Ninety Sixth Sovereign Debt News Update: Gabon’s Debt-For-Nature Swap: Some Critical Reflections

By:

The African Sovereign Debt Justice Network

September 4, 2023

Gabon completed a $500 million debt-for-nature swap on 14 August, 2023. This debt for nature swap seeks to help to refinance a small portion of its debt and lock in funds for marine conservation. The deal is expected to generate $163 million for marine conservation over 15 years while slashing its debt, making it the first in continental Africa. Credit enhancements, including political risk insurance from US International Development Finance Corporation (DFC) ensured the bond had an Aa2 rating from Moody’s, a level much higher than the sovereign’s Caa1/B credit rating.

Gabon bought back three bonds, one maturing in 2025 and two in 2031, with a total nominal value of $500 million. The buybacks were equivalent to around 4% of Gabon’s total debt. In their place, Gabon issued a $500 million blue bond which matures in 2038. The coupon on the new blue bond was priced at 6.097%, lower than the coupons on the repaid bonds which were between

6.625%-7%.

While smaller than other such debt-for-nature swaps, Gabon's is the first in mainland Africa—a continent conservationists see as ripe for such deals, replete with at-risk marine environments and often high sovereign debts—and it is hoped it will provide the impetus for more blue bonds deals across the continent.

The $500mn deal, which was arranged by Bank of America, lowers the interest rate on Gabon's debt and gives it longer to make repayments. As part of the transaction, proceeds from a new bond issuance, arranged by Bank of America, were used to refinance a portion of Gabon's existing national debt. The US International Development Finance Corporation (DFC) has provided political risk insurance of up to $500 million for the financing, which lowers the cost of debt for Gabon. This transaction, it is hoped, will enable the country to make annual contributions to an independent Conservation Fund and an endowment that will continue to fund conservation after the bonds are repaid. In fact, Gabon committed to spend $5 million a year from the savings over the next 15 years on marine conservation and to fund an endowment that is expected to grow to $88 million by 2038. That funding is projected to continue financing conservation work after that date.

The new funds are designed to help Gabon improve the management of its territorial waters, 26 percent of which are currently earmarked as protected, and make its fishing industry more sustainable. The small West African country is 88-percent covered by forest and has a vast coastline rich in marine species. Its extensive mangrove forests represent one of the most secure carbon sinks in West and Central Africa.

Proponents of the deal hope it will drive momentum to reshape the financing landscape for developing countries, which have long called for new ways to address their high debt financing costs and free up money to spend on mitigating the uneven impacts of climate change. For instance, Gabon's President Ali Bongo, who is bidding for a third term, said the swap was an important moment for eco-friendly finance deals in Africa. According to him, "all too often talks of these new mechanisms to reward countries like my own remain just that. In this case... we have made it a reality." The Nature

Conservancy, a U.S.-based environmental organization, sponsored the deal and will advise Gabon on its marine-conservation efforts.

The Other Side of the Debt Swap Story: Some Critical Reflections

Debt-for-nature deals have grown in size and frequency in recent years. The Nature Conservancy has largely spearheaded their growth, with the Gabon deal marking the organization’s largest by value following similar deals in Belize, the Seychelles, and Barbados. Ecuador completed a $1.6 billion debt-for-nature swap, the world’s largest, earlier this year, putting $12 million a year toward the conservation of the Galápagos Islands. TNC wasn’t involved in that deal.

These debt-for-nature deals are pitched as kill-two-birds-with-one-stone solutions, as they aim to conserve nature and lower debts. They also provide good branding for countries wanting to market their sustainability credentials to attract investment. However, as with all stories, Gabon’s encounter with debt for nature swap can be seen from a number of angles. Framed as a method of averting ultimate financial disaster, it may be a success. Framed as a solution to high debt burdens in developing countries, the Gabon deal is ineffective. Before this deal Gabon was on the worry list for a large 2025 bullet Eurobond maturity. This transaction offered a chance to eliminate this debt risk, but after this transaction that risk remains. In Belize, for instance, the debt for nature deal wiped out only 12% of GDP in debt as compared to the 125% burden.

The relatively small amount of debt relief isn’t incidental or unique to Belize or Gabon. Debt-for-nature swaps (and their close cousin, debt-for-climate swaps) are minimally scalable. The sheer size of the debt and number of private actors that must be enticed to participate in a wholly discretionary process is difficult to arrange on even a small scale.

It also remains a mystery how Gabon's conservation promises would be enforced and how the DFC insurance pledge would work if Gabon did one day default. Additionally, Gregory Smith, a fund manager at M&G Investments, also questioned why the swap had bought back just $95 million of a bond that needs refinancing in 2025 compared to $405 million of its two 2031 maturing bonds, referring to the bonds' nominal values.

Moreover, debt-for-nature deals were pitched in the 1980s as a means of converting existing hard currency debt into a local currency debt, so can we see this happen soon? Debt risks would be much reduced if the new loan were in local currency and not dollars. It would also be important that these deals result in a small trust fund for improving debt management capacity. One of Gabon's hurdles for lowering its borrowing costs is a low credit rating. The rating is low in part because of frequent mistakes with late debt payments, suggesting efforts are needed to improve cash and debt management.

Besides, these transactions are often complex and costly. The overall fee structure might be clear for participants in the transaction but is certainly not for the market as a whole. The case studies mentioned explicitly exclude the costs of the fees that are paid via the spread between the blue bond and loan, which can amount to substantial figures. Even worse, to this day there is no clarity on the interest on the blue loans provided to Ecuador and Gabon. If anything, the Bank of America, which served as sole initial purchaser, structuring agent and bookrunner on the Gabon deal, declined to reveal its transaction fees. However, an honest conversation about the trade-offs in terms of transaction fees versus conservation commitments requires this information to be public.

In addition, none of the debt-for-nature swaps conducted in the last two years (Belize, Barbados, Ecuador, and now Gabon) fulfil the debt transparency requirement in terms of the blue loan documentation. This degree of lack of disclosure is a major setback for international efforts to advance debt transparency, including those led by the G20. It runs the risk of normalizing again the idea that is okay for public debt contracts to remain hidden.

Finally, it remains unclear whether independent Second Party Opinion and third-party verification were conducted in the Gabon's blue bond issuance. The International Capital Markets Association (ICMA) principles for green and sustainability-linked bonds lists Second Party Opinion and third-party verification as part of the required elements to ensure the integrity of the asset class. This is meant to ensure to all parties of the fulfilment of the sustainability commitments of the bond through a publicly available performance assessment process. Debt swaps fail to fulfil this criterion. TNC as an active participant of the Gabon transaction is not an independent party. Furthermore, an audit of the conservation fund, which is neither public nor related to the conservation targets, does not appear to be material to the conservation goals. Which begs the questions: do previous debt-for-nature swaps also lack third-party verification? And why should debt-for-nature swaps be held to a lower standard in terms of verification than Green or SLB bonds?

In conclusion, these debt-for-nature transactions must be held to high standards. The Gabon debt swap, while highly lauded, demands careful scrutiny and analysis to ensure it genuinely benefits the country's economic and environmental conservation goals. It is critical to encourage transparency, robust scrutiny, and ethical financial practices. And as Smith opines, the narrative on these debt-for-nature swaps needs to be tweaked from maximising the reduction in debt levels, to maximising the reduction in refinancing risks. The African Sovereign Debt Justice Network, in its book entitled '*Transforming Climate Finance in an Era of Sovereign Debt Distress*' launched during the African Climate Summit in Nairobi, also proposes that African countries should tread with caution in adopting green finance instruments and other related market-based proposals addressing climate change. The book highlights the ongoing global commodification and corporatization of nature which fuels the trend of extractivism from Africa by developed countries. This manifests through the promotion of continuation of natural resource extraction, particularly, critical minerals, for a "green transition" despite the proven dire environmental consequences, green debt as well as a more significant role to be played by private finance in addressing climate change.

This update was prepared by Akinyi J. Eurallyah, AfSDJN Senior Fellow. Email: E.akinyi@dal.ca

View online: Ninety Sixth Sovereign Debt News Update: Gabon's Debt-For-Nature Swap: Some Critical Reflections