EXPLAINING THE BARBADOS DEBT CONVERSION FOR MARINE CONSERVATION

The Government of Barbados (GOB) recently announced the completion of a debt for nature swap which entailed the repurchase of a small fraction of its outstanding debt and the channelling of savings from this towards marine conservation. The transaction has been variously labelled as a debt buyback, debt conversion for marine conservation, blue bond for marine conservation and a debt for nature swap. This note explains the key features of the arrangement as garnered from publicly available information.

A debt buyback is a transaction in which creditors (in this case holders of Barbados Dollar Denominated (BDD) Series E 8% Bonds due 2043 and GOB US Dollar Denominated (USD) 6.5% bonds due 2029 and the debtor (GOB) reach agreement for the retirement of all or some of an outstanding debt stock on more favourable terms and conditions for the debtor than on the existing debt. This action is usually undertaken by the debtor government in a bid to reduce its debt servicing costs (either through a slash in the debt to be repaid *ie.* a haircut (discount) and/or a reduction in interest payment). Creditors engage in debt buyback arrangements because "a bird in the hand is worth two in the bush," that is, they are happy to recoup some portion of their debt in a situation where there is uncertainty about the borrower's ability to repay in the long run. Additionally, the creditors may be able convert/swap the debt written off into equity in a valuable asset (such as state-owned enterprises, land, etc.) in the debtor country. The funds for such transactions can come for the treasury and/or from a third party such as a bank or other lenders willing to take on the debtor's credit risk. For a third party, debt buybacks represent very profitable investment opportunities.

Usually, conditions are attached to how the relief granted can be used by the debtor government. For example, the government may be required to invest the domestic equivalent of the savings for agreed priority purposes such as protecting the environment, addressing poverty, privatisation of state-owned enterprises, etc. Hence the transaction is also referred to as a debt swap. Debt swaps are not new, and in the wake of the debt crisis of the 1980s and early 1990s debt swaps for equity, development, poverty reduction and the environment were part of the sovereign debt restructuring landscape. These operations mostly covered external debt held by bilateral creditors, ie., other governments, and commercial creditors. The Barbados operation involved domestic and external commercial debt held by bondholders and private entities, and the savings are to be directed to marine conservation, making it the third country, following Seychelles and Belize, to engage in a such an operation.

The operation by the GOB is much more complex than described above and involves four different parties: GOB (the debtor); Creditors (holders of Series E 2043 bonds and the 6.5% 2029 bonds); New Creditors (CIBC FirstCaribbean - CIBC and Credit Suisse - CS); and Co-Guarantors (The Inter-American Development Bank - IADB and The Nature Conservancy - TNC). GOB repurchased a small portion of its outstanding debt in the designated series (about 6% and 14% respectively) with financing from CIBC and Credit Suisse to the tune of USD146.52 mn. The transaction was underpinned by policy-based guarantees from the IADB (USD100 mn) and TNC, a US-based NGO committed to the protection of the marine environment, for USD50 mn. The TNC guarantee is backed by the United States Development Finance Corporation (US DFC) which approved USD100mn in political risk insurance/financing for the support of marine conservation in Barbados on September 11, 2019. These guarantees allowed the GOB to negotiate a better rate of interest on the financing from CIBC and Credit Suisse, while offering both comfort that they will be repaid in the event the GOB is unable to meet its commitments.

The new financing for the debt buyback, which is being characterised as Blue Financing, is a dual currency facility in which the CIBC portion is in Barbados dollars (BBD Blue Loan) and the Credit Suisse portion is in US Dollars (USD Blue Bond). Both are 15-year term loans to GOB with 3 1/2 years

grace period maturing in 2037. The interest on the CIBC loan is fixed at 3.25%; while the interest on the Credit Suisse loan is set as a margin of 0.95% per annum plus a Base Rate (interpolated US Treasury Yield Curve[1]) to be fixed at disbursement and estimated at 4.15% per annum as stated in the Resolution to Borrow presented to Parliament (September 9, 2022). The transaction also contains "natural disaster and pandemic clauses" which provide for the deferment and capitalisation of debt service payment if these events should occur.

The BGIS Press Release of September 21, 2022 reported Aggregate Principal Repurchase of USD77.6 mn of GOB 6.5% Notes due 2029 - at a clearing price of USD92.25 per USD100, which equates to a 7.75% "haircut"[2] - and prepayment of USD72.9 mn of Series E 8% bonds due in 2043 (presumably at par since this is labelled as a prepayment). It is assumed that these reported amounts also include interest accrued between the last coupon payment and September 21, 2022, the date of the debt conversion agreement. Details were not provided on the interest and principal cost savings attributable to the repurchase/prepayment operation and the distribution across each of the instruments. Neither was the overall impact on the debt level identified.

Rough calculations suggest that approximately USD147.8 mn ($295.7 mn) in principal was repurchased/prepaid and approximately USD2.6 mn ($5.3) was paid in accrued interest. Given that new loans totalling USD146.5 ($293 mn) were contracted to undertake the operation, the national debt decreased by around USD1.3 mn ($2.6 mn). Net savings on the prepayment of the domestic debt funded by the CIBC loan amount to approximately USD85 ($170 mn), all of which represented interest payment reduction. The external component of the debt buyback financed by Credit Suisse increases debt service payment by around USD1.4 mn ($2 mn) because of increased interest payment of approximately USD7.2 mn ($14.4 mn) which offset principal savings of almost USD5.8 mn ($12 mn) arising from the 7.75% "haircut" in the face value of the principal. The overall principal and interest savings on both the domestic and external components of the transaction is therefore around USD41 mn ($81.7 mn) (See Table). It should be noted this does not take account of the legal, advisory services and other transaction costs associated with the transaction which will impact the overall savings.

In summary, the debt swap resulted in a marginal decrease in the public debt due to the 7.75% discount on the external component of the swap. The estimated savings of approximately USD41 mn is due entirely to the early repayment of the BDD denominated Series E debt funded by CIBC, while the repurchase of the USD denominated debt will result in an increase in debt service payment on the external component largely owing to higher interest payment on the Credit Suisse loan. The interest forgone by the holders of the Series E bonds is in fact funding the marine conservation efforts.

As mentioned above, there are conditions attached to the debt conversion relating to improving the management of the marine environment including use of the savings. A condition of the debt conversion requires GOB to enter into a Conservation Funding Agreement with TNC and 100% of the resulting cost savings has to be channelled into marine conservation over the next 15 years. This entails the establishment of the Barbados Environmental and Sustainability Fund (BESF), and an according to one Press Release, approximately USD1.4 mn annually will be remitted to the BESF over the life of the loans to be used for marine conservation projects agreed. USD18 mn is also to be placed in an endowment trust over the next 15 years and will become accessible in 2037 for marine conservation. GOB, as part of the

[1] According to the US Treasury Yield Curve published for September 21, 2022, the daily treasury par yield curve rate for the 10 and 20-year treasuries was 3.51% and 3.73% respectively.

[2] This is not a de facto haircut, but represents the discount at which the external bond was trading at the time of exchange.

agreement, committed “to protect and sustainably manage up to 30% of its Exclusive Economic Zone and Territorial Sea – an area of more than 55,000 square kilometers” among other measures. Hence the transaction is also being described as a debt for nature swap. The full details of the commitments made by GOB for the IDB and TNC guarantees have not been disclosed. Similarly, the governance and the operational arrangements for the BESF have not been made public as yet.

Questions have been raised about the benefits of debt swaps for developing countries including their failure to reduce foreign debt obligations. One commentator, reviewing the Belize Blue Bond flagged the lack of transparency concerning the environmental conditions attached to the arrangement, including the government’s legal commitment to set aside 30% of its marine assets into a protected area, which are contained in a confidential agreement without public debate or scrutiny. Concerns have also been raised about the disproportionate influence that TNC may have in determining the future use of small island states’ marine resources. TNC has been described as the wealthiest environmental NGO in the world and it is committed to protecting 30% of the world’s marine environment. In 2018, it unveiled a strategy to mobilise private financing to buy over a billion-dollar worth of debt owed by debt-distressed tropical coastal and small island states in return for their commitment to increase the marine protected areas. The plan is supported by the US Development Finance Corporation, and based on information published by the DFC debt swaps are under consideration for Kenya and St. Lucia. Depending on the nature of the agreement reached with TNC and its role and influence in developing conservation policies for the marine environment relative to domestic stakeholders, debt swaps have the potential of circumscribing the policy space of national governments, since “they can transfer enormous power in the governance of large marine areas to foreign conservation organisation.” Countries engaging in these types of operations should therefore proceed with caution lest they give another extra-territorial entity, like existing International Financial Institutions, *de facto* leverage in determining policy for and access to vital national resources and assets.

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Table 1 ESTIMATED IMPACT OF PROPOSED DEBT SWAP ON INTEREST AND PRINCIPAL BY INSTRUMENT				
	Domestic	**External**	**TOTAL**	
	Series E	**2029 Notes**		
	BD$		**BD$**	**US$**
Repurchase price /$100	**100**	**92.25**		
Estimated Principal Buyback/Prepaid	145,122,760	150,573,765	295,696,526	147,848,263
Estimated Total Interest Payable on Principal Buyback/Prepaid Amount to Maturity	156,248,839	70,957,887	227,206,726	113,603,363
Interest Paid on Buyback/Prepaid Amount to Last Coupon Date[1]	27,089,582	24,468,237	51,557,819	25,778,909
Accrued Interest to Sept 21, 2022	677,240	4,626,235	5,303,474	2,651,737
Interest Balance on Buyback/Prepaid Amount to Maturity	128,482,017	41,863,415	170,345,432	85,172,716
Estimated Interest to Maturity on New Loans (CIBC, Credit Suisse)	44,047,575	56,245,365	102,292940	50,146,470
Interest Impact of Debt Swap (- Decrease)	**- 84,434,442**	14,381,950	**- 70,052,492**	**- 35,026,246**
Overall Principal Impact[2]	0	**- 11,669,467**	**- 11,669,467**	**- 5,834,733**
Overall Principal & Interest Savings	**- 84,434,442**	**2,712,483**	**- 81721,959**	**- 40,860,980**

1. Last Coupon Date for Series E was Augusts 31, 2022 and April 1, 2022 for the 2029 Bond.
2. Refer to Table 1 for details.
3. Information from BOG press Release dated September 21, 2022. It is assumed that the reported “Aggregate Principal Repurchased” is the consideration paid for the swap and includes principal plus the accrued interest to September 21, 2022 on these sums from last coupon payment date. The total consideration for 2029 bond is thus the principal repayment a t $92.25 per $100 of offered debt plus Accrued Interest for April 1, 2022 - Sept 21, 2022. In the case of Series E, since this is reported as a prepayment, it is assumed the consideration entails principal repurchase at par plus accrued interest for August 31 - Sept 21, 2022. Given the reported total consideration, the actual amount of the debt repurchased (principal reduction) and the purchase price are estimated for both series. An indicative interest rate of 4.15% and 3.25% was used to estimate the principal amount of the 2029 Notes repurchased and actual interest rate of 3.25% was used to estimate the Prepaid Principal for Series E. This does not account for legal and advisory services cost which has not been made public.