



## PROGRESS ON EXTERNAL DEBT RESTRUCTURING NEGOTIATIONS

### FLASH NOTE

### FIRST CAPITAL RESEARCH

#### Government-Bondholder negotiations

The government engaged in restricted discussions over the past three weeks with the nine members of the steering committee who agreed to take part in the restricted discussions of its International Sovereign Bonds (ISBs). Despite these efforts, both the parties involved were unable to reach an agreement on restructuring terms. Meanwhile, the steering committee did not agree to an extension of the restricted discussions upon expiration of the current restricted period.

#### IMF's preliminary assessments on March proposals

Before the discussions held on 27th and 28th March 2024 in London, both proposals namely "Steering Committee's March Proposal" and "Sri Lanka's Proposal" were exchanged by both parties, and Sri Lanka's proposal was rejected by the Steering Committee. Notably, the International Monetary Fund (IMF) provided preliminary assessments on the March proposals submitted by both parties, indicating alignment with Sri Lanka's debt sustainability targets for the government's proposal but not for the bondholders' proposal. The IMF staff highlighted that these assessments were preliminary, emphasizing that final evaluations would be provided only after the parties reached a tentative agreement in principle.

#### Focus on Bondholder proposals, MLB, and GLB introduction

The negotiations primarily focused on the bondholders' proposal, particularly concerning the introduction of a Macro-Linked Bond (MLB). The discussions narrowed down to four features of the MLB:

- i. The baseline parameters of the instruments proposed by the Steering Committee were calibrated by reference to the Group's "alternative baseline", rather than Sri Lanka's IMF-Supported Program baseline.
- ii. The balance of risks between Sri Lanka and holders of its ISBs - While the Group had already updated its original MLB structure to include a scenario where Sri Lanka might underperform IMF-Supported Program GDP projections, Sri Lanka invited the Group to consider a structure that would provide greater protections to Sri Lanka in such a scenario.
- iii. The test for triggering upward/downward adjustments in the MLB.
- iv. The share of additional value in an upward adjustment scenario - Sri Lanka invited the Group to consider lower bondholder allocation in the scenario in which the country outperformed IMF-Supported Program GDP projections and satisfied the upward adjustment test in the MLB.

However, significant disparities arose regarding baseline parameters, risk balance, trigger tests, and the allocation of additional value in various MLB scenarios. Meanwhile, the March proposal suggested a 20% haircut on the nominal amount of existing bonds (outstanding at December 2023) and the April proposal increased the haircut to 28% (outstanding at December 2023) with no haircuts on Public Due Interests (PDIs) in both March and April proposals. In addition to that, a consent fee representing c.1.8% of the original principal claim is to be paid upfront except PDIs at USD 225.0Mn also suggested in the Steering committee's April Proposal (refer Annexure 01 for the key evaluations of MLB structure and Annexure 02 for the MLB instalments structure). The Steering Committee also suggested the possible introduction of a Governance-Linked Bond, which Sri Lanka said it would consider subject to being provided with more details of this proposal. Such details on the possible structure of a Governance-Linked Bond were subsequently shared with Sri Lanka's advisors on 3rd April 2024.

#### First Capital Research's perspective

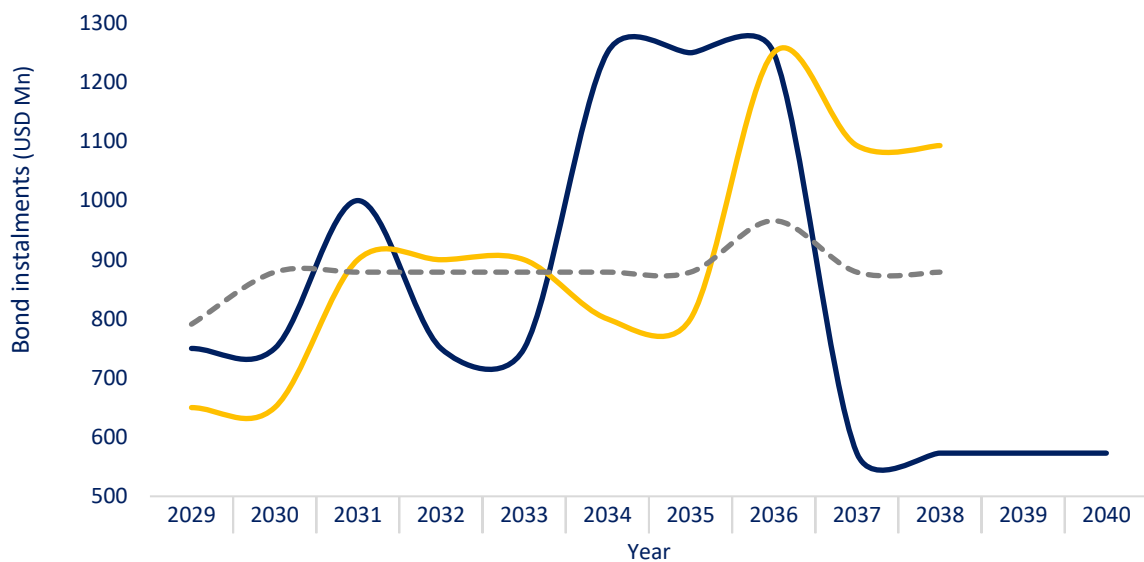
First Capital Research believes that it is crucial for the government to strive for consensus in the upcoming weeks. Any delay in discussions and failure to reach an agreement on conditions are likely to delay the IMF's review and may impact future IMF disbursement.

## Annexures

### A1: Key evolutions of the MLB structure

March Steering Committee proposal	April Steering Committee proposal
New bonds amortizing from 2029 (vs. 2027 previously)	A “shift” in the structure of the MLB, which is now centered on the IMF baseline, Upside (downside) adjustments triggered in case of GDP overperformance (underperformance) in comparison with the IMF baseline
Additional instalments introduced (final instalment in 2040 vs. 2036 previously)	Inclusion of an additional downside threshold below the IMF baseline
Amended PDI amortization profile	Inclusion of a new vanilla bond
Lower PIK coupons (3% vs. 4% previously)	Less instalments (final instalment in 2038 vs. 2040 previously)
The observation period expanded from 2 to 3 years	
Inclusion of a downward adjustment below the IMF baseline	

### A2: MLB instalments structure



	2029	2030	2031	2032	2033	2034	2035	2036	2037	2038	2039	2040
— MLB structure in March Steering Committee proposal	750	750	1,000	750	750	1,250	1,250	1,250	573	573	573	573
— MLB structure in April Steering Committee proposal	650	650	900	900	900	800	800	1,250	1,093	1,093	-	-
--- March Government proposal	791	879	879	879	879	879	879	966	879	879	-	-

Both in the April Steering Committee and March Government proposals bond instalments will be finished in 2038 whereas in the March Steering Committee proposal bond instalments will be finished in 2040.



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