perspective, the analysis identified 501 institutional investors from 31 countries. The location of identified bond holders shows a large degree of concentration (Figure 19). The distribution reflects the growing concentration of economic power in large asset managers based in the US.¹²⁷ Institutions based in the US hold bonds with a nominal value of US\$ 111 billion, equivalent to 66 per cent of the identified holders and 16.1 per cent of the total. Investors from the EU and the UK hold US\$ 25 and 14 billion, respectively.

Figure 19: Geographic distribution of identified holders of sovereign bonds – US\$ Billion (2021)



Source: Author calculations based on Refinitiv data.

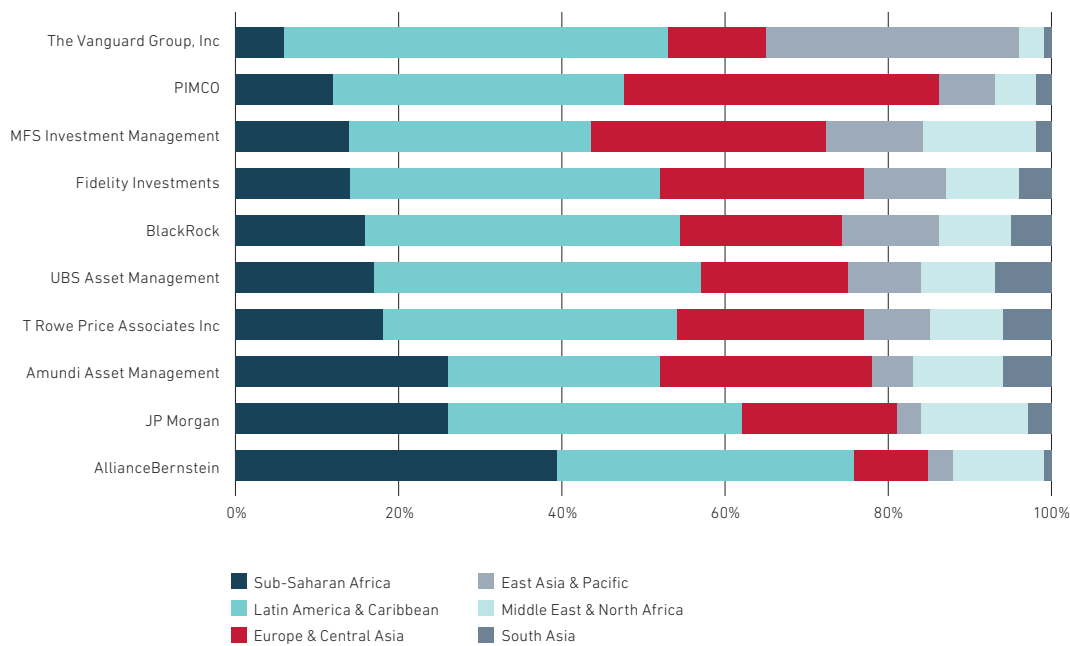
The distribution of holdings across investors shows a similar pattern of concentration. The top 25 institutional investors hold US\$ 113 billion in sovereign bonds issued by 60 countries (Figure 20). This is equivalent to 66.8 per cent of identified holders and 16.4 of the total. The top investors are located in a group of six countries, including the US, UK, Switzerland, Germany, France and the Netherlands. They are led by a group of ten firms that include BlackRock (US), PIMCO (US), AllianceBernstein (US), Fidelity Investments (US), Amundi Asset Management (FR), The Vanguard Group (US), J.P. Morgan Chase (US), UBS Asset Management (CH), MFS Investment Management (US), T. Rowe Price Associates (US) (for a description of the main bond holders per region, see Box 2).

Figure 20: Top 25 identified holders of sovereign bonds US\$ billion (2021)

Source: Author calculations based on Refinitiv data.

The holdings of these ten firms show a distinct regional pattern (Figure 21). Sovereign bonds issued by countries in LAC and ECA represent, in most cases, at least half of total holdings. This reflects the overall distribution of outstanding sovereign bonds (Figure 1). It is also worth noting the shares of holdings of sovereign bonds in SSA for AllianceBernstein, J.P. Morgan Chase and Amundi Asset Management. The strong presence of these firms in the region is reflected in the share of DSSI eligible countries in their total holdings.

For these three investors, DSSI eligible countries represent 33, 24 and 25 per cent of their holdings, respectively. Efforts to promote commercial creditor participation in either the G20 DSSI or the Common Framework ought to begin with these large and visible institutions. However, it is necessary to acknowledge that even in a scenario where these institutions are compelled to participate in debt relief, they still represent a minority of the creditor base. On its own, their participation wouldn't be enough to secure a decisive majority in a debt relief or restructuring process (see Box 3).

Figure 21: Distribution of holdings of sovereign bond by value per country group – Top 10 holders of sovereign bonds (2021)

Source: Author calculations based on Refinitiv data.

Debtors are at a structural disadvantage with respect to their creditors in the context of a debt restructuring. The power disparity is analogous to the struggle between an ant and a pack of elephants. The ants don't tend to perform particularly well in such a matchup.

Box 2: Who are the main holders of sovereign bonds of developing countries?¹²⁸

This box presents a brief description of the main holders of sovereign bonds in the US, the EU and the UK.

US Institutional Investors

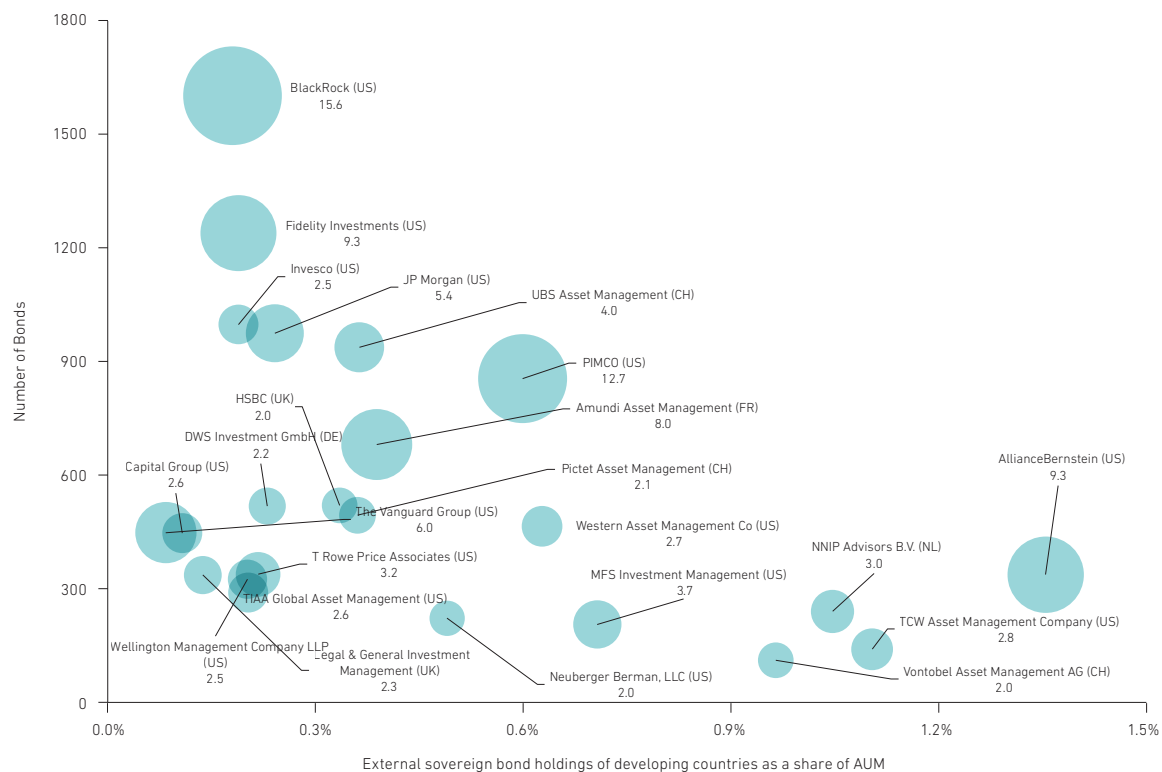
1. BlackRock (*holdings of US\$ 15.6 billion in sovereign bonds. Main identified bond holder in 15 countries*): An investment management company. BlackRock provides a range of investment and risk management services to institutional and retail clients. Blackrock offers active and index investment strategies across asset classes, including fixed-income instruments. The company has a total of US\$ 8.6 trillion in Assets Under Management (AUM) and a market capitalisation of US\$ 125 billion.¹²⁹
2. PIMCO (*holdings of US\$ 12.7 billion in sovereign bonds. Main identified bond holder in four countries*): An investment firm considered one of the world's foremost bond fund managers. PIMCO oversees more than 70 mutual funds invested in such financial instruments as corporate paper, emerging markets debt, municipal bonds, mortgage-backed securities and credit default swaps, among others. It is a subsidiary of German insurance giant Allianz.¹³⁰ The company has a total of US\$ 2.1 trillion in AUM.
3. AllianceBernstein (*holdings of US\$ 9.3 billion in sovereign bonds. Main identified bond holder in 11 countries*): An investment management company. It offers a range of investment services, based on active and passive investment strategies. The company has a total of US\$ 697 billion in AUM and a market capitalisation of US\$ 4.3 billion.
2. NNIP Advisors (*holdings of US\$ 3 billion in sovereign bonds*): A Netherlands-based active asset manager focusing on distinctive investment capabilities. These include specialised fixed income strategies (e.g., High Yield, Convertibles, Emerging Market Debt), alternative credit (illiquid) capabilities, multi-assets, and specialised equity strategies (e.g. European equities). The company has a total of US\$ 288 billion in AUM and a market capitalisation of US\$ 16.6 billion.¹³¹
3. DWS Investment (*holdings of US\$ 2.2 billion in sovereign bonds. Main identified bond holder in one country*): A Germany-based company that provides integrated investment solutions. The company offers active, passive and alternative investments across a wide range of asset classes. It invests primarily in the areas of environmental, social and governance. The company has a total of US\$ 949 billion in AUM and a market capitalisation of US\$ 8.7 billion. Deutsche Bank AG is a majority shareholder.

UK Institutional Investors**EU Institutional Investors**

1. Amundi Asset Management (*holdings of US\$ 8 billion in sovereign bonds. Main identified bond holder in three countries*): A France-based company, which operates in the field of asset management. The company offers a wide range of strategies, including active and passive management. The company has a total of US\$ 2.1 trillion in AUM and a market capitalisation of US\$ 18.2 billion.
1. Legal & General Investment Management (*holdings of US\$ 2.3 billion in sovereign bonds*): An investment management company. It is one of Europe's largest asset managers, offering investment solutions to a broad range of clients globally. The company is not publicly listed. It has a total of US\$ 1.7 trillion in AUM.¹³²
2. HSBC (*holdings of US\$ 2.1 billion in sovereign bonds*): A banking and financial services company. The company manages its products and services through three businesses: Wealth and Personal Banking, Commercial Banking, and Global Banking and Markets. The company has a total of US\$ 612 billion in AUM and a market capitalisation of US\$ 128 billion.
3. Aberdeen Asset Management (*holdings of US\$ 1.5 billion in sovereign bonds*): A financial services company, subsidiary of Standard Life Aberdeen. It manages assets for both institutions and private investors through a combination of active and passive investment strategies. The company has a total of US\$ 635 billion in AUM.

Figure 22: Top holders of sovereign bonds, holding, number of bonds and AUM – US\$ Billion (2021)

Size of the bubble indicates the size of the underwriter in billions of US dollars



Number of bonds refers to holdings of instruments at the parent level. As a result, holdings of an individual bond across subsidiaries can be reported several times at the parent level.

Source: Author calculations based on Refinitiv data.

The results of this analysis also illustrate the power imbalance between creditors and debtors. The group of 25 institutional investors included in Figure 20 has a total of US\$ 42.7 trillion in Assets Under Management (AUM).¹³³ This figure is equivalent to four times the GDP of the 62 sovereign bond issuers that are covered in this report.¹³⁴ Conversely, holdings of sovereign bonds represent a very small share of the assets of institutional investors. For the top 25 institutional investors, sovereign bonds represent on average 0.4 per cent of total assets. These investments are spread over a large number of funds and bonds (Figure 22).

This dynamic poses challenges to developing countries. Even small changes in the portfolio allocations of these investors, unrelated to domestic factors, can exacerbate debt vulnerabilities in a country.¹³⁵ At times of debt distress, the power imbalance becomes even more significant. Under the G20 DSSI and the Common Framework, countries are required to negotiate bilaterally with their commercial creditors.¹³⁶

While debtors cannot coordinate their positions, as negotiations are arranged on a case-by-case basis, lenders can organise themselves into creditor committees. These are then responsible for conducting discussions with debtors and thereby allow lenders to establish a common negotiating position. While such committees can help to address creditor coordination problems, they also increase creditors' leverage over a country.¹³⁷ This leads to an outsized disparity in the availability of financial, legal and technical resources that favour creditors to the detriment of sovereign debtors. Consequently, the latter are at a structural disadvantage with respect to their creditors in the context of a debt restructuring. The power disparity is analogous to the struggle between an ant and a pack of elephants. The ants don't tend to perform particularly well in such a matchup.¹³⁸

The multilateral response to the crisis has further augmented this problem. Policy measures such as the G20 DSSI are actually enabling private creditors to save their cake and eat it too. Lack of measures to ensure their participation in debt relief allows them to profit from risk while refusing to assume the losses once it materialises.¹³⁹ Measures such as emergency lending by IFIs and a special allocation of IMF Special Drawing Rights (SDRs) reinforce the perverse incentive structure that rewards this lack of private creditor participation. In theory, these measures are meant to support developing countries' efforts to tackle the impact of the pandemic. However in practice, these policies are actually freeing up resources to meet debt payments and boost the returns of investors on sovereign bonds. In this context, calls for voluntary participation of commercial creditors in debt relief efforts will not be successful. As long as investors benefit directly from their refusal to participate in debt relief, it is at best naïve, or at worst purposely deceitful, to expect their voluntary engagement.

This troubling dynamic can be assessed in the context of the relationship between sovereign bond coupons and creditors' revenues. As discussed in a previous section, bond coupons of DSSI eligible countries are highest among developing countries (Figure 7). From an investor's perspective, these bonds are a risky but highly attractive source of returns. Investments were not made despite the risks, but precisely because they created opportunities for substantial returns. This is reflected, on one hand, in the relative relationship between coupons and revenues, and in bonds holdings and AUM, on the other. Coupons on sovereign bonds of DSSI eligible countries represent a much higher share of investors' revenues relative to holdings as a share of AUM (Figure 23). For example, in the case of AllianceBernstein, sovereign bonds represent 0.4 per cent of AUM, whereas coupon payments on these same bonds represent 5.8 per cent of revenues.

Unless commercial creditors are compelled to participate, either through statutory approaches or sovereign defaults, they will continue to profit from vulnerable countries' debt, regardless of the human costs of the crisis.¹⁴⁰ For it to become an effective recovery tool, the multilateral response must go beyond the narrow financial interests of investors and overcome the notion of debt relief as an act of charity. Instead, it must be understood as a prerequisite to preserving domestic resources and prioritising their mobilisation to protect lives, to recovering from the pandemic and to achieving the 2030 Agenda goals.¹⁴¹

Figure 23: Coupon payments as a share of revenues and holdings as share of AUM* – Sovereign bonds of DSSI eligible countries



*Estimation based on revenues and AUM data for 2020 and average DSSI coupon payments for 2021

Source: Author calculations based on Refinitiv and Dun & Bradstreet data.

The costs of inaction on commercial creditor participation are already unsustainable. Health, social, political and economic tensions heightened by the pandemic are stretching countries to breaking point across the world. Every dollar allocated by a developing country to meet payments on sovereign bonds, is one dollar less for vaccines and healthcare, for feeding hungry people, and for keeping children in schools. There are two basic means of addressing this problem. On the one hand, promoting a fair and equitable solution through a multilateral debt workout mechanism under the auspices of the UN.¹⁴² Such an outcome would support recovery and stability, and both creditors and debtors stand to benefit in this scenario. While on the other hand, continuing to prioritise creditors' rights over human rights. This is a short sighted approach. Circling back to the metaphor of Rage Against the Machine, people will not sleep in the fire for long.

Box 3: The relative cost of debt cancellation

The lack of commercial creditor participation is one of the most noticeable weaknesses of multilateral initiatives on debt established in the context of the pandemic.¹⁴³ Calls by the UN, G20 and CSOs for commercial creditors to participate on a voluntary basis in the G20 DSSI have proved unsuccessful.¹⁴⁴ Arguments made by commercial creditors to refuse participation range from lack of transparency of the creditor base, fiduciary duties to clients, the need to ensure intercreditor equity in the distribution of losses, and a lack of requests by debtor countries.¹⁴⁵

By compiling the data on sovereign bond holdings, we are able to put these arguments in perspective. Sovereign bond holdings of large institutional investors are a minuscule fraction of AUM (Figure 22). As a result, the costs of debt cancellation owed to the main institutional investors are trivial in relative terms. Table 1 illustrates the relative impact of debt cancellation. The table is based on an abstraction which provides a useful image of the relative impact of debt cancellation. The abstraction reduces large institutional investors to an average citizen in different countries. It makes an equivalence between the AUM of the former to the wealth of the latter to provide a more tractable sense of magnitude. For example, BlackRock sovereign bond holdings amount to US\$ 15.6 billion. This is equivalent to 0.2 per cent of its AUM. To place this figure in context, we can assess how much this would represent in relative terms if BlackRock were a US citizen. In 2019, the median net wealth of a citizen in the US was estimated to be US\$ 65,904. A debt cancellation equivalent to 0.2 per cent of their wealth, would amount to US\$ 119. In the case of Legal & General Investment Management (UK), a full debt cancellation would be equivalent to asking a UK citizen, whose median net wealth is US\$ 97,452, to cancel a debt for US\$ 134. In the case of Amundi Asset Management (FR), a full debt cancellation would be equivalent to asking a French citizen, whose median net wealth is US\$ 101,942, to cancel a debt for US\$ 396.

The impact would be even smaller if the cancellation is limited to the holdings of DSSI countries, a total of US\$ 18.7 billion. Using the analogy of BlackRock and the US citizen, the cost would be US\$ 15. For Legal & General Investment Management and the UK citizen, the cost would be US\$ 12. For Amundi Asset Management and the French citizen, the impact would be US\$ 101. For large institutional investors, the relative costs of debt cancellation for the most vulnerable countries in the world are equivalent to what a citizen in an advanced economy would spend going out for dinner for one person.

While this analysis can provide a relative sense of the magnitude of the costs of debt cancellation, it can also be misleading in at least two respects. First, the holdings of sovereign bonds of asset managers such as BlackRock or Amundi correspond to investments made by third-parties, such as pension funds or individual investors. These investments are made through funds designed by asset managers. Thus, the losses arising from debt cancellation would not accrue on the asset managers themselves. Rather, it would be the investors of the different funds who would bear these losses. Second, the relationship between investors and their asset managers is a contractually-based market transaction. Investors can, and should, pressure their asset managers to fully assume their role as responsible creditors in line with the UNCTAD Principles.¹⁴⁶ These considerations should be taken into account by investors and asset managers when assessing the trade-offs between returns on investments and Environmental, Social and Governance (ESG) criteria.¹⁴⁷ Yet, there are limits to how much can be accomplished through this type of investor engagement. On one hand, asset managers have a fiduciary responsibility to maximise returns for their investors. A debt cancellation and the ensuing distribution of losses would give rise to an active collection problem within the investor base of asset managers. These institutions are not equipped to deal with this sort of issue. On the other hand, even if asset managers were to participate voluntarily, this wouldn't be sufficient to secure a binding majority in most debt restructuring processes (Figure 15). All of which, emphasises the urgency of establishing a level playing for orderly and fair debt crisis resolution. The establishment of a multilateral debt workout mechanism can provide the framework to involve all creditors in an equitable and transparent fashion.¹⁴⁸

Box 3 *(continued)***Table 1: Costs of debt cancellation for top 25 bond holders – Relative size to national mean net wealth per adult (US\$)**

Relative cost of debt cancellation of US\$ 112.8 billion						
	US	UK	Switzerland	France	Netherlands	Germany
Median net wealth per adult (US\$) (2019)	65904	97452	227891	101942	31057	35313
BlackRock (US)	119					
Legal & General Investment Management (UK)		134				
UBS Asset Management (CH)			828			
Amundi Asset Management (FR)				396		
NNIP Advisors B.V. (NL)					325	
DWS Investment GmbH (DE)						81
Top 25 bondholders (Median bond holdings)	238	351	822	368	112	127

Relative cost of debt cancellation DSSI of US\$ 18.7 billion						
	US	UK	Switzerland	France	Netherlands	Germany
Median net wealth per adult (US\$) (2019)	65904	97452	227891	101942	31057	35313
BlackRock (US)	15					
Legal & General Investment Management (UK)		12				
UBS Asset Management (CH)			139			
Amundi Asset Management (FR)				101		
NNIP Advisors B.V. (NL)					65	
DWS Investment GmbH (DE)						13
Top 25 bondholders (Median bond holdings)	38	56	130	58	18	20

Source: Author calculations based on Refinitiv data

Policy recommendations

At a time when countries around the world are struggling to tackle the impact of the pandemic, it is becoming increasingly urgent to adopt measures for private creditor participation in debt relief efforts. These must include sovereign bond holders. This report aimed to support these efforts by providing new insights into the current structure of sovereign bond markets and the analysis underscores the lack of transparency that surrounds them. This is problematic given the benefits that increased transparency can bring to debt management practices of sovereign issues, to risk assessments by investors, and to the design and implementation of multilateral debt relief initiatives.

A comprehensive set of measures is needed to address the crisis by improving transparency and ensuring private creditor participation. These ought to include:

- **Establishing a public registry for loan and debt data:** CSOs, including Eurodad, have highlighted on several occasions the need for a permanent registry of loan and debt data to be established.¹⁴⁹ The registry should be housed in a permanent institution, with the required ongoing funding. Civil society, parliaments and media should be consulted on its construction so that the data is open, standardised and structured. Information should be made available in English and the main language of the borrowing country concerned. Information on sovereign bonds should be included and be publicly available. Relevant elements include the main characteristics of each bond as well as their original prospectus. The OECD Debt Transparency Initiative falls short of the calls made by CSOs for a public registry in at least two key accounts. The initiative excludes both middle income countries and sovereign bonds from its analysis. As this report shows, it is fundamental to increase reporting coverage across income levels and borrowing instruments in order to have a clear understanding of the debt challenges faced by developing countries.
- **Regulations for improved disclosure on sovereign bond contracts and holdings:** The identification of bond holders is a first step towards the systemic analysis of their role as responsible lenders as well their fulfilment of their human rights obligations as creditors.¹⁵⁰ The substantial lack of transparency in sovereign bond markets calls for regulations on contract and holdings disclosure. With regards to the former, regulation should target underwriters to collect and make publicly available information on sovereign bond contracts. With regards to the latter, regulations should be put in place that require commercial and investment banks, as well as hedge funds, to disclose their sovereign bond positions holdings to national authorities. In both cases, the information should be provided on a quarterly basis to the public registry for loan and debt data.
- **Statutory approach to commercial creditor participation:**¹⁵¹ The UN and the G20 must send a clear signal to private creditors on their intention to support and protect borrower countries that decide to suspend payments and restructure debts in order to safeguard the rights and needs of populations. This includes taking action in key jurisdictions, and in particular in the UK and New York, to introduce legislation to prevent a lender suing a government for suspending debt payments on outstanding sovereign bonds. Additional measures include the use of Article VIII, Section 2 (b) of the IMF Articles of Agreement, which allows for the establishment of a binding sovereign debt standstill mechanism, and /or the use of 'state of necessity' defence in the case of suspending debt payments and a processes of debt restructuring.¹⁵²
- **A systemic approach to address the broken global economic architecture:** Urgent measures are required to fix the global economic architecture. These include, among others, a new allocation of Special Drawing Rights (SDR)¹⁵³, increases in Official Development Assistance (ODA)¹⁵⁴, and the establishment of effective global governance to tackle tax avoidance, evasion and illicit financial flows¹⁵⁵. These measures must be linked explicitly to statutory approaches to private creditor participation in order to ensure that additional resources are not shifted towards debt repayment.
- **Reform of the sovereign debt architecture:** Multilateral discussions need to make progress towards the establishment of a permanent multilateral framework under UN auspices to support systematic, timely and fair restructuring of sovereign debt, in a process convening all creditors.¹⁵⁶ Such a mechanism is vital to address the structural power imbalance between creditors and debtors and provide a level playing field for equitable debt resolution.

Annex: Overview of sovereign bonds

Country	Code	# of bonds	Amount (US\$ billions)	Coupon*	Governing Law**	Identified bond holders (% of total)	Main identified bond holder
Albania	AL	4	1.7	1.8	England	22%	BlackRock
Angola	AO	5	8.0	8.9	England	43%	AllianceBernstein
Argentina	AG	17	68.8	-	New York	21%	PIMCO
Armenia	AM	2	1.0	5.6	England	33%	Wellington Management
Azerbaijan	AJ	4	2.8	4.0	England	25%	BlackRock
Belarus	BY	5	3.3	6.6	England	34%	Amundi Asset Management
Belize	BZ	2	0.6	6.7	New York	35%	Vontobel Asset Management
Benin	BE	3	1.4	5.8	England	15%	M & G Investment
Bolivia	BV	3	2.0	5.1	New York	15%	Fidelity Investments
Brazil	BR	20	41.4	5.9	New York	14%	BlackRock
Bulgaria	BL	8	11.1	2.2	England	4%	The Vanguard Group
Cameroon	CA	1	0.8	9.5	England	44%	Fidelity Investments
Colombia	CB	20	32.3	5.5	New York	31%	The Vanguard Group
Republic of the Congo	CO	1	0.3	6.0	New York	66%	Vontobel Asset Management
Costa Rica	CR	20	9.3	6.6	New York	22%	AllianceBernstein
Cote d'Ivoire	IV	10	8.4	5.8	England	41%	AllianceBernstein
Dominican Republic	DR	17	23.3	6.3	New York	35%	BlackRock
Ecuador	ED	9	20.4	1.2	New York	17%	BlackRock
Egypt	EY	26	34.8	6.7	England	28%	BlackRock
El Salvador	EL	11	7.7	7.5	New York	38%	AllianceBernstein
Ethiopia	ET	1	1.0	6.6	England	51%	JP Morgan
Gabon	GA	3	2.4	6.7	England	42%	AllianceBernstein
Georgia	GG	1	0.5	6.9	-	23%	Fidelity Investments
Ghana	GH	12	10.3	8.4	England	40%	AllianceBernstein
Grenada	GN	1	0.1	7.0	-	18%	Grantham Mayo Van Otterloo
Guatemala	GW	10	6.1	5.5	New York	27%	PIMCO
Honduras	HO	4	1.9	6.7	New York	42%	AllianceBernstein
Indonesia	ID	68	71.0	3.3	New York	17%	The Vanguard Group
Iraq	IQ	3	4.4	4.9	New York	28%	Fidelity Investments
Jamaica	JM	8	5.4	8.5	New York	22%	BlackRock
Jordan	JO	9	7.8	4.7	England	24%	BlackRock
Kazakhstan	KZ	8	9.2	3.3	England	20%	BlackRock

Country	Code	# of bonds	Amount (US\$ billions)	Coupon*	Governing Law**	Identified bond holders (% of total)	Main identified bond holder
Kenya	KN	5	6.1	7.5	England	45%	AllianceBernstein
Laos	LA	1	0.2	6.9	New York	62%	M & G Investment
Malaysia	MY	1	1.9	0.5	Japan	0%	-
Maldives	MV	1	0.3	7.0	New York	24%	BlackRock
Mongolia	CQ	5	2.9	7.1	New York	40%	AllianceBernstein
Montenegro	MN	4	2.4	3.6	England	14%	Vontobel Asset Management
Morocco	MC	9	8.9	3.1	England	20%	Capital Group
Mozambique	MZ	1	0.9	5.0	-	37%	Amundi Asset Management
Namibia	WA	2	1.3	5.4	England	40%	DWS Investment
Nigeria	NG	10	10.7	7.4	England	43%	AllianceBernstein
North Macedonia	MK	4	2.6	4.0	England	22%	Danske Capital
Pakistan	PK	4	3.3	7.8	England	41%	Amundi Asset Management
Papua New Guinea	PG	1	0.5	8.4	New York	49%	Vontobel Asset Management
Paraguay	PY	9	6.1	4.9	New York	39%	JP Morgan
Peru	PE	14	18.8	3.9	New York	29%	BlackRock
Philippines	PH	29	32.3	3.6	New York	17%	The Vanguard Group
Russia	RS	14	38.2	5.1	England	20%	BlackRock
Rwanda	RW	1	0.4	6.6	-	53%	Fidelity Investments
Senegal	SG	5	4.1	6.6	England	51%	AllianceBernstein
Serbia	SB	4	6.2	3.5	England	19%	Wellington Management
South Africa	SA	16	20.9	5.2	New York	31%	PIMCO
Sri Lanka	LK	13	14.1	6.5	New York	32%	BlackRock
Suriname	SU	2	0.7	-	New York	40%	Vontobel Asset Management
Tajikistan	TJ	1	0.5	7.1	New York	42%	Vontobel Asset Management
Tunisia	TU	15	7.0	4.0	England	20%	Vontobel Asset Management
Turkey	TK	38	75.5	5.4	New York	18%	PIMCO
Ukraine	UR	14	19.7	7.2	England	42%	BlackRock
Uzbekistan	UZ	3	1.6	4.6	England	43%	T Rowe Price
Vietnam	VI	4	1.2	4.2	New York	37%	T Rowe Price
Zambia	ZM	3	3.0	7.6	England	35%	BlackRock

* Average coupon rate across outstanding bonds as reported by Refinitiv.

** Most used governing law across issued bonds.

Endnotes

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The European Network on Debt and Development (Eurodad) is a network of 59 civil society organisations (CSOs) from 28 European countries, which works for transformative yet specific changes to global and European policies, institutions, rules and structures to ensure a democratically controlled, environmentally sustainable financial and economic system that works to eradicate poverty and ensure human rights for all.

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