According to the World Bank report, in 2020 advanced economies are forecast to shrink 7% and emerging economies and developing countries are forecast to shrink by 2.5% (which the World Bank said would be the lowest rate of growth for emerging and developing economies since at least the 1960s). However, in its baseline scenario, the World Bank forecast the possibility of a moderate recovery for the global economy in 2021.

Our focus in this article are the emerging economies, and the rather bleak outlook for the emerging markets in particular represents a sharp turnaround for the emerging economies since many of those economies have been performing fairly well in the last few years. But many of the gains the emerging economies have made in recent years risk being wiped out by the current COVID-19-related economic crisis — with the possibility, for example, that millions of citizens of these countries could be thrown back into poverty — and it is expected that the impact of the current economic slowdown on emerging economies could be long-lasting.

The COVID-19 pandemic has generally arrived in the emerging economies and developing countries later than it arrived in various advanced economies. But the public health impact of the COVID-19 crisis could be particularly pronounced if and when the pandemic makes major inroads into the emerging economies and developing countries. Many of these countries do not necessarily have strong healthcare infrastructure to begin with.

Furthermore, a number of emerging economies and developing countries enter the COVID-19 health crisis starting from a fairly low base of available medical supplies and may therefore eventually face shortages of vital equipment such as respirators, surgical masks, and other personal protective equipment. COVID-19 arrived in the emerging economies at a particularly inauspicious moment, as there were already significant negative economic trends affecting the emerging economies. Most notably, there was already a collapse of key commodity prices underway, starting with the price of oil but extending to a broad array of other commodities such as various metals including copper and zinc. And the global economic slowdown associated with COVID-19 has led to decreased demand for a range of commodities, thereby putting further downward pressure on commodity prices.

Since many of the emerging economies are heavily dependent on commodity exports as one of the central pillars of their economies, the price collapse of commodities has been an especially serious blow to many emerging economies, particularly in many oil-producing countries around the globe. For example, in Africa, oil-producing countries such as Nigeria, Angola, and Algeria, among others, are likely to face major financial pressures since their economies and national budgets are so dependent on oil revenues.

Many emerging market economies also rely to a significant extent on the tourism sector. Indeed, in a number of emerging economies and developing countries, tourism may account for as much as 10% or more of GDP (and, in some cases, even 20% or more of GDP), and the tourism sector may also be a major source of employment in these countries. However, the lockdowns around the world and the closing of national borders essentially shut down most
international air travel which in turn led to a drying up in many emerging economies of the revenues generated from foreign tourists.

In recent months, there has been a significant weakening of the currencies of many emerging economies. For instance, there have been sharp declines in the value of emerging market currencies such as, among others, the Turkish lira, the Brazilian real, the Mexican peso, the South African rand, the Nigerian naira, the Colombian peso, and the Indonesian rupiah.

These widespread declines in the value of emerging market currencies could pose a serious challenge to emerging economies because many of these economies — both at the sovereign and corporate level — have incurred debt denominated in hard currencies such as the US dollar. These depreciations in the value of emerging market currencies threaten to make the servicing of foreign currency-denominated debt that much more difficult.

In this article, we will briefly discuss how the COVID-19 economic crisis could affect different types of emerging market restructurings involving sovereign debt, corporate debt, and infrastructure projects, and we will also discuss related issues concerning state-owned enterprises and non-performing loans.

**Sovereign debt restructurings**

Even before the COVID-19 crisis began, there were a number of emerging market sovereigns that were experiencing financial distress to one extent or another. Yet, the COVID-19 crisis is only likely to make these particular sovereign debt situations even more challenging.

In Latin America, there are several countries that had sovereign debt travails prior to the arrival of COVID-19. Venezuela, for instance, has been in default on its outstanding debt for over two-and-a-half years, and it has a huge stock of outstanding debt and other liabilities (estimated to be US$150bn or more). The pandemic only potentially aggravates the existing grave humanitarian/social crisis in Venezuela (which is also accompanied by a financial/economic crisis and a political crisis).

Argentina, with its well-deserved reputation as a serial defaulter, was already facing a debt crisis before the arrival of COVID-19, and the pandemic has only exacerbated the difficulties facing Argentina. The Argentine government must now make greater expenditures on health care as well as fund economic stimulus measures, thereby further unbalancing its budget.

With more of a whimper than a bang, Argentina entered into default once again on May 22, 2020, by some counts the ninth such default in its history as an independent nation. As of this writing in mid-June 2020, Argentina was still engaged in discussions with its creditors to see whether a restructuring deal could be reached.

Another Latin American sovereign, Ecuador, which has been dealing with the economic fallout from the drop in the price of oil as well as one of the worst coronavirus-related public health crises in Latin America, reached an agreement in April 2020 with its bondholders to postpone for four months debt service payments on bonds in the amount of US$800m.

Other non-Latin American countries were also experiencing financial distress prior to COVID-19, including countries such as Lebanon and Zambia. Lebanon defaulted on a US$1.2bn bond in March 2020, and Zambia, a copper-producing country which has been hard hit by the major drop in copper prices and the decline in its currency vis-à-vis the US dollar, is exploring options for restructuring its debt burden of approximately US$11bn.

As the COVID-19 crisis takes a greater toll on emerging economies with the passage of time, it is expected that many more countries will enter into debt distress, triggering either debt restructurings or debt defaults. As a possible harbinger of the troubles to come, approximately 100 countries have already approached the International Monetary Fund for emergency financial assistance.

It should be noted, though, that there are even concerns in some quarters that the IMF, which currently has resources of approximately US$1 trillion at its disposal, may nonetheless not have enough available firepower to deal with all of the financing requests it may ultimately receive from distressed sovereigns around the globe.

Moreover, in a further sign of the seriousness of the current situation, the G-20 countries, in their capacity as bilateral creditors, recently agreed to a debt service moratorium vis-à-vis the poorest 77 countries in the world that will last until December 31, 2020.
A number of recent issuers of sovereign debt were first-time issuers which were taking advantage of the ample supply of liquidity in the international capital markets and the relatively low interest rates associated with the Federal Reserve’s low interest rate policy in the years after the 2008-09 financial crisis. For example, in Sub-Saharan Africa, first-time issuers included, among others, countries such as Ghana, Gabon, Senegal, Namibia, Nigeria, Zambia, and Rwanda. However, in the current adverse global economic environment, countries such as these may now face serious debt sustainability issues, and this could ultimately give rise to the need for some form of debt restructuring and/or debt relief.

Traditionally, in the sovereign debt world, the International Monetary Fund (IMF) — the multilateral institution that financially stressed countries would invariably approach for financial assistance in their hour of need — has occupied centre stage in many, if not most, sovereign debt restructurings. Yet, in the current environment, there is a new player that cannot be ignored: China. China has become the world’s largest official creditor, and its global lending now apparently dwarfs lending from the World Bank and the IMF combined.

Nevertheless, China’s lending arrangements in the emerging economies and developing countries have been marked by a fair amount of opacity, and it is not clear what approaches or principles will guide China in dealing with sovereign debt restructurings in the current COVID-19-related economic environment. In some recent cases, China has apparently been willing to grant only limited debt relief to sovereign debtors (although in an article a year ago The Economist cited a study that found that China engaged in at least 140 restructurings and write-offs of external debt since 2000). In other cases, such as in the case a few years ago of the Sri Lankan port of Hambantota, China essentially effectuated a debt-for-equity swap when the Sri Lankan government could not repay a loan from China. In that case, China effectively exchanged the debt owed by Sri Lanka for a 99-year lease of the Sri Lankan port (which happens to be strategically located on the Indian Ocean). In yet another set of cases, China is reportedly believed to be trying to take additional collateral to back up its loans in exchange for any debt relief that China grants to sovereign debtors.

China is not a member of the long-established Paris Club of bilateral creditors, so China does not need to abide by any of the Paris Club principles (e.g. the principle of transparency) nor does it need to feel obligated to work in concert with other bilateral creditors that are members of the Paris Club. Yet, in a multi-creditor situation, the non-China bilateral and multilateral creditors may well be disinclined to grant debt relief to a sovereign if they believe that China will not make any comparable sacrifices.

These non-Chinese creditors may be concerned that whatever debt relief they grant the sovereign in question will end up being used to repay debts to China (and, importantly, will not be used by the governments to fund necessary public health expenditures and economic stimulus measures).

A first test case of this multi-creditor scenario may arise in Zambia which as mentioned above is seeking to restructure its loans with external creditors. Zambia apparently owes approximately US$3bn on US dollar bonds, and it also owes approximately US$3bn to China. And at the same time Zambia has also sought financing under a so-called rapid credit facility from the International Monetary Fund to help it address the fallout from the coronavirus crisis.

How Zambia’s debt situation is ultimately resolved could shed light on whether China will be able to pursue a go-it-alone approach in debt restructurings even where there are other external creditors and financing sources, or whether China will eventually have to work with other parties in such multi-creditor situations in order to reach an overall debt restructuring solution.

Separately, another issue worthy of our attention is how holdout creditors — sometimes referred to a “vulture funds” — will seek to maximise their recoveries in the next round of sovereign debt restructurings. In connection with Argentina’s default in 2001 and the ensuing restructurings, a group of hedge funds pursued a strategy of fairly aggressive litigation focused on advocating a somewhat unconventional interpretation of the pari passu clause in the relevant New York law-governed bond documentation.
What will be their legal hook this time? It may be hard to say now with any specificity until some concrete sovereign debt restructuring disputes develop. Yet, distressed debt funds can be expected to scour the underlying bond documents to identify any clauses that they believe they might be able to use to their advantage in any potential litigation against the sovereign in question. Crucially, the willingness of some distressed debt funds to pursue bold and fairly aggressive — and even costly and drawn-out — legal strategies should not be underestimated, especially given the possibility of such funds achieving hefty returns if their strategies and plans work out successfully.

At a very practical level, to the extent that the situation presents itself, one could also look for holdout creditors to exploit series-by-series voting in the first-generation collective action clauses (CACs) adopted in the early 2000s. In pursuing such a strategy, a holdout creditor would seek to amass a blocking position in a particular series of the sovereign’s debt and thereby prevent the restructuring of the series of debt in question. That would free the holdout creditor to pursue litigation to recover the full face value of the debt of that series (notwithstanding the fact that the holdout may have purchased the debt at a substantial discount).

Corporate debt restructuring
In recent years, companies in the emerging markets borrowed heavily in the capital markets, particularly with interest rates being as low as they were. Even before the COVID-19 crisis, many of these companies were possibly overleveraged, and thus with COVID-19 related global economic slowdown, many of these companies may face financial distress as they navigate a landscape in which their revenues decline due to the overall economic slowdown.

This recalls in some respects the situation in the wake of the Asian financial crisis when there was widespread financial distress in the corporate sector in countries such as Thailand, Indonesia, the Philippines, and Korea, and numerous companies fell into default or sought a debt restructuring.

In a positive development in the last two decades — dating to the Asian financial crisis itself — insolvency laws have been reformed in many emerging markets around the globe. While creditors can take some comfort from the fact that the insolvency laws in many emerging market economies have been modernised, they must still reckon with the fact that there could be a gap, sometimes even a very substantial gap, between law and practice. For certain creditors which do not have extensive experience in the emerging markets or lack a sophisticated understanding of the restructuring dynamics in these markets, this realisation could come as a rude awakening.

Furthermore, creditors may be confronted with the harsh reality that some local courts in certain emerging market jurisdictions may suffer from a lack of independence and capacity, and that, in certain situations, some of those courts may even possibly be tainted by corruption.

It should be noted that, in response to the COVID-19 pandemic, numerous jurisdictions around the world have modified their insolvency laws in a variety of different ways, such as among things the steps taken in certain jurisdictions to temporarily suspend for the duration of the pandemic any mandatory duty to file for insolvency that would apply under normal circumstances. Thus, debtor companies and their creditors should familiarise themselves with any changes that have been made to the relevant jurisdiction’s insolvency law in response to the pandemic.

Creditors in emerging market jurisdictions — particularly foreign creditors — also need to recognise that, as a general matter, they may well not be playing on a level playing field with the debtor. In the emerging markets, a large number of companies are controlled by so-called controlling shareholders, who are often powerful and influential families in the local jurisdictions.

In certain emerging market restructurings, the controlling shareholders may strongly resist any restructuring plan, whether formulated in an in-court or out-of-court process, that seeks to diminish or set limits on their control of the company in question. This may be the case, for example, with restructuring plans involving debt-for-equity swaps that would give the creditors a large equity stake in the company and which would therefore diminish the control of the controlling shareholders over
the company. Accordingly, circumstances may force creditors to realign their expectations as to potential recovery values on their outstanding debt in light of these stubborn realities on the ground.

Foreign creditors, in particular, will also need to be mindful of the fact that they cannot simply extrapolate from their restructuring/insolvency experiences in their developed home country jurisdictions. Those experiences and their knowledge of the home country insolvency laws generally may be of little avail and/or relevance when these foreign creditors are addressing restructurings in emerging market jurisdictions, particularly where cases end up (or there is a possibility that they might end up) in a local insolvency proceeding. Moreover, strategies that might work in their home country jurisdictions — e.g. a "loan to own" strategy — may have difficulty gaining any traction in many emerging economy jurisdictions.

There is another pitfall that creditors in emerging market restructurings need to be aware of in certain emerging market jurisdictions, and that is the potential on the part of certain debtors/controlling shareholders for corporate frauds or malfeasance on a scale that can be truly mind-boggling. The debtor companies and in particular their controlling shareholders may have diverted corporate funds through sham sale transactions, the deposit of corporate funds in offshore banks wholly owned by the controlling shareholders, and/or various types of non-transparent related party transactions, and they may have earlier incurred substantial financial losses that were not previously disclosed to creditors.

Yet, these diversions of funds and losses can literally run into the hundreds of millions of dollars (as was the case in several suspect transactions in the US$13.9bn Asia Pulp & Paper restructuring in the early 2000s), and these diversions and losses, of course, can represent a substantial loss of value for creditors. That is why creditors, to the extent possible, are well advised to press debtors/controlling shareholders early in any emerging market restructuring process to establish cash monitoring programs for the debtor companies so that the creditors can carefully and closely monitor future cash outlays by the company. Similarly, the creditors would also be well served by undertaking comprehensive and thorough due diligence on the debtor company.

In some restructurings in recent years, certain emerging market debtors have turned to foreign jurisdictions to take advantage of more favourable insolvency laws to reach a successful restructuring outcome. For example, such debtors have proceeded under a UK scheme of arrangement (as in a situation several years ago involving Vinashin, a Vietnamese state-owned shipbuilder, in which it was seeking to bind holdout creditors) and under Chapter 11 in the US (as in the recent filings by two of the largest Latin American airlines, Avianca Holdings SA and LATAM Airlines Group SA).

Of course, as is true in the world of international restructuring generally, many emerging market debtors have sought recognition of the local insolvency proceeding in a foreign jurisdiction. For instance, this has become fairly routine for many Brazilian debtors in recent years where those debtors, acting through a foreign representative of the local insolvency proceeding, have sought Chapter 15 recognition in the US in order to bind US bondholders to a plan approved in the relevant Brazil reorganisation (recuperação judicial) proceeding.

**Infrastructure project restructurings**

In the last decade or longer, many emerging economies have undertaken ambitious infrastructure projects, whether in the form of new power/renewable energy projects, ports, airports, toll roads, telecom projects, and so forth. Many such projects were structured as public-private partnerships (PPPs), where the host governments granted concessions of one type or another to private parties and where there was equity investment provided by private sponsors and debt financing provided by, among others, banks and bondholders.

Nonetheless, the COVID-19 crisis could put a great deal of pressure on these projects, just as the Asian financial crisis put a great deal of pressure on the infrastructure projects of that era, particularly those in Southeast Asia. Ultimately, many of those projects from that era required major restructurings, and the restructurings were often incredibly complex.
and very messy and not infrequently took several years to complete.

There are two basic sources of potential pressure for the recent crop of infrastructure projects structured on a PPP basis. The first is that if the COVID-19 economic crisis plays out in the same way that the Asian financial crisis did, any severe slowdown in the affected national economies could lead to a sharply lower level of demand for the services provided by or the product produced by the infrastructure project in question.

For instance, such a scenario could lead potentially to a far lower level of demand from the offtaker for the power being produced by an independent power project (IPP). Thus, the basic economics of the affected projects could come under stress as the project may not be generating the expected revenues due to the lessened demand.

The second basic source of pressure could flow from any major depreciation of the local currency. If there has been a sharp depreciation of the local currency (and the currency risk has not been hedged), then it could become unaffordable for, say, an offtaker of power from an IPP to pay the tariff at the contractual rate set forth in the original power purchase agreement. The basic problem is that there is a currency mismatch: the offtaker receives revenues from its customers in the local currency, and yet the offtaker needs to pay the project effectively in a hard currency.

The scenarios described above of lower demand and a depreciated local currency could lead to serious pressures on the original contractual arrangements. The project may wish to hold its counterparty (e.g. the offtaker) to the original contractual arrangements, whereas the project’s counterparty may argue that it should no longer be bound by the original contractual arrangements since there has been a major change of circumstances since the relevant contracts were entered into.

These conflicting perspectives on the part of the project and its counterparties could result in a default under the relevant operating agreements (and even ultimately under the financing documents), a renegotiation/restructuring of the project’s operating and/or financing arrangements, or even a dispute between the parties in the form of litigation or arbitration.

Any discussion of infrastructure projects in the emerging economies would not be complete without a reference to China’s expansive and ambitious Belt and Road Initiative (BRI). China has financed and constructed BRI projects around the world, but in the current COVID-19 environment, many of these projects may be rendered uneconomic by the downturn in the local economies where the projects are based and may require renegotiation with the relevant Chinese parties.

Even pre-COVID, certain countries such as Malaysia were already trying to renegotiate some of their BRI projects with China. Malaysia, for example, claimed that the costs of the BRI projects in question in Malaysia were too high and needed to be renegotiated.

As China has BRI projects far and wide in so many emerging economies, it will be very interesting to see whether over time China develops a standard playbook for dealing with situations of distressed BRI projects, and if so, what that playbook entails. To be sure, the way that China deals with distressed BRI projects may be intertwined with China’s approach to dealing with sovereign debt issues where sovereign borrowers are experiencing financial distress.

**State-owned enterprises (SOEs) and non-performing loans (NPLs)**

As a final matter, two other areas bear mentioning in any discussion of emerging market restructurings: state-owned enterprises (SOEs) and non-performing loans (NPLs). We will highlight selected key issues related to SOEs and NPLs in the brief overview discussion that follows.

In many emerging markets, there may be a not insignificant presence of SOEs in the local economy. And yet many of these SOEs may be unprofitable, and, despite this, often the relevant national governments continue to pour money into these SOEs on an ongoing basis from year to year to keep them afloat.

Due to the pressures on a sovereign’s public finances from the COVID-19 crisis, a moment of reckoning may have finally arrived for a number of national governments in terms of how they handle unprofitable (and possibly even insolvent)
SOEs. Specifically, the governments may have to face a stark choice. They will have to decide whether such SOEs will need to be restructured [if that is possible] and/or privatised [either through a public sale of stock or by a sale to a private investor], or whether they will need to be liquidated.

A separate issue relates to non-performing loans (NPLs) in a national banking system. It is likely that, in view of the financial distress that many companies in emerging market jurisdictions are likely to face in the current crisis, the banks in the relevant emerging market jurisdiction will start to accumulate many non-performing loans on their balance sheets.

If the banks just sit on the NPLs and do not take any action to remediate the NPLs, the ability of the banks to lend will be curtailed to the extent that the banks are required to set aside loan loss reserves in connection with the NPLs. This will not be beneficial to the banks since after all they are in the business of lending, and it will not be beneficial to the national economy because lending is key to spurring new economic activity.

Thus, banks and national governments will have to develop effective strategies for addressing any significant build-up of NPLs in the national banking system. For banks, if they do not already have such a capability in place, they will need to establish a unit within the bank that is dedicated exclusively to handling the bank’s NPLs with the aim of maximising recovery on the NPLs.

In addition to considering recovery options based on litigation, restructuring, and/or an insolvency filing, banks might seriously explore whether there are any private investors interested in purchasing the NPLs at a discount from their face value [either individually or as part of a portfolio of NPLs]. This would be a relatively straightforward way for the banks to clean up their balance sheets.

As to the national governments, they might consider an approach that has been used in prior situations where national banking systems are confronting a huge volume of NPLs: establishing a so-called asset management company (AMC). The AMC would acquire the NPLs from the banks for a negotiated purchase price, and the AMC would then be tasked with realising value on the NPLs it had acquired.

Perhaps the COVID-19 economic crisis will stimulate creative new thinking on innovative approaches for handling NPLs on a large scale beyond the tried-and-true approach of establishing AMCs. The bottom line, though, is that there will need to be effective ways to address the issue of NPLs so that, first, the health of the banks and the banking system can be preserved, and, second, new lending (and therefore new or renewed economic activity) can take place.