Sovereign Debt: Coming into the Light?

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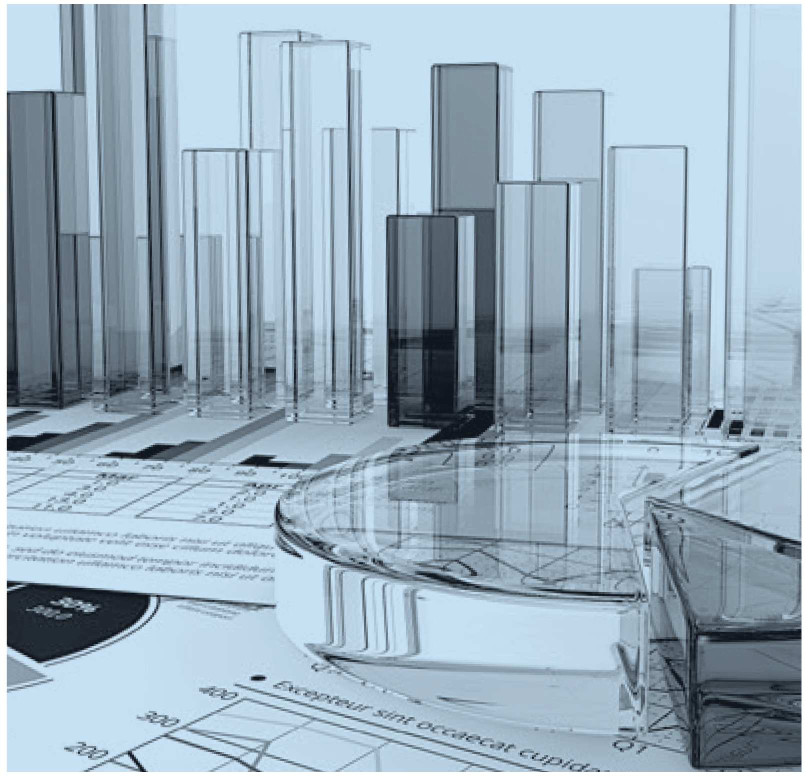

On May 20, 2019, ex-banker Detelina Subeva entered a guilty plea in New York admitting her part in a money laundering scheme relating to the proceeds of a bribe paid in connection with the secret loans made to Mozambique in 2013. The indictment of the former banker is one of the latest developments in the long-running USD 2 billion tuna bond scandal. The case was first made public in 2016 by international journalists who uncovered the hidden guarantees made by the then- Finance Minister of Mozambique. This guilty plea is likely to be the loosening of the thread that will unravel a ball of corruption linked to one of the most notorious examples of the lack of transparency in the world of sovereign debt.

If corruption festers in darkness, then transparency can provide the purifying light. Calls for the introduction of tools to keep sovereign loans out of the shadows have become steadily more emphatic in recent times, picking up converts from, quite predictably, civil society groups to, perhaps more unexpectedly, financial institutions. Still not all devotees are singing from the same hymn book. Here are some of the most recent offerings on the subject matter:

These papers trumpet the various virtues of greater debt transparency: greater accountability, more efficient markets, better debt sustainability, and swifter debt restructuring if we ever come to that. How can greater transparency be achieved?

Recent Calls to Tackle Hidden Debts

June 2018

G20 Note: "Strengthening Public Debt Transparency – The Role of the IMF and the World Bank"

- The World Bank and IMF are obviously interested parties in this debate as they have to pick up the pieces when a sovereign needs restructuring.
- In order to agree the terms of a restructuring, they - and other creditors – need to who know who is owed what.
- This is the case even if the hidden loans were not the trigger or main cause of financial distress for that sovereign.

August 2018

IMF Working Paper: "Fiscal Transparency, Borrowing Costs, and Foreign Holdings of Sovereign Debt"

- The working paper (which does not necessarily represent the views of the IMF) explores the effects of fiscal transparency on the borrowing costs of 33 emerging and developing economies and on foreign demand for their sovereign debt.
- The results suggest that higher fiscal transparency reduces spreads and increases foreign holdings of sovereign debt.
- In other words, debt transparency can contribute to lower borrowing costs and higher borrowing levels.

March 2019

The International Monetary Fund's Fiscal Transparency Code

- The IMF's Fiscal Transparency Code was first published in 1998 and most recently revised and updated in 2019.
- The Code covers various elements of fiscal transparency including fiscal reporting, which should offer relevant, comprehensive, timely, and reliable information on the government's financial position and performance.

April 2019

The Jubilee Debt Campaign's "Transparency of loans to governments"

- The Jubilee Debt Campaign is a UK-registered charity that helped bring about US$130 billion of debt relief for developing countries between 2000 and 2015 as part of the global Jubilee campaign, but saw their work undermined in several countries by hidden loans.
- In this briefing, they made the case for the citizens' right to know about the public debts.

May 2019

The International Institute of Finance (IIF) Draft "Principles for Debt Transparency"

- The IIF is the trade body representing the world's largest financial institutions.
- These Principles are designed to enhance transparency in private sector lending.
- The Principles are intended to be voluntary and will complement efforts to improve transparency on the part of public sector lenders and borrowers.
- The Principles are being submitted ahead of the 2019 G20 Ministerial in Japan for potential endorsement in June 2019.

Voiding undisclosed debts

The most radical solution proposed so far is that legislation should be passed so that by operation of the law of the relevant jurisdiction a lender cannot enforce sovereign debt that has not been disclosed by inclusion in a public register of debt. This solution put forward by the Jubilee Debt Campaign could be highly effective, but its implementation would be difficult. Overwhelmingly, debts of sovereigns owed to external creditors or denominated in a currency other than the currency of the sovereign are governed by English law or New York law. It is highly unlikely that the governments with the power to introduce legislation to effect this change would disadvantage their legal export industries by doing so unilaterally. Even if English and New York law were changed, other legal systems could be used as the governing law of the undisclosed debt. Borrowers and creditors intent on keeping their dealings secret are not likely to be too interested in a comparative analysis of the relative benefits of a third country's law versus English law or New York law if that third country's law does not require public disclosure.

Withholding access to rescue funds

Quite rightly the IMF and other international financial institutions whose role it is to provide funding of last resort take a very dim view of hidden debt. Countries hoping to be bailed out will find access to rescue funds much harder if they have hidden debt. In the case of Mozambique, the uncovering of the secret loans in 2016 resulted in international donors unceremoniously cutting off funding to the country. Still an argument can be made that these rescue funds should be made available when a country facing an economic crisis is in need of a rescue package regardless of whether all relevant debt of the country is fully disclosed. After all, the goal of rescue funding is to benefit the population of the distressed sovereign. That population will not have been responsible for the debt being concealed, other than indirectly by their poor choice of politician, if they had that choice. As long as the government promises not to repeat the sins of the fathers, perhaps all should be forgiven.

Making it voluntary

This may not be as ineffectual as it sounds. It is much easier to keep debts concealed for nefarious purposes if the failure to disclose those debt is not considered unusual or contrary to a standard of behaviour, whether voluntary or not. However, the standard should be comprehensive, not limited to a sub-set of debt. For example, the draft "Principles for Debt Transparency" prepared by the Institute of International Finance is drafted with many narrow definitions that look like they are lifted from a loan agreement. It would not take long for a banker or lawyer to come up with a debt structure that falls outside the definition of "Financial Transactions" used to set the scope of the voluntary disclosure regime proposed. For example, local currency loans are excluded as are derivatives for hedging purposes. So a state-owned oil company with dollar revenues could borrow in its domestic currency with cross-currency swap to hedge the loan into dollars to match its own revenues. As drafted a sovereign guarantee of the swap and the loan would not be within the scope of disclosable "Financial Transactions."

Encouraging increased disclosure through securities law

Currently, sovereigns with internationally listed debt securities are required in many jurisdictions to include disclosure on public sector debt. If the key jurisdictions were to introduce rules requiring more comprehensive disclosure of public sector debt, this would compel sovereigns looking to raise money in the international capital markets to have better debt transparency systems in place so that they can comply with the increased disclosure standards. The disclosure requirements would need to be calibrated carefully so that issuers can realistically comply with them. For example, one-third of low-income countries do not report on guarantees extended by the public sector, while fewer than one in 10 report debt of public enterprises. Greater transparency regarding public debt liabilities needs to be achieved over time. The increased disclosure requirements should not make it so onerous that it would be impossible for issuers to comply with them and we have actually seen more efforts toward transparency on guarantees and other contingent liabilities in recent Eurobond prospectuses.

Expand the scope of money laundering legislation to include hidden debts

Existing money laundering legislation already imposes a burden on those handling money to ensure that the funds being passed along are not proceeds of crime. If account banks are required to check the provenance of funds credited to a sovereign's account to ensure that such funds do not originate from an undisclosed source of debt (which may not necessarily be proceeds of crime), it is arguable that the burden on such account banks would only be incremental to the money laundering checks that they need to comply with currently. More importantly, given that only a few currencies represent a very high percentage of all monetary transactions, the impact could be huge even if only a few key jurisdictions made this change to their money laundering legislation. Unlike the governing law of a loan agreement, money laundering rules are much more difficult to side step. The challenge would be to define what undisclosed debt means in this context. Cynics may argue that there's no legislating for fraud if the actors are intent on wrongdoing, but adding a criminal sanction may concentrate the minds of individuals who might otherwise follow the wrong path. There would be the added benefits of whistle blowing protections for the brave and the incentive of bargains for guilty pleas like the one entered by Ms. Subeva. ■

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