The Liquidity and Sustainability Facility

Supporting African Sovereigns and private investors by contributing to a liquidity strategy on par with international standards

11.10.2022

United Nations Economic Commission for Africa
The LSF was established by the UN ECA in November 2021 at the COP 26 in response to several major challenges facing African countries, in particular:

- the ongoing coronavirus pandemic
- the historical high cost of borrowing for African Sovereigns
- the urgent necessity to address climate change and its consequences.

It was the culmination of a long engagement process under the UN ECA leadership with the international community at large:

- IMF MD, Board of the IMF, IMF teams, WBG
- G7, G20 & COP successive teams and sherpas
- Elysée Summit on the financing of African economies, COP 26, ECA Conferences
- US Treasury, Ministère du Trésor, Finance and Foreign Ministries of Germany, Italy, Spain, UK
- Finance Ministries of Mexico, Argentina, Brazil, Pakistan, Egypt, South-Africa, Indonesia, etc.
Africa faces ever increasing challenges

- Debt burden and historical high cost of borrowing
- Difficult recovery post Covid
- Rising interest rates globally
- Climate change financial gap
- High inflation, energy & food shortages post-Ukraine invasion
- Large financial outflows
The LSF has two clear objectives

Supporting the liquidity of African Sovereigns Eurobonds

African governments have historically faced high cost of borrowing. Compression of liquidity premia and improved sovereign access to Eurobond markets has the potential to save African nations an estimated USD 11 billion on borrowing costs over the next five years. Improved liquidity can have the effect of compressing yields by strengthening the demand and consequently, the price of eligible sovereign bonds. By supporting these objectives, the LSF supports the debt sustainability of African nations.

An estimated USD 11 billion saved on borrowing costs

Incentivising green and SDG-related investments

The LSF aims to support the green and sustainable recovery of emerging and frontier markets sovereigns. Currently, the share of sustainability-linked bonds issued in Africa and the Middle East accounts for less than 1 per cent of the global total amount, indicating that there is a large potential for growth, and opportunities for SDG investors. The LSF will utilise its resources to engage with investors with a special focus on green and SDG linked investments, thus promoting sustainability-linked investments in Africa.
The LSF is endorsed by 26 African States

Africa demands global financing reform

On May 23, 2022

African Ministers of Finance and National Planning have said the international financial system was outdated and unfair to many developing countries.

The finance ministers stated this at the Conference of Ministers (CoM2022) — organised by the United Nations Economic Commission for Africa (ECA) and hosted by the government of Senegal.

In a communique issued at the end of the conference, the 26 ministers urged G20 countries to extend the Debt Service Suspension Initiative (DSSI) by two more years to help “create fiscal space for urgent spending”. They asked for the Common Framework to be modified to make debt restructuring effective and broad-based to include commercial creditors.

Another key demand was that developed countries support the recycling of $100 billion in Special Drawing Rights (SDRs), of which they said $60 billion should be allocated to the Poverty Reduction and Growth Trust (PRGT) and to the new Resilience and Sustainability Trust (RST).

In addition, they asked for new SDRs and drew attention to the ECA’s Liquidity and Sustainability Fund (LSF), which they said should be established to allow African countries to use SDRs to improve liquidity, stabilise currencies and reduce the costs of credit.
The LSF brings benefits to both African governments and private investors

Supporting African Sovereigns and private investors by contributing to a liquidity strategy on par with international standards

For African governments
- A well-functioning repo market could improve the liquidity of sovereign bonds by providing a mechanism for bondholders to refinance their positions.
- And can contribute to reducing interest rates by compressing the liquidity premium, strengthening the demand and consequently, the price of eligible sovereign bonds.

For private investors
- The enhanced liquidity could make African Sovereign Eurobonds more attractive to investors.
- By fostering liquidity, the LSF is attracting a wider range of international investors to the African bond market.
01. Enhance African international sovereign debt sustainability

Repo markets matter
“A well functioning repo market supports liquidity and price discovery in the cash market, thus helping to improve the cost of funding for firms and governments and the efficient allocation of capital.”

BIS, 2017
“As a global asset manager, Amundi is proud to support the LSF. This mechanism will foster the emergence and the structuring of the African sovereign debt market, on par with the best international standards. It represents an important milestone for investors, as the African continent offers promising opportunities in terms of sustainable fixed income investment, in particular green bonds.”

Vincent Mortier, CIO, Amundi, 2022
“Today every developed market sovereign issuer benefit from extensive well-functioning repo markets enhancing the liquidity and the attractiveness of their sovereign debt, hence lowering their borrowing costs”

LSF, 2022
Developed countries have long enjoyed the existence of large “repo” markets for their government bonds, facilitating the creation of stable additional funding sources for their public finances.

The LSF objective is to kickstart the same dynamic for African sovereign bonds by providing investors with competitive funding through repurchase agreements (“repo”).

→ Level the playing field for Africa

US Repo Market Total Size

- $16,000 Bn
- $4,500 Bn
- The US Repo market is 28% of the total US Treasury debt market
- Target repo market size equivalent to 20% of African Eurobonds
- Around $30 Bn

Source: SIFMA Research

The Wall Street Journal

Fed Launches Standing Repo Facility to Boost Market Liquidity

July 28, 2021

Large repo facilities exist across all developed economies
Well tested risk mitigation process

**Initial Repo arrangement**

<table>
<thead>
<tr>
<th>LSF</th>
<th>Private investor</th>
</tr>
</thead>
<tbody>
<tr>
<td>$100</td>
<td>$90</td>
</tr>
</tbody>
</table>

Collateral value: $100

Loan Value: $90

$10 Initial margin

**If collateral value deteriorates, additional collateral posted**

<table>
<thead>
<tr>
<th>LSF</th>
<th>Private investor</th>
</tr>
</thead>
<tbody>
<tr>
<td>$95 + $5</td>
<td>$90</td>
</tr>
</tbody>
</table>

Collateral value: $95 + $5 = $100

Loan Value: $90

$5 additional collateral

Initial margin

- Sovereign default risk remains with the **Private Sector Investor at all times**
- LSF exposed to credit risk of PSI, mitigated through collateral and margin calls
- The LSF’s administrator vets counterparties based on credit assessment
- Underlying sovereign is neither involved nor exposed to any additional risk
A repo facility dedicated to African Eurobonds, specifically designed to operate at the highest standards of global markets

**LSF facility**

- Repo facility for eligible African sovereign bonds, offering enhanced terms for Green & SDG linked bonds

1. LSF receives African Government Eurobonds as collateral
2. LSF lends cash value of the bonds minus initial margin
3. At maturity (generally open and less than 12 months) Private Sector Investors repurchase bonds for the original cash consideration + interests

**G7/IMF (on-lent SDRs), MDBs, Commercial Banks, Financial Institutions**

- LSF receives funding
- LSF pays return to funders

**African sovereign debt market**

- Investors buy African bonds at issue on the secondary market

**Private Sector Investors**

- Governments issue eligible bonds

The universe of eligible bonds the LSF accepts as collateral is reviewed periodically by the Board. Priority is given to countries with a good track record of policy reform and strong governance as well as to Green and SDG linked issuances.
From liquidity to debt sustainability

The LSF can help drive a virtuous cycle for Africa

The LSF could help save African issuers an estimated $11bn in interest costs over a five-year period
02. Help finance a green and sustainable recovery
The LSF is an opportunity for Africa to catch up in the sustainability and Green Bond markets

<table>
<thead>
<tr>
<th>Country</th>
<th>Green Bonds</th>
<th>Amount (USD m)</th>
<th>First Issuance</th>
<th>Use of proceeds</th>
</tr>
</thead>
<tbody>
<tr>
<td>Kenya</td>
<td>1</td>
<td>41</td>
<td>Sep. 2019</td>
<td>Buildings</td>
</tr>
<tr>
<td>Namibia</td>
<td>1</td>
<td>5</td>
<td>Dec. 2018</td>
<td>Energy, buildings, transport, water, waste, land use, adaptation &amp; resilience</td>
</tr>
<tr>
<td>Seychelles</td>
<td>1</td>
<td>15</td>
<td>Oct. 2018</td>
<td>Land use &amp; marine resources</td>
</tr>
<tr>
<td>Nigeria</td>
<td>4</td>
<td>136</td>
<td>Dec. 2017</td>
<td>Energy, transport, water, land use</td>
</tr>
<tr>
<td>Morocco</td>
<td>4</td>
<td>356</td>
<td>Nov. 2016</td>
<td>Energy and buildings</td>
</tr>
<tr>
<td>Egypt</td>
<td>1</td>
<td>750</td>
<td>Sep. 2020</td>
<td>Transport, energy, energy efficiency</td>
</tr>
<tr>
<td>South Africa</td>
<td>6</td>
<td>1,554</td>
<td>Apr. 2012</td>
<td>Energy, buildings, transport, water, waste</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>18</strong></td>
<td><strong>2,857</strong></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Global issuance over 2013-2020

- **Global**: 539 billion USD
- **Middle East & Africa**: 5 billion USD

Source: Climate Bonds Initiative and UNECA, October 2020

Sustainability-linked issuance by region

Source: UN Global Compact Sustainable Finance, HSBC December 2020
To help finance its Green and Sustainable recovery

The LSF can be used to mobilise capital investment towards key sustainable efforts

Climate action and green economy initiatives aligned with the Paris Agreement:

- SDG-specific initiatives and instruments (e.g., SDG-bonds, UN ECA's "SDG 7" initiative on clean energy)
- The World Bank's initiative to address nature and biodiversity

And a wider range of sustainable development priorities including:

- Overall climate adaptation and resilience
- Digital technology investments
- Waste and waste management
- Sustainable forestry, and SME capacity building
03. Transparent market mechanisms on par with international standards
The Liquidity and Sustainability Facility (LSF) DAC

Legal Structure
- Designated Activity Company (DAC) with limited liability
- incorporated under the laws of Ireland
- Issued share capital held on trust for charitable purposes

Constitution
"The principal object for which LSF has been established is to foster a functioning repo market to compress yields by strengthening the demand and consequently, the price of eligible African sovereign bonds, pursuant to which demand will be enhanced by improving liquidity, through the creation of a repo market, involving LSF, and by acquiring, directly or indirectly, such sovereign bonds as collateral for development financing, in a sustainable manner, at competitive rates."

The LSF is not regulated by a financial professional body.
The Board ensures the LSF adheres to its public good mission and to the highest standards of transparency. It is composed of Directors representing the LSF multiple stakeholders. It will also include a Risk and Audit committee.
Diversified funding and low counterparty risk

**Funding**

The LSF operates an Asset and Liability Management policy with a funding plan for credit and repo lines of various terms matching its transactions, established with a diversified pool of financial institutions representative of the multiple LSF stakeholders, globally as well as in Africa.

It includes central banks, MDBs and IFI, private and commercial banks

**Funding of the LSF is not subsidised**

**Optimal funding capacity**

Optimal funding capacity is estimated at **USD 30 Bn** over the medium term. To that effect, the LSF is actively engaging with the IMF and G20 on the on-lending of their unused-SDRs.

**Quality Counterparties**

The LSF transacts with counterparties established in recognized jurisdictions and of the highest quality and reputation such as insurance companies, banks, pension funds, asset management firms, and public and private investment funds.
Thank you

Possible topics for follow up:

• Funding
• Grant