Arnold & Porter

Sovereign Advisory

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COVID-19: The Response of the International Financial Institutions and Some Considerations for Sovereign Debt Management Officers

In their efforts to finance the fight against the COVID-19 pandemic, countries around the world have sought both funding and information from, among other sources, the international financial institutions (IFIs). Many of the IFIs already have or are in the process of introducing lending facilities targeted to helping countries mitigate the effects of the pandemic. The **International Monetary Fund** and **The World Bank Group**, in consultation with the World Health Organization, have facilities available for their 189 member countries, while the regional development banks, such as the **Asian Development Bank,** the **European Bank for Reconstruction and Development,** the **Inter-American Development Bank, the African Development Bank**, and similar institutions, are offering financial assistance for countries in their respective regions. In that connection, we set out below descriptions of some of the wide array of facilities IFIs are offering, followed by links to the sites of these IFIs which provide more information about the facilities, eligibility and access.

Considerations for Sovereign Debt Management Officers

The developments discussed below have numerous implications for sovereign debt management officers (DMOs). For example, certain IFI facilities are only available for low income and emerging economy countries, so middle income and advanced economy countries may not qualify. In addition, to qualify for a given facility the country may need to demonstrate that its debt is sustainable, which can be a difficult argument to make when a DMO is also considering recommending either a debt restructuring or other debt relief.

At the same time, DMOs need to consider the implications of their choices to their country's sovereign debt ratings and future borrowing costs. For example, in terms of debt relief, it may make a difference whether the creditors themselves volunteer the relief or whether the country would be required to apply for it, and whether only official creditors provide relief or whether private creditors are included as well. In addition, DMOs need to understand other implications of possible debt moratoria, including the implications for access to IMF rapid finance facilities.

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Finally, for many developing countries the capital markets remain open, both for issues of bonds and for bilateral and syndicated loans. That said, at a time when many countries have imposed travel restrictions or issued stay-at-home requirements, DMOs can expect that the markets may be less agile, as many market participants, including the DMOs themselves, may be working from home offices.

Arnold & Porter's sovereign finance team is available to discuss these options with you.

The International Monetary Fund (IMF)

The IMF has in place facilities and instruments to help countries respond to the COVID-19 pandemic. To date, more than 90 of its 189 member countries have approached the IMF about accessing either existing facilities or creating new facilities[1], in what is believed to be the largest number of requests ever received by the IMF at one time.

IMF financing arrangements available for member countries include:

- ***Emergency Financing*.** The Rapid Credit Facility (RCF) and Rapid Financing Instrument (RFI) support facilities provide emergency financial assistance to low income and emerging economy countries without needing to have a full-fledged IMF program in place. The total available pool under these rapid financial support facilities is US$50 billion, which amount may be increased to US$100 billion.[2] Many emerging economy countries have already applied. Under each of the emergency facilities, a member country can draw up to 50 percent of its quota (i.e., its share of IMF capital). To qualify, a country needs to demonstrate that its debt is sustainable (or on track to be sustainable, including any debt restructuring operations underway). Therefore, DMOs considering whether to recommend a debt moratorium should consider whether such a step would disqualify the country for access to the IMF's rapid assistance facilities.
    - ***Rapid Credit Facility***. The IMF developed the RCF to provide rapid, low-access and concessional financial assistance to low income countries (LICs) that are facing an urgent balance of payments need. Funds are provided as an outright disbursement without ex-post program-based conditionality or reviews. Funds made available under the RCF carry a zero interest rate, with a principal grace period of 5½ years and a final maturity of 10 years. The total available pool under the RCF is currently US$10 billion.[3] Because the RCF does not require program-based conditionality, it is meant to provide flexible support in a wide variety of circumstances, including the current COVID-19 pandemic. The RCF also provides policy support and can help catalyze foreign aid.
    - ***Rapid Financing Instrument***. The IMF developed the RFI to provide rapid, low-access financial assistance to emerging economy countries facing an urgent balance of payments need, without the need to have a full-fledged program in place. The RFI is targeted to countries eligible for the concessional financial support of the IMF's Poverty Reduction and Growth Trust (PRGT) (in general, countries with income per capita below a specified threshold and without the capacity to access international financial markets on a durable and substantial basis). Through the RFI, the IMF can provide support to meet a broad range of urgent needs, including those created by the COVID-19 pandemic. Financing under the RFI is subject to financing terms similar to other IMF facilities, including a commitment fee, an interest rate based on

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[1] For more information, see: https://www.imf.org/en/News/Articles/2020/04/03/tr040320-transcript-kristalina-georgieva-participation-world-health-organization-press-briefing

[2] See: https://www.imf.org/en/News/Articles/2020/04/03/sp040320-opening-remarks-for-joint-imf-who-press-conference

[3] See: https://www.imf.org/external/np/exr/facts/pdf/rcf.pdf

Special Drawing Rights (SDRs) plus a margin (100bp), a surcharge (based on the amount and time that the credit is outstanding), and a service charge of 50bp at each draw. Amounts are to be repaid within 5 years. The total available pool under the RFI is currently US$40 billion.[4] A country requesting RFI assistance must cooperate with the IMF to make efforts to solve balance of payments difficulties and to describe the general economic policies that it proposes to follow, and to qualify would need to demonstrate that its debt is sustainable.

- ***New financing arrangement.*** The IMF can also use its existing facilities, such as its Stand-By Arrangements, which is the Fund's standard lending instrument for emerging and advanced market countries. Unlike the RCF and RFI emergency facilities, which are concessional arrangements for poorer countries, all member countries that face external financing needs are eligible for Stand-By Arrangements. However, while in 2009 the IMF streamlined and simplified conditions for lending under its Stand-By Arrangements, and more funds were made available up front, access to funding under these arrangements tends to be less agile than under concessional arrangements. That said, approvals can be accelerated under the IMF's Emergency Financing Mechanism, which was used during the 2008/2009 global financial crisis, including facilities with Greece, Hungary and Iceland. Financing arrangements include a commitment fee, an interest rate based on Special Drawing Rights (SDRs) plus a margin (100bp), a surcharge (based on the amount and time that the credit is outstanding), and a service charge of 50bp at each draw. Amounts are to be repaid within 5 years.
- ***Increases and changes to existing programs***. For a country that already has a lending program in place, the IMF can modify the existing program to make funding available for new, urgent needs the country is facing as a result of the COVID-19 pandemic.
- ***Debt relief grants***. Through its Catastrophe Containment and Relief Trust (CCRT), the IMF can provide a mixture of concessional lending and debt relief grants to poor countries with outstanding IMF obligations. Debt relief under the CCRT is designed to free up the country's resources for exceptional balance of payments requirements resulting from a crisis, such as a pandemic. The relief is meant to allow the country to use its available funds for crisis relief instead of for debt service to the IMF. Resources from the CCRT are available to low-income countries, and past beneficiaries have included Haiti, following the 2010 earthquake, and Guinea, Liberia, and Sierra Leone, in connection with the 2013-2016 Ebola outbreak in West Africa. In response to the COVID-19 pandemic, in March 2020 the IMF expanded the CCRT qualification criteria to better cover the circumstances created by a global pandemic and to focus on delivering support for the most immediate needs, allowing its poorest member countries to qualify for debt service relief for up to two years. At the same time, the IMF has appealed to wealthier countries to help replenish the CCRT, which at the beginning of the crisis only had US$200 million available.

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In addition to the existing programs discussed above, the Managing Director of the IMF, Kristalina Georgieva, stated in a recent interview[5] that the IMF is considering launching a program to offer short-term US dollar liquidity lines to countries with strong macroeconomic fundamentals experiencing short term liquidity constraints. The program would complement a similar program of the US Federal Reserve, which provides US dollar liquidity to central banks holding US dollar-

[4] See: https://www.imf.org/en/About/Factsheets/Sheets/2016/08/02/19/55/Rapid-Financing-Instrument

[5] See: https://www.imf.org/en/News/Articles/2020/04/03/tr040320-transcript-kristalina-georgieva-participation-world-health-organization-press-briefing

denominated debt, but would be aimed at countries that do not hold enough US treasury securities to participate in the Federal Reserve program.[6]

The World Bank Group

The World Bank Group has also been very active in addressing the pandemic. On March 17, 2020, The World Bank Group approved a dedicated US$14 billion fast track facility (FTF)[7] to help member countries respond to immediate health needs brought on by the pandemic. The FTF includes US$8 billion in funding for the International Finance Corporation (IFC) to support private companies and their employees affected by the economic consequences of the pandemic, much of which will be disbursed through client financial institutions for trade financing, working-capital support and medium-term financing to private companies.

The World Bank Group has been working with regional development banks to co-finance pandemic-related efforts.

On April 2, 2020, The World Bank Group approved a set of emergency support operations amounting to US$1.9 billion for 25 developing countries[8] (with additional operations moving forward in over 40 countries), including projects in Africa; East, Central and South Asia; Latin America; and the Caribbean. In addition, World Bank Group President David Malpass stated that the bank is prepared to deploy up to US$160 billion (through the World Bank, the IFC and Multilateral Investment Guarantee Agency (MIGA)) over a 15 month period to help countries respond to immediate health needs and to support economic recovery.[9]

The World Bank Group has also begun redeploying resources from existing projects to fight the pandemic, activating Catastrophe Deferred Drawdown Options (Cat-DDOs). Cat-DDOs are contingent financing lines that provide immediate liquidity to countries to address crises while funds from other sources are being mobilized.

In addition, The World Bank Group has been working with regional development banks to co-finance pandemic-related efforts.

Regional Development Banks

The regional development banks have also prioritized their responses to dealing with the pandemic. For example:

- **The Asian Development Bank.** The ADB first responded to the crisis in early February 2020, and since then has provided in excess of US$225 million to member countries' governments and businesses.[10] On March 18, 2020, the ADB announced an initial US$6.5 billion package to help its developing member countries respond to the pandemic, which would include US$3.6 billion in sovereign operations (to address health and economic consequences), US$1.6 billion for companies directly impacted by the pandemic, US$1 billion in concessional funding, and US$40 million in technical assistance and rapid access grants. Given the crisis, the ADB is also adjusting its financing instruments and business processes, for faster and more efficient access to funding.

[6] See: https://finance.yahoo.com/news/imf-mulls-fed-program-supply-164212702.html

[7] See: https://www.worldbank.org/en/about/what-we-do/brief/world-bank-group-operational-response-covid-19-coronavirus-projects-list

[8] See: https://www.worldbank.org/en/news/press-release/2020/04/02/world-bank-group-launches-first-operations-for-covid-19-coronavirus-emergency-health-support-strengthening-developing-country-responses

[9] See: https://www.worldbank.org/en/news/speech/2020/04/02/remarks-by-world-bank-group-president-david-malpass-during-press-call-on-first-operations-for-covid-19-coronavirus-emergency-health-support

[10] See: https://www.adb.org/news/adb-announces-6-5-billion-initial-response-covid-19-pandemic

- **The European Bank for Reconstruction and Development.** On March 16, 2020, the EBRD announced[11] a €1 billion "Solidarity Package", with measures to help companies in its member countries affected by the pandemic. Described as a first step, the package is meant to provide new and additional funding for the EBRD's existing clients, with emergency liquidity, working capital and trade finance components. For small and medium-sized businesses, the package provides short-term finance (two years) through financial institutions, while corporates and energy developers can access two year working capital facilities, and municipal, energy and infrastructure clients can access balance sheet restructuring and short term liquidity support. Existing loans might be eligible for extended maturities or conversion to local currency.
- **The Inter-American Development Bank (IDB and IDB Invest)**. The IDB has worked with the WHO and the Pan-American Health Organization for technical support on the crisis, and has stated that it has up to US$12 billion in resources available to help countries that request support for the pandemic and its consequences. Of the US$12 billion in total resources, IDB Invest will contribute US$5 billion, of which US$4.5 billion will focus on companies affected by the pandemic and US$500 million will be used for targeted investments in the health sector in direct response to the crisis. The IDB will focus its support in the following main areas: (a) preparedness and response capacities to help contain the transmission of COVID-19 and mitigate its impact; (b) measures to protect the income of the most affected populations through existing transfer programs, non-contributory pensions and grants; (c) assistance to small and medium-sized enterprises through financing programs and short-term liquidity guarantees, foreign-trade financing and guarantees, loan restructuring, and support for strategic supply chains; and (d) the design and implementation of fiscal policies to mitigate the economic impacts of the pandemic. To accelerate its response, the IDB is also looking at streamlining its internal processes.[12] In support of its efforts, the IDB has just issued a US$2 billion sustainable development bond in the international capital markets.[13]
- **The African Development Bank**. The African Development Bank (AfDB) has also begun to take measures to try to mitigate the effects of the pandemic, as the pandemic is expected to lead to US$10.6 billion in increased unplanned health expenditures on the continent, in addition to economic damage from the disruption of global supply chains, demand side shocks, reduced commodity prices, lower remittances and increasing inflation.[14] To help fund these mitigation efforts, the AfDB issued a US$3 billion, three-year Fight Covid-19 Social bond, the proceeds of which are meant to help alleviate the economic and social impact of the Covid-19 pandemic on Africa.

National Governments

National governments have also announced a wide range of financing facilities, including direct and indirect loans, grants, swaps and repo arrangements too numerous and varied to describe. Measures have also included regulatory relief by banking regulators, securities regulators and stock exchanges.

In the United States, the US$2.2 trillion Coronavirus Aid, Relief and Economic Security Act (the CARES Act) includes nearly US$11 billion dollars in support for developing countries affected by the pandemic, including funding for the African Development Fund (ADF), the African Development Bank (AfDB) and the World Bank's International Development Association (IDA), as well as funds for the New Arrangements to Borrow, an emergency backstop facility in cases where the IMF needs to supplement its resources for lending purposes.

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[11] See: https://www.ebrd.com/news/2020/ebrd-unveils-1-billion-emergency-coronavirus-financing-package.html

[12] See: https://www.iadb.org/en/news/idb-group-announces-priority-support-areas-countries-affected-covid-19

[13] See: https://www.iadb.org/en/news/idb-launches-2-billion-0875-5-year-fixed-rate-sdb-global-benchmark

[14] See: https://www.afdb.org/en/documents/covid-19-pandemic-crisis-proposal-grant-usd-2-million-emergency-assistance-support-covid-19-response-african-countries-emergency-and-special-assistance-grants

At the same time, the United Kingdom announced that it would contribute £150 million to the IMF's CCRT, in the form of a £75 million grant plus an additional £75 million conditional upon need. Japan and China have also pledged contributions to the CCRT.[15] Support from the CCRT is available to countries that are extremely vulnerable to the rapid spread of COVID-19 and which experience either a loss of 10% of gross domestic product or a cumulative 10% fiscal loss (i.e. falling revenue/increased spending).[16]

Calls for Debt Relief

On March 25, 2020, Mr. Malpass and IMF Managing Director Kristalina Georgieva issued a joint statement calling on official bilateral creditors to suspend debt payments from the world's poorest countries, so these countries can instead use available funds to fight the COVID-19 pandemic.[17] Subsequently, African Ministers of Finance released a communique welcoming the joint statement's call for debt relief by official bilateral creditors. In addition, the communique called for, among other actions, (i) access to US$44 billion to finance public sector external debt service, including on sovereign bonds, to be pooled through a special purpose vehicle, and (ii) an instrument to provide additional liquidity, particularly for the procurement of basic commodities, food, fuel, pharmaceuticals, and essential medical supplies.[18]

Complicating matters to some degree is the potential reluctance of creditor countries to provide debt relief without similar debt relief and restructuring by private creditors. Requiring the inclusion of private creditors would certainly slow relief from official bilateral creditors, but could also impact whether a given rating agency would consider it a sovereign default under its sovereign rating criteria. Fitch Ratings, for example, does not count relief by *official* creditors as a default, but similar relief from *private* creditors would be considered a default.[19]

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Should you require additional information about the matters discussed above, please contact any member of the Arnold & Porter Sovereign Finance team, who would be pleased to discuss the information above in greater detail.

[15] See: https://www.imf.org/en/News/Articles/2020/03/27/pr20116-imf-enhances-debt-relief-trust-to-enable-support-for-eligible-lic-in-wake-of-covid-19

[16] See: https://www.gov.uk/government/news/uk-helps-worlds-poorest-countries-withstand-the-economic-shock-of-coronavirus

[17] See: https://www.imf.org/en/News/Articles/2020/03/25/pr20103-joint-statement-world-bank-group-and-imf-call-to-action-on-debt-of-ida-countries

[18] See: https://www.uneca.org/stories/communiqu%C3%A9-african-ministers-finance-immediate-call-100-billion-support-and-agreement-crisis

[19] See: https://www.fitchratings.com/research/sovereigns/sovereign-debt-relief-momentum-is-accelerating-31-03-2020

Arnold & Porter

Sovereign Finance Practice

Arnold & Porter is a recognized leader in advising sovereigns in their international financial affairs, representing clients across a wide range of financial transactions from Africa, Asia, Europe, Latin America, and the Middle East. We have significant and ongoing engagement with the world's most prominent international financial institutions, including the International Monetary Fund (IMF); the World Bank, International Finance Corporation (IFC) and Multilateral Investment Guarantee Agency (MIGA); the Inter-American Development Bank (IADB); the European Bank for Reconstruction and Development (EBRD); the African Development Bank (AfDB); and the Bank for International Settlements (BIS), in significant financial transactions and other novel legal assignments.

We assist and advise our sovereign clients in numerous financial transactions, including:

- Private and public debt securities offerings
- Sovereign bond documentation
- Liability management transactions
- Project and syndicated loans
- Export credit agency financings
- Financings of multilateral financial institution loans
- Debt restructuring
- Privatization transactions
- Derivatives transactions
- Asset management operations for central banks

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