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Debt Transparency: The Essential Starting Point for Successful Reform

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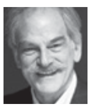

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PREFACE

This article—addressing the basic issue of market transparency—is the second publication in a series being prepared by the Bretton Woods Committee's Sovereign Debt Working Group (SDWG). The goal of the SDWG is to develop concrete reform proposals for the sovereign debt market. The two motivations for the work of the SDWG are (1) the sharp, Covid-19-related buildup in sovereign borrowing that likely will require relief and restructuring during the next few years and (2) the significant reforms that are needed to improve the efficiency, inclusiveness, and effectiveness of sovereign liability management.

As discussed in this analysis, establishing a broadly accepted and consistent information base regarding existing debt obligations is a foundational requirement for successful systemic reform—a need heightened by the dramatic shift in the number of funding sources since the Global Financial Crisis. This is far from the whole story, however. Beyond agreement on data sources, clarity—and predictability—regarding organizational and analytical aspects of setting the specific terms for debt relief will be vital. As a result, the key reform goal in this regard should be viewed as "procedural transparency" in order to signal the breadth of the reforms that will be required for success, beyond simple "data transparency."

The SDWG's intention for this publication is to spur meaningful work on market reforms. There is no doubt that the upcoming challenge of dealing with sovereign debt issues will engage International Financial Institutions (IFIs), international organizations such as the Organization for Economic Co-operation and Development (OECD), bilateral official agencies, and private sector lenders, as well as borrowing sovereigns. As the current report concludes, "The time has come for a transparency agenda that consists of actionable measures that create tangible incentives and consequences to change behavior." Effective action is necessary and long overdue.

We would like to thank the entire SDWG membership for their contributions to this ongoing effort. We extend our appreciation to Mark

Walker, Rich Cooper, and their team, Destiny Kanu and Rathna Ramamurthi, for their drafting and support. We also thank the Bretton Woods Committee secretariat, Emily Slater, Elena Tosana, and Robin Muthig for their coordination and support. We look forward to receiving your comments regarding this publication, as well as to maintaining an open dialogue with all those interested in strengthening this important aspect of global governance.

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EXECUTIVE SUMMARY

The global pandemic and the resulting heightened financial needs of emerging market sovereign borrowers have made access to international financial markets more critical than ever. Nonetheless, the current architecture of the sovereign debt market impedes the ability of sovereign borrowers to access this market on a consistent and sustained basis. For the less developed economies, sovereign lending is characterized by widespread informational opacity that not only impedes access to funding and undermines investor confidence but also contributes to less-informed policy formulation and an increased risk of corruption and financial instability.

While calls for greater transparency have been made frequently, the path to achieving greater transparency remains elusive. Indeed, there currently is no consensus among market participants regarding what information should be disclosed, how to compel or encourage the relevant parties to make such disclosures, or what the consequences for failing to do so should be.

This article has two goals: (1) to examine the shortcomings of the current regime and (2) to lay out a road map regarding how to effect the needed changes in the international architecture for sovereign finance. The primary purpose is to achieve real progress on transparency and the related challenge of strengthening the degree of engagement, fairness, and trust in the process of sovereign restructurings. Thus, the goal reaches beyond data transparency to encompass what we refer to as "procedural transparency." This effort aims to broaden access to international financial markets while, at the same time, providing more reliable and timely information to market participants.

As outlined in this article, making meaningful progress will require developing a broad consensus regarding what information should be disclosed and what minimum voluntary and, if necessary, mandatory disclosure standards should be introduced over time. Equally as important is developing a consensus regarding what set of incentives and disincentives should be introduced into the system in order to change behaviors to achieve the better outcomes that are desired.

Change of this scale, scope, and importance will not occur easily or quickly. It will require policy makers and political leaders to take action, and not simply to espouse support for increased transparency. In fact, this effort will require the participation of those active in the sovereign finance arena—sovereign borrowers, the private sector, multilateral and regional development institutions, rating agencies, regulators, the OECD, the G20, and other political bodies that oversee or regulate these entities. Although changes will need to be implemented gradually so as not to exacerbate the financial challenges brought on by the pandemic, engagement is needed now, before the emergence of another wave of sovereign defaults and restructurings.

Because improved informational and procedural transparency in the sovereign debt market would lead to better outcomes, it should be an imperative for all actors in the sovereign finance arena. To move this agenda forward, policy makers and market participants need to coalesce around a set of concrete and actionable measures:

1. Developing a consensus around "minimum voluntary disclosure requirements" and ongoing reporting obligations for all sovereign lending, and a similar consensus on limiting the use of bank secrecy laws and contractual provisions in private lending agreements to prevent otherwise appropriate disclosure.
2. As part of that consensus-building process, bringing in China, the largest lender to the emerging markets and a member of the G20, to ensure its support and engagement. Chinese authorities share the goal of providing greater access to funding for these markets. That shared goal can serve as a building block to drive engagement and support for greater transparency.
3. Bolstering and broadening the recent OECD initiative to create a usable and reliable digital database of sovereign financial information that draws on data and information from all available official and private sources.
4. Working with credit rating agencies (and their regulators, if necessary) to utilize rating requirements as a means to promote greater transparency. In particular, the achievement of specified rating levels would be conditioned on compliance with predetermined minimum disclosure rules. In addition, disclosure "scorecards" for sovereign borrowers—which would include a standard set of basic information—should be developed to reward progress and to penalize noncompliance. The goal would be to make greater transparency a key part of the investment community's decision-making process, much in the way that sustainability goals now inform and galvanize the allocation of capital across financial markets.
5. Changing the mix of incentives and disincentives for sovereigns so they are rewarded for actions that promote greater transparency and discouraged from taking actions that undermine it. This could include a variety of measures, such as linking concessional funding and/or debt relief from the official sector to the achievement of designated transparency benchmarks and the use of public-private partnerships to assist sovereigns in meeting these objectives on an accelerated basis.
6. Building out the capacity of sovereigns to gather, generate, verify, and monitor financial information so they have the capability to meet whatever minimum standards are developed.

7. Changing the regulatory landscape to promote a renewed transparency agenda. In the absence of an overarching regulatory regime, individual debtor countries should consider enacting legislation requiring public disclosure of sovereign debt as a condition for its issuance and validity. In general, the goal should be that nondisclosed debt should not benefit from tax and other incentives if sovereign borrowers, or their lending counterparts, fail to disclose such debt in a timely manner.
8. Similarly, making legislative changes in lending jurisdictions to further a renewed transparency agenda. This would include requiring large financial institutions, as part of their domestic reporting requirements, to disclose lending arrangements with sovereigns. It also would require reevaluating the limitations on the dissemination of client financial information in cases where that information can be disclosed without harming the interests of the sovereign clients or putting legitimate confidential information at risk.
9. Leveraging the unique position and role of the official sector (including the International Monetary Fund, the World Bank, regional development banks, etc.) to promote greater transparency. Comprising lenders of last resort, providers of technical expertise, and recipients of a great deal of financial data and information from sovereign borrowers, the official sector is in a unique position to bend the curve toward a more transparent market for sovereign borrowing. Measures that the official sector could take to promote greater transparency include requiring sovereigns to make certain information and financial data provided to official institutions (including information provided pursuant to the World Bank's Debtor Reporting System) publicly available. At the same time, as mentioned above, the official sector also needs to be more active in providing technical support to emerging market sovereigns so that the incurrence of liabilities by a sovereign and its instrumentalities can be more effectively managed and the sector's data collection and reporting abilities improved and modernized.

As part of a broader transparency agenda, this article also examines ways to enhance procedural fairness and inclusiveness in the debt restructuring process, particularly with regard to private sector participation in sovereign restructurings. Currently, typical sovereign restructuring treats the private sector in a manner that inevitably leads to mutual distrust, suspicion, and reduced engagement. To address this, we propose that the sovereign finance community lean into greater inclusiveness in the restructuring process by formally acknowledging the benefits that can be derived by the structured use of ad hoc creditor participation. To that end, we suggest promoting and enhancing the use of engagement clauses, which are found in many sovereign bond documents and require sovereigns to recognize the formation of creditor committees and to pursue transparent engagement in times of stress. Ad hoc creditor committees have demonstrated that they can add value and structure to what otherwise could be a chaotic process. These clauses, and the committees that emerge from them, should be revitalized and recognized officially as legitimate negotiating counterparts to sovereigns during the restructuring process.

I. INTRODUCTION

In 2020, Zambia became the first African nation to default on its debt following the outbreak of the Covid-19 pandemic. The ensuing events unfurled as one might expect: Zambia's decision to withhold payment on a Eurobond led to a swift downgrade of its credit rating and triggered a wave of doubt among creditors trying to salvage their investments in what looked to be a sinking ship. The Zambian government's refusal to disclose the amount and terms of what the market understood to be very substantial debt to Chinese financial institutions contributed to a level of distrust that made it virtually impossible to make progress on the country's restructuring. This also made the notion of equitable burden sharing little more than an empty slogan.

The story of Zambia's restructuring, as yet unfinished, is not unique. For decades, the international architecture for sovereign restructurings has operated without a set of generally accepted rules and procedures to promote transparency. Information opacity is widespread, and while frequent calls for greater transparency have been made, there is no consensus—even among investors—regarding what information should be disclosed, how to compel or encourage relevant participants to make such disclosures, or what the consequences should be for failing to do so. Absent a global regulatory regime designed to promote and ensure transparency, each individual sovereign debtor enjoys a great deal of discretion as to what it chooses to disclose or not disclose. In these circumstances, reaching a common understanding of what a transparent system would look like and creating the proper incentives to achieve that objective are daunting tasks.

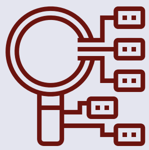
Information opacity is widespread, and while frequent calls for greater transparency have been made, there is no consensus—even among investors—regarding what information should be disclosed, how to compel or encourage relevant participants to make such disclosures, or what the consequences should be for failing to do so.

Yet, the stakes are too high not to make a serious effort.[1] Enhanced transparency is critical for investors to be able to properly assess risk. When risk is more uncertain, the costs of borrowing rise and it becomes more difficult to attract investment. Better, more comprehensive disclosure can also fortify a debtor country's long-term credibility and help to create an atmosphere of trust, which is particularly important when it comes to navigating periods of financial stress. Transparency—and the trust that it engenders—provides a foundation for establishing comparable treatment in cases of debt rescheduling, informing policy decisions by government officials (and the consequences of

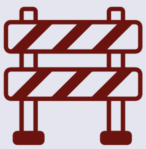
1 See, for example, Carmen Reinhart and Ceyla Pazarbasioglu, "Key to Resolving COVID's Global Debt Crunch: Transparency," *World Bank Blogs*, March 9, 2021, https://blogs.worldbank.org/developmenttalk/key-resolving-covids-global-debt-crunch-transparency; Ceyla Pazarbasioglu, "Current Sovereign Debt Challenges and Priorities in the Period Ahead," IMF *Views and Commentaries*, November 16, 2020, https://www.imf.org/en/News/Articles/2020/11/16/vc111620-current-sovereign-debt-challenges-and-priorities-in-the-period-ahead; "Communiqué, G20 Finance Ministers and Central Bank Governors Meeting" (Fukuoka, Japan, June 8–9, 2019), https://www.mof.go.jp/english/policy/international_policy/convention/g20/communique.htm; "OECD Debt Transparency Initiative," OECD, March 29, 2021, https://www.oecd.org/finance/OECD-Debt-Transparency-Initiative.htm; Alex Weber (Chairman IIF), "We Need Transparency to Keep Countries out of a Debt Spiral," *Financial Times*, June 18, 2019; and Jessica Hickle, "Debt Transparency: An Open Government Solution to Mitigating Debt Crises" (Open Government Partnership, February 8, 2021), https://www.opengovpartnership.org/stories/debt-transparency-an-open-government-solution-to-mitigating-debt-crises/.

The key elements this paper addresses:

Identify complete range of actors



Identify and evaluate obstacles



Identify and evaluate incentives and disincentives

Effective responses to actors who actively limit transparency

Consensus on information disclosure

Data collection and dissemination

such decisions for their citizens), as well as for designing investment products that allocate risk to those investors most willing to shoulder it.[2] Finally, while greater transparency over fiscal matters is not an antidote for public corruption and mismanagement, it can help reduce their severity and impact.

Restructurings by Argentina, Lebanon, Zambia, and many other sovereigns illustrate the danger of information opacity and the risks that arise when creditors and other stakeholders cannot accurately assess a debtor country's financial position. We see this today even in areas outside traditional sovereign debt finance where investment managers focused on environmental, social, and governance (ESG) investments grow increasingly frustrated by the lack of quality information made available by emerging market countries to support investor appetite for these products.[3]

So, what are the key elements needed to make progress on this issue?

First and foremost, the complete range of institutions that play or could play a role in promoting greater transparency and the constraints they face in doing so need to be identified. Second, the obstacles to transparency must be identified and evaluated. Third, incentives and disincentives that could be used to promote greater transparency need to be identified and evaluated. Fourth, effective responses should be formulated and agreed upon regarding the treatment of those agents—on both sides of the table—who actively seek to limit transparency. Fifth, a consensus needs to be developed regarding what information should be disclosed. Sixth, an effort should be made to ensure that the data that are made available are as reliable as possible and are disseminated in a manner that advances the objectives of greater transparency. This article addresses each of these topics in turn, and then offers some thoughts on next steps and implementation.

Efforts to enhance transparency will generate greater benefits when tied to greater procedural fairness and inclusiveness during sovereign restructurings. History has demonstrated that process matters: Successful restructurings are more likely when creditors believe that they have been treated fairly and equitably.

Indeed, the fear of being treated unjustly can cause long-term investors to exit from their investments at the first sign of distress, even before a restructuring has begun. This, in turn, clears the way for more aggressive, short-term investors to dominate the restructuring process. If perceived shortcomings in how these processes are conducted are addressed, the cost and efficacy of such processes would improve, and the outcomes likely would prove to be more

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2 Notably, the provision of public sector debt data is a key component of the Common Framework and debt relief therefrom. *Common Framework for Debt Treatments beyond the DSSI*, Club de Paris, https://clubdeparis.org/sites/default/files/annex_common_framework_for_debt_treatments_beyond_the_dssi.pdf (accessed December 27, 2021).

3 Phil Moore, "REDD Insight: Green, Social and Sustainability Bonds in Africa," REDD, May 13, 2021, reddintelligence.com.

durable. All participants in sovereign debt markets would benefit from knowing that they are receiving fair and equal treatment. Importantly, improved procedural transparency will require many of the key actors in sovereign finance to rethink foundational assumptions regarding how sovereign restructurings should be conducted and which actors should be engaged at the outset.

In the interest of promoting enhanced procedural transparency—that is, a well-defined, well-understood, and widely supported process—this article makes several proposals that would foster greater engagement and inclusion, particularly with private sector investors in the context of sovereign restructurings.

II. THE PRINCIPAL ACTORS

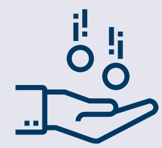
Even a cursory examination of the sovereign debt market reveals that information opacity is the rule, not the exception. Although some market participants, notably Chinese institutions, have received the lion's share of criticism when it comes to creating impediments to greater transparency, the more fundamental truth is that the international architecture for sovereign debt simply does little to promote or require adequate disclosure on a consistent and comprehensive basis. In fact, many major market participants—both debtors and creditors—perceive that they benefit from providing less than full disclosure. At the same time, many participants encounter legal, regulatory, political, or operational constraints to providing better and more timely disclosure. Additionally, sovereign debt obligations remain difficult to measure and accurately report, and there is no independent regulator or overarching legal or regulatory regime that demands it (except in a few limited situations).

To change this, most—if not all—of the key actors involved in sovereign debt management will need to commit in tangible and meaningful ways to facilitate greater transparency. This includes, of course, sovereign borrowers, whose decisions regarding what to disclose or not to disclose are important determinants of how transparent the system will be. But it also includes public and private sector lenders and creditors. In particular, China, as the largest single lender to the emerging markets, will be critical in determining whether the current system can be made more transparent.

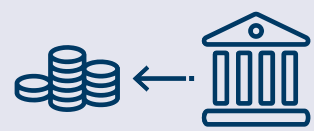
Most important, to move toward a more transparent system, international development and financial organizations—including the International Monetary Fund (IMF), the World Bank, and regional development banks—will need to take affirmative actions to promote greater transparency. These institutions stand in a unique position to promote real and lasting change, but their willingness and ability to do so will depend on the appetites of their stakeholders to actively support such an effort. Other institutions, such as the OECD, credit rating agencies, and information-gathering regulators, including the US Securities and Exchange Commission (SEC) and the Bank for International Settlements (BIS), also can play important roles in this effort.

Key Actors in Sovereign Debt Architecture

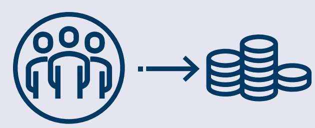
Sovereign Borrowers



Sovereign Creditors and The Paris Club



The Private Sector Creditors and the IIF



Official Sector: IMF, WB, MDBs, OECD

Ratings Agencies and Regulators

G20 and Other Political Bodies

Encouragingly, some evidence of progress is visible already. On the private sector side, the International Institute of Finance (IIF) has taken a leadership role in promoting transparency. The Principles for Debt Transparency (Debt Transparency Principles), developed under IIF auspices, specify an aspirational set of financial transactions that should be disclosed by sovereigns.[4] The Debt Transparency Principles are based on the premise that improved transparency facilitates good governance, combats corruption, and supports debt sustainability. They are complemented by other preexisting initiatives that have sought to establish best practices.[5]

The efforts of the IIF, in turn, have contributed to the OECD's decision—endorsed by the G20—to create a public debt data repository[6] for low-income developing countries (LIDCs). However, to achieve even the limited mandate of the OECD, it will be critical that both debtor and creditor sovereigns act decisively to supply relevant information to the OECD, as well as removing contractual and legal obstacles that deter private sector creditors from providing appropriate information to the OECD.

The IIF has recently published an Implementation Note that provides private sector financial institutions with some helpful background on the OECD initiative and how they can support the OECDs efforts.[7] The Implementation Note details who falls within the Debt Transparency Principles' scope, how the OECD processes the submitted information, who provides the information to be processed, and the practicalities of participation in the program. In addition, the Implementation Note provides sample language for confidential information carveouts and a template letter for institutional lenders seeking the consent of sovereigns to participate in the OECD initiative. The publication of the Information Note should help lending institutions that are inclined to support the efforts of the OECD to create a useful data repository do so and also generate additional publicity and momentum regarding this important initiative.

While the efforts of the IIF and the OECD are welcome first steps, on their own they will not result in a regime of materially greater transparency. Others

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4 The IIF Voluntary Principles for Debt Transparency are focused on "private sector foreign-currency lending to sovereigns, sub-sovereigns and public sector entities (or borrowers with public guarantees) in PRGT-eligible countries." *See* "Voluntary Principles For Debt Transparency," IIF, June 10, 2019, https://www.iif.com/Publications/ID/3387/Voluntary-Principles-For-Debt-Transparency. In this paper, we have taken a broader view of liabilities that should be subject to enhanced disclosure (*see* pg. 15-16) and have taken a more holistic approach to transparency, focusing on measures that could be introduced into the ecosystem over time to encourage greater transparency.

5 One such example is the IMF Fiscal Transparency Code: https://www.imf.org/en/Topics/fiscal-policies/fiscal-transparency#Fiscal%20Transparency%20Code. Although the IIF has played an active role in promoting greater transparency, on an individual or industry basis, the private sector has not taken the type of robust action it could if requiring greater transparency were a high priority. Although individual lenders are unlikely to put themselves at a competitive disadvantage by insisting on disclosure from sovereign borrowers that goes beyond what is the market standard in today's environment, if progress is to occur on this issue, the private sector will have to be more active in pushing for greater transparency than it has to date.

6 This Debt Transparency Initiative seeks to bring together data users and data providers that lend to low-income and emerging market countries to provide useful, aggregated lending data. "OECD Debt Transparency Initiative," OECD, March 29, 2021, https://www.oecd.org/finance/OECD-Debt-Transparency-Initiative.htm.

7 "Implementation Note, IIF Voluntary Principles for Debt Transparency," IIF (last visited Jan. 16, 2022).

also will need to act. Regulators and credit rating agencies need to create incentives for greater disclosure, including establishing consequences for failures to disclose. However, regulators can only regulate markets over which they have jurisdiction. Credit rating agencies depend on access to information—much of which can be provided only by the sovereign issuers whose debt they are rating. The ability of these institutions to effect change is constrained by their limited jurisdictional mandate and their dependence on sovereigns or other actors for the underlying information. In the absence of a global consensus on the need for greater transparency, it is therefore unrealistic to expect that regulators and/or rating agencies will be able to lead the fight for greater transparency.[8]

Of all the actors active in the sovereign debt arena, multilateral institutions—including the IMF, the World Bank, and regional development banks—are in the best position to exert influence over the shape and content of a transparency regime for sovereign debt. This reflects their unique role as lenders of last resort and as providers of resources and expertise that are in high demand, especially from emerging and developing economies. They also regularly receive substantial financial information and data from sovereigns who could elect to make such information and data available in a manner that could promote transparency with minimal cost and burden. These institutions, if supported by their members, are also less constrained than others by their jurisdictional footprint or by concerns about whether an individual sovereign will take their next call.

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As an obvious example, as part of a new transparency agenda, sovereigns could be prompted to elect to disclose publicly a subset of the financial and other information they provide to the IMF. Although the IMF and the World Bank have both opposed imposing such requirements, this opposition presumably reflects their members' views. Without the support of their key members, these multilateral institutions' advocacy for greater transparency will not by itself bring about meaningful change. Other political support will also be required, including from the members of the G20 and the Paris Club.

III. INFORMATION TRANSPARENCY

Operational, Regulatory, and Contractual Obstacles to Disclosure

While there is no global regulatory regime that mandates disclosure standards for sovereign debt, information is available that can provide substantial guidance for market participants. For example, data on debt liabilities can be found in national financial accounts, official government publications, and a slew

8 Nonetheless, both of these institutions have compelling reasons for promoting enhanced transparency. Most important, investors may misprice risks if regulators and credit rating agencies are unaware of the full scope of a country's liabilities. The result could include avoidable losses and reduced market access to otherwise worthy borrowers.

of databases that draw data from a combination of voluntary and mandatory submissions.[9] Aggregated data from several of these databases are published annually on the International Debt Statistics (IDS) database, and the IMF's National Summary Data Pages provide countries that participate in its dissemination programs the opportunity to publish their gross debt figures directly.

Given the seeming abundance of these data, why is it so hard to obtain universally available, in-depth information on existing sovereign debt? Several factors contribute to this challenge.

Barriers to universally available, in-depth information on existing sovereign debt:

- Patchwork of databases
- Voluntary rather than mandatory disclosure
- Institutional capacity constraints
- Contractual impediments

Patchwork of databases. Typically, the information is disclosed and accessible through what amounts to a patchwork of databases established for different and often unrelated purposes, with data that are often inconsistent. For example, the Quarterly Public Sector Debt Statistics (QPSDS) and Quarterly External Debt Statistics (QEDS), developed by the World Bank and IMF and operated by the World Bank, have differing scopes of data collection for institutional sectors and instruments and cover different subsets of countries. The IMF's annual Government Finance Statistics (GFS), Special Data Dissemination Standard Plus (SDDS Plus) and Debtor Reporting System (DRS) share similar input disparities that reflect their differing respective institutional purposes.[10] Unless this information can be gathered, verified, and transformed into useful and standardized inputs, just because there is an abundance of data does not mean the data will contribute much to advancing a transparency agenda.

Voluntary rather than mandatory disclosure. Because there is no overarching regulatory regime mandating disclosure apart from bond offerings—where disclosure of varying degrees is required by the SEC and similar national regulatory bodies—and disclosures captured by IMF and World Bank databases,[11] sovereigns can choose whether and how much to disclose. And experience shows that sovereign borrowers generally do not voluntarily disclose all information that market participants would consider relevant. In part, this reflects borrowers' fears that increased disclosure may discourage

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9 Samba Mbaye, Marialuz Moreno Badia, and Kyungla Chae, "Global Debt Database: Methodology and Sources" (IMF Working Paper WP/18/111, May 14, 2018), 11.

10 Particularly of note, in 1996 the SDDS was established to assist IMF members seeking access to international capital markets with publicly disseminating their economic and financial data. Following the SDDS, in 1997, the General Data Dissemination System (GDDS) was developed for member countries with less developed statistical systems and was meant to serve as a framework for evaluating their data improvement and priority-setting needs. Finally, in 2012, in order to help address data gaps identified during the Global Financial Crisis, the SDDS Plus was devised as an upper tier of the IMF's Data Standards Initiatives. Today, however, only 26 IMF member countries adhere to SDDS Plus. "IMF Standards for Data Dissemination" IMF *Factsheets*, March 26, 2021, https://www.imf.org/en/About/Factsheets/Sheets/2016/07/27/15/45/Standards-for-Data-Dissemination#:~:text=The%20Special%20Data%20Dissemination%20Standard,financial%20data%20to%20the%20public.

11 The World Bank's DRS captures some data, but it applies only to active and potential World Bank borrowers. It attempts to capture the details of loans, including debt service schedules and loan terms on a loan-by-loan basis. The utility of the DRS is limited, however, as only aggregated data is made publicly available via the IDS.

prospective investors, have adverse political consequences, and/or conflict with some other national interest.

Many sovereigns have avoided more fulsome disclosure to avoid drawing public attention to failures in ongoing policy, to obscure the need to take on additional indebtedness, or for other political reasons such as to avoid publicly evidencing their reliance on foreign interests. In other cases, the rationale for a lack of disclosure is more sinister and goes beyond political vulnerability or the fear that greater disclosure will inhibit new funding. In these cases, illegal or improper conduct is the underlying issue. In such cases, the justification for greater disclosure is self-evident. An egregious example is Mozambique: In 2019 it was revealed that US$2 billion of loans to state-owned entities guaranteed by the government had been neither disclosed nor approved by the Mozambican parliament as required by the constitution.

Experience shows that sovereign borrowers generally do not voluntarily disclose all information that market participants would consider relevant.

Existing disclosure requirements applicable to sovereign bond offerings and the incurrence of sovereign loans go only so far. Although the SEC regulates issuers of sovereign bonds who seek to access US retail markets,[12] the vast majority of emerging market issuers are not SEC registered.[13] While emerging market issuers of non-SEC registered international bonds generally provide disclosure that is similar to that required in an SEC-registered context, the information is not public (although often it can be obtained by those willing to make the requisite effort in searching for it). Furthermore, unlike for SEC-registered issuers, there is no requirement for them to update the markets on material developments or on changes in the country's financial position. In the case of local bond issues, disclosure often is minimal and not something local investors typically demand or expect.

In addition to these limitations, bank secrecy laws that regulate how financial institutions protect the nonpublic information of their customers often work to limit disclosure by restricting lenders from providing information without the consent of their borrowers. To address this issue, the international lending community and its regulators will need to build a consensus on limitations on the use of bank secrecy laws and contractual provisions in private lending

12 SEC-registered sovereign issuers generally provide reports annually, as well as updated interim information, in the context of offerings. These reports must include, among other things, the sovereign's total outstanding internal and external short-term and long-term debt and the title, issue date, maturity date, interest rate, currency, and amount outstanding for each issue of long-term debt. In addition to the required disclosures, sovereign issuers often provide additional disclosures in line with developed market practice and in response to what their bankers think investors will demand before investing.

13 Seventy-one sovereign entities have registered with the SEC, leaving all remaining sovereign issuers, a significant number of which are in emerging markets, not registered. Even in the context of non-SEC-registered offerings, sovereigns provide much of the same debt information to potential bondholders, and the extent of those disclosures is similarly driven by established market practice and marketing advice from the bankers. Market practice is to include aggregated debt information for the government and public sector with a breakdown by creditor type. Some sovereigns even list their multilateral, bilateral, and private creditors and provide more detailed narrative disclosure on the objective of various official sector loans. However, in contrast to the disclosure required in an SEC-registered offering, the offering documents for a non-SEC-registered international bond issue, although relatively widely available in many cases, are not technically public, and there is no requirement for the sovereign to keep them updated.

agreements that prevent appropriate disclosure. Given the risks inherent in lending to sovereigns and their instrumentalities, including the risks of corruption and the misuse of the proceeds from such borrowings, there are strong public policy arguments as to why the terms of sovereign lending should be made public in most circumstances. If the international lending community would accept this basic principle, then we have little doubt that any legitimate concerns regarding protecting information relating to pricing or proprietary lending terms could be easily managed.

The international lending community and its regulators will need to build a consensus on limitations on the use of bank secrecy laws and contractual provisions in private lending agreements that prevent appropriate disclosure.

Institutional capacity constraints. In recent years a growing number of emerging market countries have tapped international capital markets and upgraded their capacity to gather, generate, report, and monitor the information that such access requires. However, the number of countries that cannot meet these requirements still far exceeds the number that can. This is particularly the case with LIDCs, which generally have less capacity to generate and report the type of information that would lead to full transparency.[14] A recent World Bank report highlights the fact that 40 percent of LIDCs have not published any sovereign debt data in the last two years. Moreover, for those countries that have published information, there are significant discrepancies in their reported figures across different data sources.[15] Existing voluntary databases have consequently fallen short in ensuring high-quality, consistent data from LIDCs.[16]

Contractual impediments. Even leaving aside the issue of bank secrecy laws, lenders generally are reluctant to disclose the terms of their lending arrangements for competitive and other reasons (including not wanting to be exposed to local politics that often call attention to significant sovereign lending). For many sovereign lenders, maintaining the confidentiality of lending terms may serve other geopolitical or financial interests. As a result, even when sovereign debtors would be amenable to more transparency, there may be contractual impediments to full disclosure imposed by their lenders.

To illustrate this problem, consider that it took a multiyear effort by a team of professors, economists, and global development researchers to collect a sample of 100 loan contracts between Chinese state-owned entities as lenders, and 24 developing countries in Africa, Asia, Eastern Europe, Latin America, and Oceana as borrowers. That team estimated that this sample of 100 contracts

14 Less than 50 percent of LIDCs meet minimum requirements in terms of staff capacity in debt management offices. Debt management offices of LIDCs also face significant technological deficits. Diego Rivetti, *Debt Transparency in Developing Economies* (Washington, DC: World Bank Group, 2021), 5, http://documents.worldbank.org/curated/en/743881635526394087/Debt-Transparency-in-Developing-Economies;

15 Rivetti, *Debt Transparency in Developing Economies*, 5.

16 For example, the QPSDS is thorough—it collects outstanding public sector debt broken out by the type of instrument, maturity, currency, and residency of a country's creditors. It allows sovereigns to disclose both gross debt and net debt at nominal value, as well as traded debt securities at market value. However, it still struggles to compile useful, accurate information from LIDCs. *Public Sector Debt Definitions and Reporting in Low-Income Developing Countries* (IMF and World Bank, January 31, 2020), 15.

represented a small a fraction of the more than 2,000 sovereign loan agreements between Chinese state-owned lenders and developing countries since the early 2000s.[17] And the difficulty the team encountered in obtaining underlying debt documents is not unique to Chinese lenders.

As a general rule, very few debtors or lenders make public the terms (or sometimes even the existence) of sovereign loan agreements.[18] For instance, the team described Cameroon as a "vanishingly rare example" of a country that publishes all of its project-related loan contracts with foreign creditors.[19] But few would dispute that understanding the terms and conditions of outstanding loans, and in some cases, the identities of the lenders, is critical to making sense of the issuers' financial position, the relative priority of loans, and the existence of any preferential payment arrangements. That this information exists but typically is not disclosed in a form that is useful for market participants (even while addressing the legitimate concerns of sovereign borrowers and lenders alike), underscores the prospective importance of enhancing transparency and of including the disclosure of such basic information as part of an effective transparency regime.

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Creating Incentives to Disclose and Consequences for Nondisclosure

Despite the potential benefits, it is highly unlikely that an overarching global regulatory regime mandating greater transparency in sovereign finance will be adopted any time soon. There are too many conflicting interests and objectives for decisive advances to occur quickly. Instead, meaningful progress on this issue likely will require a wide range of actions from a diverse group of actors.

Ideally, coupling enhanced disclosure requirements with tough penalties for the failure to disclose would create appropriate incentives to disclose. Some of these measures would have effect at the time of the incurrence of a financial liability, and others would be ongoing—the objective of disclosure being to make relevant information as to the debtor's financial strength and debt capacity available on a continuing basis.

17 Anna Gelpern, Sebastian Horn, Scott Morris, Brad Parks, and Christoph Trebesch, "How China Lends: A Rare Look into 100 Debt Contracts with Foreign Governments" (CGD Working Paper 573, March 31, 2021), 5, 12.

18 This is particularly true in the context of resource-backed loans, which tend to include strict confidentiality clauses due to the sensitive nature of transactions involving natural resources. Rivetti, *Debt Transparency in Developing Economies*, 69.

19 Gelpern et al., "How China Lends," 45. The study of Chinese loan contracts with sovereigns identified offmarket confidentiality clauses; special bank accounts to provide Chinese lenders, essentially, cash collateral for their loans; and clauses that tried to position the lender as a preferred creditor by excluding the underlying debt from any restructuring in the Paris Club or from receiving comparable debt treatment. It also revealed broad-ranging default and cross-default clauses tied to China's national interests. For example, the contracts included cross-default clauses tied to actions taken by the sovereign debtor against the interests of other People's Republic of China entities, including expropriation. The contracts also contained events of default linked to law or policy changes on the part of the debtor country and to China's diplomatic relations with the debtor country.

As part of this effort, a heightened set of mandatory disclosure requirements could be triggered when a distressed debtor seeks relief. Although these measures primarily would be aimed at requiring greater disclosure from sovereigns, they also could include appropriate disclosure mandates for banks and other financial institutions. As discussed earlier, both debtors and creditors may have reasons why they might want to limit disclosure of the nature, details, or even the existence of a particular financing transaction. Since either party might seek to require the other to keep confidential the terms or existence of the transaction, a duty of disclosure would need to apply equally to both.

The most meaningful and dramatic change in conduct would result from disclosure requirements enacted by the IMF, the World Bank, and other regional development institutions. That being said, any measures that limit access to official sector support need to be carefully calibrated and implemented as they could result in less access to official sector funding at a time when the global pandemic has taken a heavy toll on emerging market countries, particularly LIDCs. And any policy that conditions funding or support to sovereigns on meeting minimum transparency standards runs the risk of pushing sovereigns to look elsewhere for such funding, including to actors that do not share the objective of promoting greater transparency.

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Measures linked to the incurrence of new financial liabilities. If adopted, measures linked to incurrence of new financial liabilities should improve the quantum and quality of information available, as well as enhance financial market efficiency. They also would have the salutary effect of helping to curb excess borrowing, as lenders would be better able to gauge the true financial situation of prospective borrowers. As a result, market pricing would be better aligned with inherent credit risks.

Such measures could come in the form of debtor country legislation or regulations requiring prior authorization and public disclosure of new debt as a condition on its issuance, validity, and enforceability.

- These rules could specify the level of disclosure required and could invalidate any contractual, legislative, or regulatory restrictions on disclosure. Many countries already require legislative approval of sovereign debt, so requiring that the material terms of such debt be disclosed (subject to certain exceptions) would not represent a dramatic shift.[20] With the potential annulment of a contract at stake, lenders would have a powerful incentive to ensure that the required authorization and disclosure have been made. Indeed, in these circumstances, lenders might be expected

20 See, for example, Argentina, whose new law requires that financing agreements with any international organization be approved by law. Law to Strengthen Public Debt Sustainability, Law No. 27,612 (Argentina, March 3, 2021).

to insist on the right to correct or supplement any disclosure made by the borrower or to provide the disclosure themselves if need be. Model language for such laws could be developed and tailored to different jurisdictions and legal systems.

- There could be a grace period following enactment of the applicable rules, after which the borrower would be precluded from paying any preexisting undisclosed debt, possibly with exceptions such as acceleration as appropriate, until such time as it or the lenders make the prescribed disclosure. This approach would create a further powerful incentive for a sovereign borrower to make the requisite disclosure and, if such disclosure is not made, the holder of the debt would have a clear incentive to do so.
- Local law could mandate that new debt not adequately disclosed within a prescribed period following its incurrence would automatically cease to benefit from favorable withholding or other tax treatment or would be subordinated to both existing and future senior debt. The degree of subordination could be fashioned incrementally to give time for corrective disclosure; it could range from voting and payment subordination all the way to subordination of liens and could extend from existing indebtedness to future indebtedness.
- Applicable securities or listing regulations could prevent an otherwise eligible sovereign issuer, including any of its instrumentalities, from accessing the applicable markets (perhaps for an extended period) if it is not compliant with disclosure requirements, on the premise that such a failure omits or misstates the terms of material debt.
- For some jurisdictions where local capital markets exist or could be developed, legislation designed to promote greater transparency could be enacted. This might encourage local stakeholders (e.g., pension funds, local regulators, and public advocacy groups) to advocate for greater transparency that encompasses but is not limited to sovereign finance.

Measures could come in the form of debtor country legislation or regulations requiring prior authorization and public disclosure of new debt as a condition on its issuance, validity, and enforceability.

Ongoing disclosure incentives and requirements not tied to the incurrence of new liabilities. A consensus among market regulators and international institutions for a tougher and more complete disclosure regime would encourage sovereign debtors to adhere to stricter disclosure standards.

- As a first step, the IMF, the World Bank, regional development banks, bilateral credit agencies, the G20, securities exchanges, and other private and public bodies could develop and adopt voluntary standards of disclosure in order to develop consensus as to best market practice. This consensus should start with an agreement on minimum financial disclosure standards that could be implemented quickly with a set of common definitions and terms and a timetable to achieve broader, enhanced standards that could be implemented over time. The consensus should also include a decision regarding the appropriateness of confidentiality clauses or other provisions that undermine the goal of promoting transparency.[21]

- Rating agencies could strengthen their disclosure requirements so that market access would be conditioned on compliance with prescribed disclosure rules. For example, a rating of B or better could be made conditional on adherence to IMF data dissemination standards (or the election of a sovereign issuer to make publicly available certain information that has been made available to the IMF or World Bank). Absent demonstrated compliance, a country would be subject to an automatic rating downgrade or deprived of an otherwise earned upgrade. Given the gatekeeping role rating agencies play in the investment process, this could be a powerful tool to create the right incentives for sovereigns to change behavior in favor of greater transparency.
- Creating transparency scorecards and objective minimum disclosure standards could also push market participants to be more rigorous when it comes to making their own investment decisions. Presumably, such investors would wish to avoid having to explain to their clients when those issuers encounter difficulties due to incomplete or misleading disclosure.
- Given the extensive and expanding appetite for ESG investment, one also could envisage a transparency agenda gaining similar traction in the investment community, given the link between transparency and good governance—and the desire to fight the corruption that thrives in environments where information is withheld. One could imagine sovereign bond offerings including key performance indicators tied to transparency, whereby sovereign issuers are rewarded for their progress on these issues. Indeed, it is possible that the link between the achievement of greater transparency and lower debt funding costs could attract the interest of public-private partnerships in which private parties willing to provide know-how, resources, and expertise could be used to promote these objectives on an accelerated basis.
- The standards recommended by SDDS could be strengthened to include greater disclosure requirements, and its scope could be expanded beyond capital markets issuances. In addition to being a requirement for credit ratings of B or better, compliance with an enhanced SDDS also could be adopted by lending institutions and their regulators.

Given the extensive and expanding appetite for ESG investment, one also could envisage a transparency agenda gaining similar traction in the investment community, given the link between transparency and good governance...

21 Of course, there are limited circumstances, such as national security or legitimate competitive considerations, that may justify the inclusion of confidentiality clauses in sovereign loan agreements, but those could be addressed as part of the process.

- The IMF, the World Bank, regional development banks, other bilateral lenders, and multilateral institutions could agree on a set of mandatory minimum disclosure requirements that sovereigns (and their instrumentalities) must meet and abide by if they wish to have access to official sector resources and support, including access to the IMF's Special Drawing Rights (SDRs). These sorts of requirements could start initially with a more limited set of basic financial information and require broader disclosure over time so as not to impede access to official sector funding at a time when funding is urgently needed, such as in the pandemic's wake.
- Such measures should be accompanied by the provision of technical support for improving data gathering and verification, as well as financial support from these agencies to enable sovereigns to build their internal capacity to meet these standards. Given the increased debt taken on by state-owned enterprises in recent years—and the challenges that such borrowing often presents to governments that sometimes are not fully apprised of its existence and/or terms—official sector technical support should include advice regarding methods and procedures to improve debt management by sovereigns and their instrumentalities.
- Another option could be the provision of incentives that would include more favorable financial treatment (e.g., lower financing costs or longer terms) for those countries that meet or exceed minimum disclosure standards. Even if this initiative were phased in over time and, in exceptional circumstances, were to allow access to sovereigns that don't comply with all these rules, it could significantly improve the landscape for transparency in sovereign finance.

Incentives in the context of official sector liquidity support and debt restructuring. While it is important that financial market participants be aware of all relevant facts at the time a liability is incurred, it is no less critical in the context of restructuring, where creditors are called upon to adjust their claims and the official sector is often called upon to provide substantial liquidity support. In these cases, transparency plays two roles: First, it enables stakeholders to make sound judgments as to the appropriate level of relief and the adequacy of fresh resources deployed to return the debtor to a sustainable growth trajectory, and second, it enables stakeholders to ascertain that the burden of debt relief is fairly allocated.

In these circumstances, there is likely to be a heightened need for full disclosure. Disclosure made before the debtor has entered a period of distress may be insufficient to determine whether a proposed restructuring plan is likely to succeed and whether it treats different creditors on comparable terms. For example, the relief provided through adjustments to interest rates and amortization can be assessed only if prior interest rates and amortization are known

While it is important that financial market participants be aware of all relevant facts at the time a liability is incurred, it is no less critical in the context of restructuring, where creditors are called upon to adjust their claims and the official sector is often called upon to provide substantial liquidity support.

in detail. Similarly, a creditor with a financing agreement linked to a different transaction may be willing to compensate for an adjustment to its financing agreement with an offsetting adjustment to another agreement.

Under the current practice, the IMF and the Paris Club assess comparability of debt relief by looking at classes of creditors, as opposed to the positions of individual creditors. This seems a reasonable approach, although it may not always obviate the necessity of gathering information on a creditor-by-creditor basis. In all likelihood, the additional information required to assess comparability of treatment will need to be determined on a case-by-case basis. Nonetheless, it should be possible to define generic categories of pertinent data, as discussed in "Disclosure Requirements" (see page 16).

Where a restructuring is contemplated, one might envisage two targeted sets of measures:

1. Official and bilateral creditors will explicitly condition the provision of fresh funds and any debt relief to be granted on enhanced disclosure by the debtor and other creditors.
2. The same enhanced disclosure will be made available to the private creditors providing debt relief, and those creditors might stipulate in their restructuring agreements that the relief itself will be reversed and prior obligations restored if the disclosure is materially inaccurate or contains a material omission.

Legislation could also be enacted that creates an incentive for sovereign debtors to be more forthcoming. In what may be a precursor of such legislation, the New York state legislature introduced a bill in May 2021 that would create a mechanism for restructuring sovereign and subsovereign debt governed by New York law. The proposed legislation would condition a sovereign's ability to opt into the program on a comprehensive debt audit, including the public debt contracting, refinancing, and negotiation processes.

One major goal of the proposed legislation is to determine the lawfulness, transparency, and sustainability of the restructured debt. The proposed legislation is not clear as to whether the results of the audit would be public, but it does underline the importance of having a complete picture of a sovereign's liabilities before conducting a restructuring. Of course, even this legislation and the debt audit mechanism it contemplates would have a limited impact because it would force disclosure only for instruments governed by New York law and sovereigns that opt into the statute. And it would apply only after the debts had proven to be unsustainable.

Determining Which Liabilities Would Be Subject to an Enhanced Disclosure Framework

Although it may seem obvious, it is worth stating that the framework of enhanced disclosure should focus on obligations arising from financial transactions. This does not include all commercial transactions, nor does it include the asset and revenue side of a country's balance sheet and revenue statement. While the latter is clearly important and would be of interest to investors, such a broad disclosure regime would be challenging to design and implement on a global basis and would require expertise and costs that would create significant burdens for most sovereign issuers.

Of course, limiting disclosure to financial transactions will create boundary issues. For example, absent a financing component, contracts for the development of long-term infrastructure projects would be outside the purview of this framework. If, however, a seller, project sponsor, or financial institution extends credit to the sovereign to finance or refinance the cost of long-term assets (e.g., a refinery or port facility) or goods or services, that extension of credit would be included and considered a financing transaction subject to enhanced disclosure.

Of course, additional disclosures regarding any material asset or transaction could be useful information to have available publicly. However, any disclosure regime needs to balance the burdens of disclosure, including the adverse effects that mandating such disclosure could have on the ability of the issuer to conduct its affairs and effect such transactions, against the benefits such disclosure would have on financial markets, particularly as related to risk and price assessment. In this context, focusing on financing transactions draws the line in the appropriate place.

The following financial obligations should be subject to enhanced disclosure:

- Obligations in favor of private, official, and bilateral creditors, in whatever form, secured or unsecured, in respect of borrowed money and guarantees or other assurances of repayment thereof;
- Obligations to pay the deferred purchase price of goods or services owing to a seller or provider thereof or to a financial institution;
- Obligations in respect of derivatives entered as financial transactions, excluding commercial hedging transactions by a buyer or seller of a commodity in the ordinary course of business;
- Refinancings of current or past-due commercial obligations that would not have been included absent refinancing;

- Financial transactions separate from but linked to a commercial transaction,[22] in which disclosure should extend to the terms of the linked commercial transaction, at least in the context of a restructuring;
- Judgments and arbitral awards related to financial (and in some circumstances, commercial) transactions;
- Any financial liabilities disclosed to an official or bilateral creditor and not otherwise disclosed to private market participants; and
- Obligations to deliver commodities in the future in exchange for an up-front prepayment.

Required disclosure should, at a minimum, enable a sovereign lender or purchaser of sovereign debt to make an informed decision as to the underlying credit and, in periods of issuer distress, the relative treatment of all stakeholders in any restructuring.

Trade finance maturing in less than one year, commercial transactions that do not include an extension of credit, and noncash transactions, such as the obligation to deliver a commodity, would lie outside the scope of the disclosure framework proposed here. A materiality standard also should be applied for practical reasons, so that individual transactions below a prescribed threshold would similarly fall outside the enhanced disclosure framework.[23]

Sovereign debtors may have legitimate reasons not to disclose the existence, much less the terms, of certain transactions, such as defense or national security–related contracts or those whose disclosure might jeopardize or harm some important public policy interest. In such circumstances, borrowers will be unlikely to agree to have a third-party review of such claims for exclusion. Although the exclusion of unreviewable claims of this nature would by definition be subject to abuse, outside the context of national security, the sovereign may be able to provide sufficient information without compromising its legitimate interests to enable stakeholders to assess the legitimacy of its claim.

Disclosure Requirements

In light of the purposes to be served by enhanced disclosure, some terms of a financing transaction (for example, the currency in which the obligation is expressed) may be of greater importance to new or continuing investors, and others (such as linkages between a financing and other agreements) may be of more relevance to participants in a restructuring.

Required disclosure should, at a minimum, enable a sovereign lender or purchaser of sovereign debt to make an informed decision as to the underlying credit and, in periods of issuer distress, the relative treatment of all

22 Thus, for example, in the case of a loan to a sovereign repayable by the delivery of oil under a separate long-term purchase agreement, both the loan agreement and the oil sales agreement would be subject to enhanced disclosure in a restructuring.

23 While some may argue that certain trade undertakings, particularly those that are substantially overcollateralized, should fall within the agreed disclosure regime, the practical need to update and monitor such arrangements could be burdensome and, at the same time, could create opportunities to game the regime if they are included.

stakeholders in any restructuring. Accordingly, required disclosure should include the following:

1. ***Information about the liability***
   - i. Amount owed
   - ii. Maturity and amortization
   - iii. Whether in local or foreign currency (disclosure of which foreign currency should not be required, except perhaps in a restructuring context)
   - iv. Obligor, if other than the sovereign
   - v. Nature of liability—for example, loan, tradable security, arbitration award or court judgment, purchase money financing, other, or guarantee of any thereof
   - vi. Collateral or other security arrangement, designated source of repayment or other arrangement giving preferred access to assets of the debtor (if applicable)
   - vii. Identity of guarantor and its relationship to the sovereign debtor (if guaranteed other than by the sovereign)
   - viii. Details as to terms of subordination (if subordinated)
   - ix. Basis on which the price of or volume of a commodity to be delivered is determined (if an obligation for future delivery of a commodity)
2. ***Information about the creditor***
   - i. Nature—for example, private lender or bondholder, judgment creditor, bilateral creditor, international financial institution, or regional development bank
3. ***Information relating to a proposed restructuring***
   - i. Identification of liabilities of the sovereign proposed to be included and those proposed to be excluded from the proposed restructuring
   - ii. Detailed description of proposed treatment of liabilities to be included, including any related proposed modification of other agreements between the sovereign and its creditors or affiliates thereof
   - iii. Description of whether the amount or timing of payments in respect of the liability is linked in one form or another to payment or performance by the debtor under another transaction—for example, whether the principal amount or interest rate was determined as a function of the price of goods to be sold or purchased by the sovereign obligor, whether the purchase price of goods sold or purchased

by the sovereign in a transaction was related to the liability at a price other than market

iv. Description of collective action clauses, if any, applicable to included liabilities

Operationalization through the OECD Initiative

Efforts of the OECD and the IIF have been critical to making tangible progress on advancing the objective of greater transparency in sovereign finance. The official sector (in particular, the IMF and the World Bank) and the IIF, on behalf of private financial institutions, have agreed that the OECD will make the Debt Transparency Principles operational by creating a digital platform to serve as a repository of sovereign debt disclosure data.[24] In its initial stages, this effort will focus on information pertaining to lending to LIDCs. While the mandate of the OECD is limited and the database it is creating relies exclusively on information provided by financial institutions and not sovereigns, the OECD has the expertise,[25] resources, and knowledge base to process the raw data it receives and convert it into useful, neutral, standardized information that can be disseminated to the market.

The OECD effort should be expanded to ensure that the data repository will best serve the objectives of transparency, be a tool that will improve the efficiency and fairness of markets, and facilitate the better design and execution of sovereign debt restructurings.

Creating this enhanced database represents an important, albeit limited, step. Based on a preliminary review of the published work of the OECD on this initiative, as well as discussions with OECD officials, the OECD effort should be expanded to ensure that the data repository will best serve the objectives of transparency, be a tool that will improve the efficiency and fairness of markets, and facilitate the better design and execution of sovereign debt restructurings.

Some specific improvements could include the following:

- Data reporting requirements should be expanded to cover all emerging market sovereigns (not just the current subset of countries eligible for the Poverty Reduction and Growth Trust, or PRGT). Under current plans, the effort will be incomplete unless the official sector and sovereigns themselves provide relevant information regarding their known and contingent financial undertakings and obligations.

24 The IIF's Implementation Note to the IIF Voluntary Principles for Debt Transparency serves as a guide for how the program will be administered. While the Implementation Note will alert market participants to the OECD data repository initiative and hopefully result in greater private sector participation in that effort, it does not address the broader issues of how to change the system by overcoming existing impediments to greater transparency or creating the right mix of incentives and disincentives to change behaviors to promote more transparency. "Implementation Note, IIF Voluntary Principles for Debt Transparency," IIF (last visited Jan. 16, 2022).

25 The preliminary reporting template developed by the OECD does not distinguish between financial terms that may be of greater interest to different actors, nor does it define what financing transactions need to be disclosed. The template itself seems to ask for information that, on the one hand, may not be material to market participants (such as the identity of a lead arranger), while at the same time omitting critical information that an investor—whose asset is proposed to be restructured—will require. No doubt these gaps, and the template itself, were heavily influenced by the OECD's reliance on market participants, and not sovereign governments, to provide the relevant information.

- Outreach to, and engagement with, a diverse range of lending institutions should be prioritized. Without concrete commitments from sovereigns, only a subset of lending parties will be engaged actively in the OECD's efforts, creating a risk of unintentionally penalizing reporting firms unless more widespread support is assured.
- The OECD should work closely with other stakeholders, including the private sector, sovereigns, and the official sector, to reach a consensus on what data can be used, and by whom. Consideration should be given to finding the best way to ensure that data that are provided can be safeguarded against improper use (thus facilitating sovereign and other stakeholder's willingness to participate in such effort).
- Information relating to the outcomes of sovereign restructurings should be included.
- Sovereign involvement in this exercise should be treated as critical, since enhanced transparency at the national level is necessary to ensure that a data aggregator like the OECD has access to all relevant debt data, rather than being forced to rely exclusively on the private sector to provide a limited, and highly selective, subset of information. Here again, developing a mix of positive and negative incentives to promote cooperation will be important; official sector support and assistance could be tied to cooperation with the OECD's efforts as a way to obtain buy-in from emerging market sovereigns.
- Information from any existing databases of borrowing countries, market participants, and official institutions (the IMF, the World Bank, and the BIS, among others) should be provided to the repository. That information, which currently exists in myriad formats, must be coded in a standard form for ease of comparability, aggregation, and other uses. There is no reason why some categories of information that are currently being provided to the official sector could not be made publicly available in a way that protects the interests of borrowing and lending parties alike. This is unlikely to happen spontaneously, and mechanisms will have to be developed to ensure that the various actors report data in a consistent fashion.
- Information related to lending by Chinese state-owned institutions, an important component of emerging market sovereign debt,[26] must be included in any public database. Chinese institutions therefore should be encouraged to participate in the OECD data repository. It has been suggested that the OECD—of which China is an observer, but not a member—may not have the Chinese authorities' full confidence as a

26 Gelpern et al., "How China Lends."

repository of information. Nonetheless, there is no impediment to the OECD's providing adequate assurances that it will be an impartial aggregator of information.

- Once the repository reaches a critical mass of participation by private sector actors across all geographies, borrowers and creditors should be obligated to provide required information within a specified period of time after the closing of a financing transaction. As necessary, governments and regulatory authorities should take steps to promote compliance with this proposed requirement, recognizing that compliance with the OECD program currently is voluntary.
- Because several sovereign borrowers may lack well-organized and complete records of the pertinent terms of the liabilities that they are expected to disclose, official financial institutions as well as the private sector should make a special effort to increase the record-keeping and reporting capacity of borrowers.

Private sector lending to sovereigns (and the applicable regulatory regime) should additionally set an exemplary standard of transparency for international lending, with the intent of "crowding out" bad practices and normalizing and encouraging principles of transparency.

With respect to access to this information, the simplest approach would be to make all (or almost all) information available publicly on a specialized website. Certain information pertinent to a restructuring (such as a calculation of the net present value of relief granted by a significant creditor or creditor group) might be made available only when needed, and then perhaps only to the participants in the restructuring and official providers of new money. Information that would be material to a new investor, however, should be made publicly available at the outset. As it stands, the OECD plans to publicize sovereign debt data in phases, beginning with PRGT country data. However, a concerted effort should be made to expand the scope of data acquisition and publication as soon as is feasible.

Creating Best Practices for Sovereign Lending

Beyond the issue of enhancing the OECD's efforts to produce a user-friendly data repository of financial information that could provide greater transparency, there is the important question of whether the G20 should develop a "best practices guide" to bilateral sovereign lending. The all-too-frequent use of restrictive confidentiality clauses, linking of lending to political and non-commercial objectives, and inadequate protections against the use of funding in furtherance of corrupt practices are issues that the G20 should take up. As a first step, member countries could and should adopt their own policies to discourage these sorts of practices.[27] Encouragingly, some member states, including China, apparently already have taken (or are considering) some initial steps in this direction.

27 See, for example, the Multilateral Cooperation Center for Development Finance (MCDF), https://www.themcdf.org/ (accessed December 7, 2021).

Private sector lending to sovereigns (and the applicable regulatory regime) should additionally set an exemplary standard of transparency for international lending, with the intent of "crowding out" bad practices and normalizing and encouraging principles of transparency.

Given the significant role played by Chinese financial institutions as lenders in emerging markets, Chinese regulatory authorities — including the People's Bank of China — could endorse and enforce standards for the terms of lending by Chinese institutions that, at a minimum, would address some of the lending practices that have attracted so much attention in the international financial community. To date, these institutions have operated somewhat independently, leading to undisclosed lending terms that at times have put borrowing sovereigns in a challenging position, something that is at odds with official Chinese policy.

Given the significant role played by Chinese financial institutions as lenders in emerging markets, Chinese regulatory authorities—including the People's Bank of China—could endorse and enforce standards for the terms of lending by Chinese institutions that, at a minimum, would address some of the lending practices that have attracted so much attention in the international financial community.

IV. PROCEDURAL TRANSPARENCY

While progress on the issues of information asymmetry and transparency likely will take time, promoting greater procedural transparency—that is, creating a debt restructuring process that is well-defined, generally accepted, and widely perceived as fair and inclusive—can and should be addressed more immediately. As it stands, and as illustrated by the case of Ecuador, sovereign debt holders want to feel that they are being treated fairly vis-à-vis other creditors and need to feel that the processes used to engage with them are equitable both at the time of new debt issuances and in the midst of restructurings. When creditors perceive a lack of procedural transparency, they are disincentivized to participate constructively in sovereign debt restructuring processes, which can, in turn, impede meaningful progress. At its core, the lack of private sector engagement and inclusiveness in sovereign debt management arises from an absence of will, not of means or capacity. As a result, converting the current system to one that includes greater engagement should be an objective shared by all.

Since the 1980s, private sector credit has constituted roughly half of all external sovereign debt claims.[28] Yet critical decisions as to the contours and terms of sovereign debt restructuring have been made by the IMF and other official and bilateral creditors with little transparency or opportunity for the private sector to have meaningful input into determinations critical to its engagement. This dynamic inevitably prolongs the restructuring process and constrains the outcomes. Moreover, it creates doubts among some participants whether official creditors in practice are acting to protect their own interests. The reality is that the incentive for the private sector to cooperate in a sovereign restructuring is reduced materially when little or no effort is made to bring private sector financial market participants into the process, and when the

28 Matthias Schlegl, Christoph Trebesch, and Mark L.J. Wright, "The Seniority Structure of Sovereign Debt" (NBER Working Paper 25793, May 2019), fig. 1, https://www.nber.org/system/files/working_papers/w25793/w25793.pdf.

solutions offered don't reflect the full range of outcomes that might otherwise be available with greater creditor engagement.

Changing the Narrative

Under current practice, real and effective private sector engagement is the exception rather than the norm in sovereign debt management. One reason for this is an embedded bias of the official sector. This is seen in the way sovereign debt management is carried out and in much of the commentary from those who follow and write about it. For those who embrace it, the story line, in its extreme form, is clear and unmistakable: The private sector is seen as focused on "short-term" gains and the avoidance of losses; it is populated by "vulture" funds and potential "holdouts" seeking to extort distressed sovereigns. In this paradigm, the IMF and other like-minded institutions are neutral arbiters asked to dispassionately craft policies to reform the sovereign debtor. In this world view, engagement is a necessary evil, but it should be limited and back-end loaded, and it should never involve more than the minimum required to get a deal.

If one leaves private sector engagement to the end of the process after the completion of a sovereign's debt sustainability analysis (DSA) and the development of specific fiscal and economic policies that the troubled sovereign will be forced to adopt—then there simply isn't much room for meaningful private sector involvement.

Of course, this narrative is a caricature, even if aspects of it occasionally ring true. The reality is that the private sector comprises a multitude of actors, many of whom have interests and objectives that extend beyond short-term financial goals. Many are sophisticated, longterm investors that manage billions of dollars of capital that needs to be deployed and is specifically targeted to emerging market borrowers who benefit from this funding.

In good times, when sovereigns are looking to fund their budgetary expenditures or refinance upcoming maturities, these same investors are courted and coveted. The truth is that many of these investors understand the balancing act that the public sector needs to navigate in times of stress, as well as the challenges of managing through a crisis with inadequate resources while subject to volatile political and social forces. They have their own fiduciary obligations, and their investment choices provide a range of opportunities they must consider. They regularly engage with the official sector and have the potential to offer insight and solutions that are anchored in their knowledge of markets and financial products with which many in the official sector are less familiar.

The reality is that if one leaves private sector engagement to the end of the process after the completion of a sovereign's debt sustainability analysis (DSA) and the development of specific fiscal and economic policies that the troubled sovereign will be forced to adopt—then there simply isn't much room for meaningful private sector involvement. This is even more troubling when this late-stage engagement is tethered to a determination around "comparability of treatment" that is used to cajole or force the private sector into shouldering a greater share of the burden than the official sector. Importantly, it doesn't allow for the exploration of market solutions or new money alternatives that may help mitigate a loss of market access, nor does it take into account how fiscal imbalances could be better addressed by more creative financial or economic solutions.

Opportunities for Change

Aside from working to change some of the inherent bias in the system, a key issue is to identify actions that can effectively promote a more inclusive and ongoing means for private sector engagement in sovereign debt management.

The best path to doing so involves building momentum around mechanisms that could be leveraged to promote a broader sharing of information with the private sector—together with real and earlier engagement—and doing so in a way that is tailored to fit the unique circumstances of each sovereign restructuring. In this regard, a one-size-fits-all mechanism is unlikely to be successful. This was evident in the DSSI adopted by the G20 at the beginning of the global pandemic. Efforts to enhance procedural transparency with mechanisms that can be tailored to the varying circumstances of each specific restructuring seem a wiser—and likely more effective—solution to addressing this issue.

While greater engagement will not completely dispel private sector doubts about the fairness of the process, nor the public sector's perceived conflicts of interest, enhanced engagement would be an important first step in improving the process.

One mechanism that could be used as a potential starting point for greater procedural transparency is leaning into so-called engagement clauses found in an increasing number of sovereign bond documents. These clauses require sovereigns to recognize the formation of creditor committees (e.g., Ad Hoc Committees) and to pursue transparent engagement strategies should a sovereign experience financial stress. These clauses vary in their scope, but they offer a contractual means to formalize and enhance the path that some sovereigns have utilized when approaching their bondholders to seek debt relief.[29] Of course, they should be made more robust and go beyond the limited scope of involvement that is contemplated today. In many ways, they should be viewed

29 The International Capital Markets Association (ICMA) published a standard engagement clause in August 2014 that stipulates that the issuer must engage with the committee in good faith; provide certain information to the committee, which aligns with the information requirements in ICMA's standard collective action clauses; and pay any reasonable and documented fees and expenses of the committee. "Standard Aggregated Collective Action Clauses (CACs) for the Terms and Conditions of Sovereign Notes" (International Capital Markets Association, August 2014), https://www.icmagroup.org/Regulatory-Policy-and-Market-Practice/Primary-Markets/primary-market-topics/collective-action-clauses/. One can imagine ICMA and others working with sovereigns to agree on model "engagement clauses" for bond documentation and carrying the idea forward to bank debt and other forms of external indebtedness where appropriate.

as a first step in a progression toward a system that is characterized by broader and deeper private sector engagement.[30]

Official sector recognition and encouragement of these clauses would further strengthen their effectiveness. Ad-Hoc Committees would be the negotiating counterpart to the sovereign and should have the ability to engage financial and legal advisors experienced in sovereign restructurings; all reasonable, non-litigation-related costs should be borne by the sovereign debtor.[31] These Ad-Hoc Committees could be granted access to material data and information on the sovereign's debt and economic and fiscal programs to better enable them to perform their mission. Such Ad Hoc Committees could engage not only with the affected sovereign, but also with the official sector to understand the conclusions that were reached and the assumptions on which the underlying DSA was based.

Ad-Hoc Committees would be the negotiating counterpart to the sovereign and should have the ability to engage financial and legal advisors experienced in sovereign restructurings.

Such Ad Hoc Committees would not be granted consent rights over the DSA but merely be given an opportunity to be heard and to exchange views. They would and should possess no statutory or fiduciary duties to other creditors—in effect, they would serve only the interests of their members.

Membership in these committees would be accompanied by restrictions on trading while in possession of material nonpublic information. There should be enhanced disclosure regarding the identity of committee members and of any conflicts they may have, including material short positions in the sovereign's securities. The disclosure, often required by creditor committees to force a sovereign borrower to cleanse them of material nonpublic information, also could be reciprocal: In the US Chapter 11 context, Rule 2019 requires committees to disclose information to the public about its members, their claims, the purchase price and timing of the securities acquired by their members, and other related matters.[32] A formal regime of committee formation, recog-

30 Lee Buchheit, Guillaume Chabert, Chanda DeLong, and Jeromin Zettelmeyer, "The Sovereign Debt Restructuring Process," (Paper Presented at IMF Sovereign Debt Conference, Washington, DC, September 13–14, 2018).

31 Ad Hoc Committees are neither new nor novel in the sovereign context. In the 1980s, bank creditor committees played a leading role in helping to negotiate and make effective a series of sovereign restructurings, and they proved to be constructive counterparties to distressed sovereigns, albeit in a more genteel setting than today's sovereign restructuring environment. Among other things, these Committees played in an instrumental role in the development and successful use of the so-called Brady bonds, first used in the restructuring of Mexico's debt. But even in today's sovereign universe of disaggregated and diverse creditor groups and instruments, we have seen, in Argentina and Ecuador most recently and in numerous other cases, how such Committees can be useful in developing solutions that rely on consensus rather than litigation. Of note, Argentina restructured approximately $63.4 billion in outstanding aggregate principal of its foreign-law-governed debt across 25 series of bonds in a transaction that was settled on September 4, 2020. Ecuador restructured approximately $17.4 billion in aggregate principal across 10 series of debt securities in a transaction that was effective as of August 31, 2020. Creditor committees also play an important role in the effective use of debt restructuring mechanisms that hinge on consensus among creditors—such as collective action clauses and exit consents. Ian Clark, Thomas MacWright, Brian Pfeiffer, Dimitrios Lyratzakis, and Amanda Parra Criste, "Sovereign Debt Restructurings in Latin America: A New Chapter," White & Case *Insight*, October 25, 2021, https://www.whitecase.com/publications/insight/latin-america-focus/sovereign-debt.

32 Interestingly, political appetite for organizing Ad-Hoc Committees exists already—examples include the proposed legislation in New York state (New York Senate Bill S6627, § 300), which seemingly embraces the incorporation of organized committees as part of the reforms of the sovereign restructuring process.

nition, and concomitant information disclosures may thus advance procedural transparency.[33]

V. CONCLUSION AND NEXT STEPS

Enhancing transparency in sovereign finance will be critical if the anticipated post-Covid-19 cases of debt distress are to be addressed successfully. Greater transparency will make markets more accessible, result in a better and more efficient allocation of capital, inform and discipline the formulation of policy, and result in a fairer, more inclusive restructuring process. Moreover, enhanced transparency over time should help to facilitate increased capital flows to countries that embrace and abide by minimum disclosure standards, while providing investors with a greater sense of confidence regarding risk and pricing decisions.

Even though the prospective systemic benefits of greater transparency have been recognized generally, scant progress has been made in requiring or persuading the relevant actors to make the disclosures that would be required. In large part, this has reflected the lack of adverse consequences for any individual participant for not doing so. Nonetheless, the means to achieve greater informational and procedural transparency are widely recognized and are available to those market participants willing to utilize them. This article has described many potential steps, including specific tools focused both on the lending community and on sovereign borrowers. That said, our list undoubtedly is incomplete; there are additional tools that others could devise that could also be deployed to promote greater transparency.

To accomplish the broader objective, however, the international investment community—including both the private and official sectors—needs to move beyond debate and discussion. The following *key priorities for immediate action* by participants actively engaged in sovereign debt management deserve to be highlighted:

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33 The actions of Puerto Rico's 2017 Financial Oversight and Management Board, launched under the Puerto Rico Oversight, Management, and Economic Stability Act (PROMESA), illustrate a similar method of creditor engagement that builds on the process utilized under the US Bankruptcy Code, which contemplates a formal statutory committee and the possibility of informal Ad-Hoc Committees and may be a useful precedent for sovereign restructurings. The Oversight Board consisted of a seven-member governing committee, including experts in finance, law, health care, and public policy, and had the power to approve a fiscal plan and the terms of restructuring. The Oversight Board made certain to give its various creditor committees an opportunity to be involved in its DSA process in order to hear (but not necessarily incorporate) the creditors' views on economic assumptions in the model and policy prescriptions. Board members met with creditors before finalizing the DSA as part of the plan process. In the end, while most creditors disagreed with the Oversight Board's results and findings, they were not ignored. Most important, the creditors were able to walk away without feeling that they were simply presented with a biased bill of goods that they had to live with. The front-loaded creditor engagement enhanced the perception of procedural fairness among creditors and stands in contrast to the typical sovereign model, whereby the IMF asserts its right to act with absolute discretion.

The Case for a Transparency Institute

Given the absence of any statutory oversight of the sovereign liability process, consideration should be given to the creation of a standing institution that could help promote greater transparency and inclusiveness in the debt restructuring process.

An institution (the "Transparency Institute") that has as its mission to be an advocate for greater informational and procedural transparency would benefit all participants in sovereign restructurings. This Transparency Institute, which could be funded by a mix of private and public sector sources, would have a limited purpose, and would not serve the specific interests of any debtor country or any creditor group. Rather, it would be available at the request of the parties for advice and assistance when issues of information asymmetry and procedural due process present impediments to progress. Prospectively, it would comprise individuals well known and respected in the international financial community and experienced in sovereign debt management.

The Transparency Institute's goal would be to make its members available to apply their practical insights and problem-solving abilities to help resolve issues and advance the integrity of the sovereign debt process. The Transparency Institute would not have binding authority to dictate to any party. Instead, the Transparency Institute's value would stem from its right to assist parties in specific situations and, more generally, to work on advancing procedural transparency. Over time, it would accumulate information and experience and advocate for best practices in the sovereign liability process.

Of course, this concept would have value only if it were accepted and supported by all participants, including the official sector, in sovereign debt markets. The Transparency Institute's success would require significant work in order to develop a broad consensus regarding the role, duties, limitations, and rules that would apply to its participation in any dispute. The Transparency Institute's mission might well expand in time to providing assistance to sovereigns in strengthening their capacity to generate reliable information or comply with more rigorous disclosure requirements.

- **There needs to be a consensus on minimum mandatory disclosure standards.** Practically speaking, this will require that the private and official sectors work together. It is possible that a consensus could be arrived at and implemented in stages, with a more basic set of minimum mandatory standards adopted initially and a more comprehensive set of mandatory standards developed over time. Without doubt, support from the official sector will be critical, and ultimately achieving a broad consensus—incorporating the perspectives of China and other actors such as the rating agencies—should be the goal.
- **The Paris Club should provide meaningful guidance** to multilateral development banks and demonstrate targeted and public support for global transparency initiatives and proposals.
- The IMF, World Bank, regional development banks, and other multilateral institutions like the Paris Club should act to motivate sovereign debtors to disclose information by providing the types of incentives and disincentives outlined in this article. **Ultimately, a sovereign's access to official sector resources should be limited unless it can meet certain minimum thresholds of transparency.**
- **Rating agencies should link their credit assessments more directly to adherence to minimum voluntary disclosure standards** by the sovereign borrowers that they rate and should share information among themselves in order to facilitate greater access to data (while maintaining independence with respect to their analysis). Correspondingly, digital database efforts should be expanded and accelerated, as discussed in "Operationalization through the OECD Initiative."
- **Debtor countries and lending jurisdictions should consider legislation that would encourage principles of transparency in sovereign lending.** Such legislation could, for example, require public disclosure of sovereign debt as a condition to its issuance and validity. Such legislation could also ensure that nondisclosed debt does not benefit from tax and other incentives if sovereign borrowers, or their lending counterparts, fail to make such disclosures in a timely

manner. On the side of the lending jurisdictions, large financial institutions could be required to disclose lending arrangements with sovereigns, and relevant actors could rethink the limitations on the dissemination of client financial information in cases where that information can be disclosed without harming the interests of the sovereign clients or putting legitimately confidential information at risk.

- **Resources and funding should be allocated to emerging market sovereign borrowers to help them build out their capacity** to generate, track, and synthesize financial information and data so they can, over time, possess the institutional means and expertise to meet whatever minimum standards are developed.
- **Creditors should utilize existing engagement clauses to revitalize Ad-Hoc Committees and to help strengthen their effective participation in sovereign debt negotiations.** The official sector should recognize and encourage these clauses to further strengthen their effectiveness.

The time has come for a transparency agenda that consists of actionable measures that create tangible incentives and consequences to change behavior.

Bretton Woods Committee

Sovereign Debt Working Group Members

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