

Thoughts on Ukraine Debt Relief:

Challenges and Opportunities



The RRR4U (Resilience, Reconstruction and Relief for Ukraine) consortium is a partnership of four Ukrainian civil society organizations with financial support from the Open Society Foundations and the International Renaissance Foundation. The consortium members are the Center for Economic Strategy, the Institute for Economic Research and Policy Consulting, the Institute for Analytics and Advocacy, and the DiXi Group.



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Executive Summary



The full-scale war of Russia against Ukraine resulted in large financial needs. The debt is estimated to exceed 100% of GDP already in 2025. Therefore, high debt burden creates debt sustainability risks and requires discussion of debt treatment.

In 2024 Ukraine negotiated an extension of the standstill-2022 on the official external debt and services fully the domestic debt and the debt to the IFIs. At the same time, the government is currently negotiating with Eurobond holders on the restructuring of approximately USD 20 billion in private debt as the two-year standstill agreement, reached at the beginning of the full-scale war, approaches its end in August 1, 2024. The positions of the government and the creditors differ significantly regarding the terms and conditions of new notes. The situation is tense, and the negotiations are challenging for both sides.

In this paper, we examine the broader context of Ukrainian debt and explore potential future policies that could benefit Ukraine, focusing on possible debt relief mechanisms in relation to domestic and external debt. The analysis brings us to the following consideration on the debt treatment for Ukraine:

- The restructuring of domestic bonds held by commercial banks will bring only a little relief while creating risks for financial stability, and thus is not advisable.
- The options for reprofiling of bonds in the portfolio of the NBU might be considered to bring down interest expenditures, but these options need to be thoroughly assessed so that the NBU will not bear losses. In any case, there is a little urgency on that as the debt is mainly long-term;
- Private external debt restructuring is the issue for the nearest future. Given the need for post-war fast economic recovery, retaining the market access for Ukraine would be very important to attract new debt and equity investments in future as soon as there is a window of opportunity. The private debt restructuring with the reasonable haircut, extra-long maturity and the minimal coupon payments on par at least on a short-term horizon might be the option for Ukraine. It still has to be accepted by private bondholders – they are looking to receive more favourable terms now, than Ukraine can offer. The crucial difference indeed is in the possibility to pay any coupon, which is not considered as possible under current IMF program and according to the Paris Club conditions.
- In terms of the other official debt and the debt to IFIs, Ukraine would benefit from the negotiation of debt swaps, even though there might be a haircut or partial writing off this debt in 2027, when standstill expires. The option of using debt-for-nature/climate swaps with official lenders as auxiliary tool for public debt management should be explored. In particular, there might negotiated the use of third parties (NGOs, development banks etc.) which have experience with both implementing debt conversions (serving as credit enhancement vehicles) and promoting the dialogue between debtors and creditors (serving as intermediary).

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- The negotiations with the IMF on the cancellation of the surcharges on loans would be beneficial for Ukraine's debt sustainability and should be negotiated.
- There is a need to ensure positive net inflow from IFIs, so that the debt and interest repayments are not higher than inflows during the next few crucial years.

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Introduction



The full-scale war of Russia against Ukraine resulted in large financial needs. The debt is estimated to exceed 100% of GDP already in 2025. Therefore, high debt burden creates debt sustainability risks and requires discussion of debt treatment.

In 2024 Ukraine negotiated standstill extension on the official external debt and services fully the domestic debt and the debt to the IFIs. At the same time, Ukraine is currently negotiating with Eurobond holders on the restructuring of approximately USD 20 billion in private debt as the two-year standstill agreement, reached at the beginning of the full-scale war, approaches its end in August 1, 2024. The positions of the government and the creditors differ significantly regarding the terms and conditions of a new loan. The situation is tense, and the negotiations are challenging for both sides.

In this paper, we examine the broader context of Ukrainian debt and explore potential future policies that could benefit Ukraine, focusing on possible debt relief mechanisms in relation to domestic and external debt.

Background



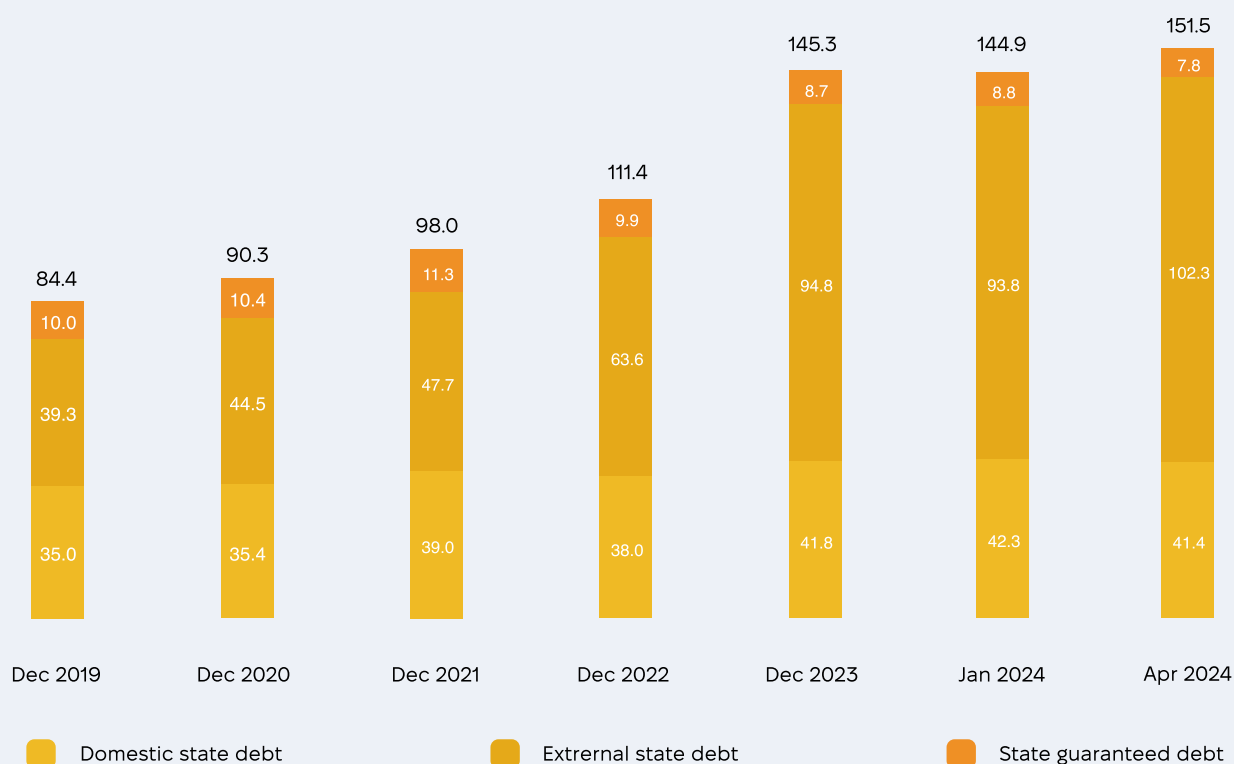
Before full-scale invasion by Russia, Ukraine's pre-war fiscal policies resulted in a decline of state and guaranteed by state debt from 80% of GDP in the end of 2016 to 50% of GDP in 2019. Ukraine succeeded not to increase debt-to-GDP ratio even during COVID-19 times. It was expected that cost of borrowings for the country would decline with economic growth and further policy improvements.

However, the situation changed substantially after February 24, 2022, when Russia started full-fledged war against Ukraine. As the government had to increase financing of defence and security, all other priority spending had to be covered by the international aid. Only part of the latter came as grants, while the rest were borrowings. As a result, state and state-guaranteed debt surged in relation to GDP and is expected to exceed 100% in 2025. As of end of April 2024, the total debt reached UAH 6 trillions or equivalent to USD 151.5 bn. State debt comprised 95% of total with 71,2% of those were external borrowings (see below more details).

Ukraine is facing significant fiscal challenges now and presumably in the next decade due to external debt repayments. This implies that a portion of the country's financial resources may need to be allocated to servicing debts, potentially impacting Ukraine's economic stability and development prospects.

Given the fiscal burden, seeking debt relief mechanisms becomes crucial for Ukraine. In 2022, the standstill was reached for Eurobonds until August 2024, which requires difficult negotiations now. On the positive side, the standstill on official debt lasts until 2027, giving Ukraine more lasting breathing space.

Figure 1. State debt and guaranteed by state debt of Ukraine, USD bn



Source: Ministry of Finance

Ukraine uses external financing to cover budgetary needs that have increased significantly during the full-scale invasion. About 50% of the state budget is spent on defence, and Ukraine finances these needs by internally-sourced revenues; the rest of the budget expenditures (primarily social support, education, healthcare, etc.) are covered by foreign financing, which explains the growth of Ukraine's external public debt. In such circumstances, it is very important to minimise external debt payments in order to free up fiscal resources to finance defence and priority social needs.

The Medium-Term State Debt Management Strategy for 2024 - 2026 (the Strategy), adopted in October 2023 as a response to war-related challenges and risks, has the majority of components, relevant and advisable for the execution. As it is rightfully pointed out in the document, **Ukraine's primary objective is to close its financing gap in order to continue to support the war effort and provide the basis for a rapid reconstruction of the country.** Therefore keeping the focus on attracting grants and low-interest, long-term debt for the war-time and immediately after is paramount. No hostile actions against any creditor (except for the aggressor and related parties) should be taken. This corresponds with the Objective 1 of the strategy - attract long-term concessional funding and maximise share of grants in official sector support.

If ranking the donors' efforts against this objective, the major and most beneficial partner during 2022-2023 was the USA, which has provided 22.9 bn as grants. It constituted approx 31.1% of the financial aid received by Ukraine during 2022-2023. The continuation of this support is key for Ukraine's debt burden easing, however, it is uncertain under likely challenging political circumstances in the US. Therefore, the US advocacy by Ukrainian officials and the civil sector must be prioritised as well as efforts to retain the trust of the US officials and taxpayers. Russian propaganda and disinformation campaigns must also be dealt with.

The EU, which provided mainly concessional loans within the macrofinancial aid framework, has developed a new approach to the medium-term support for Ukraine. The Ukraine Facility was approved for EUR 50 bn and 4 years, allowing for predictable and steady financing flow. Given the dire situation with the US and no guarantee that this turbulence won't become permanent, reliable and regular financial aid is of utmost importance. The terms of the support (mix of grants and highly concessional loans with interest non-payable at least for 10 years) is also beneficial for Ukraine. To fulfil the conditions of the EU, Ukraine must follow the 'Ukraine Plan', working on a set of reforms marked as conditionalities.

At the same time the loans from the IMF are coming in with the significant interest attached, and while it is important to stay in the programme as the umbrella for the other donors' support, the best way to avoid increasing of the immediate interest pressure on budget is to limit the amount of incoming funds to the amount that Ukraine has to redeem to the fund. Of course this would not be the case in a situation where the other sources are dried up, when any source of funding would be desirable. The advocacy for the cancelation of the IMF's surcharges and other measures potentially pushing down the cost of the debt service could be advisable here.

Scope and terms of debt treatment operations



Local State Debt



No restructuring for local commercial bondholders, possible reprofiling of the debt to the NBU

Domestic government bonds holdings are at UAH 1642 bn as of June 18, 2024. About 85% of them are owned almost equally by the NBU and commercial banks. The NBU entered the full-scale war period with the large portfolio of government bonds (UAH 313 bn). Its holdings more than doubled in 2022, when it has purchased directly from the Government UAH 400 bn of domestic bonds to finance the deficit, when there was an extreme need for financing of defence and security, against the backdrop of insufficient international financial assistance.



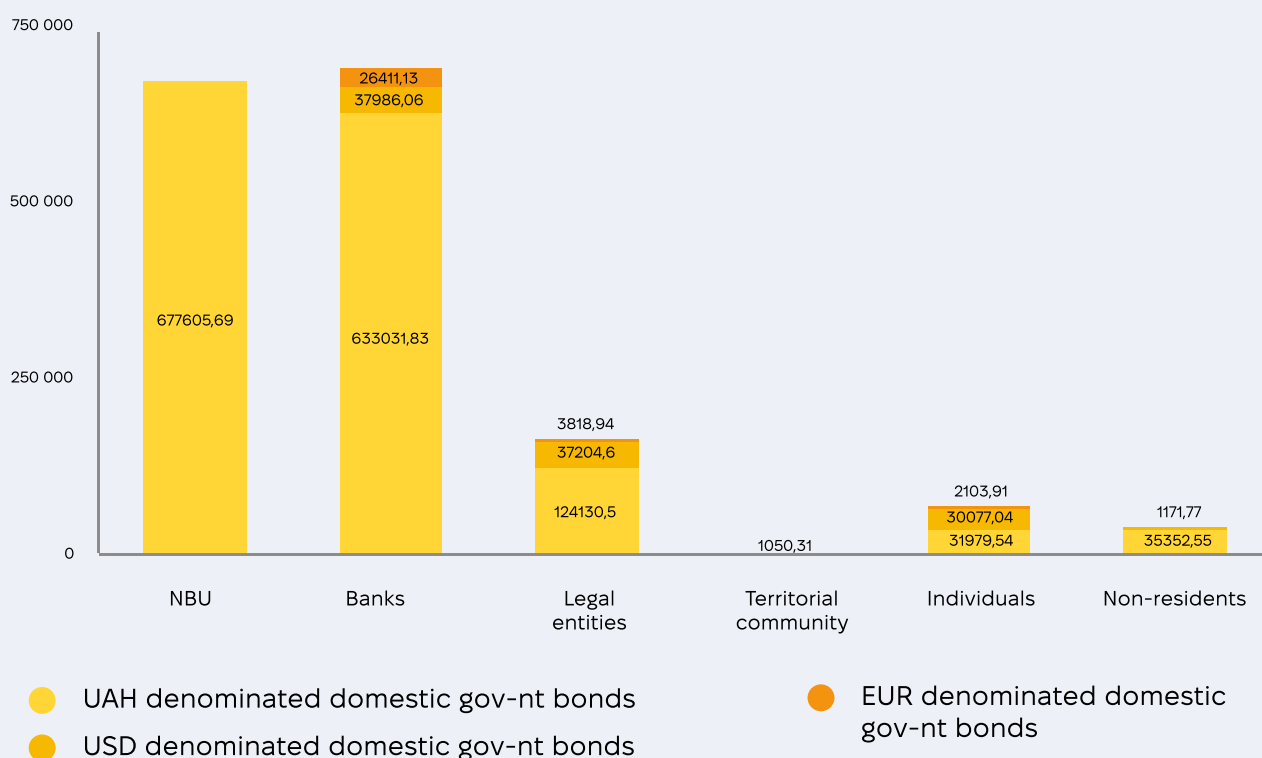
Commercial banks holdings: As of June 18, 2024, commercial banks own UAH 697 bn of domestic government bonds as compared to UAH 521 bn in the day of full scale invasion. Currently the demand for government bonds from banks is not high despite enormous liquidity cushion; the Ministry of Finance ensured the debt roll-over rates just above 100%, but not more. Any debt restructuring of this debt would be detrimental for the banking sector and financial sector stability.

First, state-owned banks account for more than 73% of the banking sector's government bond portfolio. Therefore, debt restructuring will result in the necessity to recapitalize these banks by the Government, resulting either in higher fiscal spending or additional issue of state domestic bonds (the latter was previously used for banks recapitalization).

Second, the banking sector showed resilience during the full-scale invasion. As a result, it kept the trust of population and business so far, and shaking this trust, risking the general stability, is inadvisable. The extra profits gained by the banks during the high interest rate period were subject to a windfall tax - it was introduced at 50% for 2023 profits and 25% for 2024 profits and, thus, this while sourced from the government bonds and the NBU's deposit certificates interest, contributed to increased fiscal revenues. State-owned banks also pay dividends from their profits to the budget.

To summarise, the restructuring of domestic bonds would undermine financial system in Ukraine and would be of a very little help to resolve challenges for fiscal situation.

Figure 2: Domestic government bonds by holders as of June 18, 2024, UAH bn



Source: NBU



NBU holdings: The NBU holdings at UAH 677 bn as of June 18 are more than twice higher than before the full-scale invasion. In 2022 the NBU monetised the deficit at UAH 400 bn (with a maturity of 30 years) through direct purchase of military government bonds. The interest on these bonds is floating and equals to annual average key rate of the NBU. Thus, the Government was paying 25% p.a. on these papers during prolonged period, with a declining trend now, after the inflation was tamed and the NBU has started the cycle of the key rate reduction. Overall, there is a possibility of the debt reprofiling (debt treatment) for at least UAH 400 bn of military bonds.

In fact, in 2017 the NBU and the MinFin already had an experience of debt reprofiling of about UAH 220 bn of bonds:



bonds worth about UAH 145.2 bn were converted into long-term hryvnia-denominated bonds with various periods of maturity and interest pegged to inflation



bonds worth about UAH 74.4 bn were swapped for long-term hryvnia-denominated bonds with various periods of maturity with fixed interest rates.

While the long term to maturity helps manage the debt burden from the face value redemption, the floating coupon increases the interest burden on the budget in high inflationary environment. The paid coupons are however accounted for within the NBU's revenues and then might be transferred back to the budget within the NBU's profits – but with a one-year lag.

In 2024 or in 2025, even if no further deficit monetisation is performed, the debt reprofiling might be considered as possible and needed to reduce government interest costs, as well as postpone post-war principal repayments. However, the parameters should be estimated thoroughly so that the NBU does not carry losses in 2024 or 2025 as its losses should be then covered from the budget.

At the same time, the previous reprofiling also provides lessons learned. The maturities of the bonds under reprofiling of 2017 were extended until 2047, and in case of the military bonds - until 2052. So, they are already long enough but could be extended further subject to how the general post-war debt redemption profile would look like. However, the rates are quite high for military bonds and under the risk for inflation-indexed bonds. As a result, the scenario of the reprofiling, which might be assessed, can include swap for bonds with fixed rather low interest rate, but the bond's principal might be indexed for inflation (with simultaneous increase in maturities, so that the Government does not face excessive payments to the NBU withing following years).

External official bilateral debt



In 2024 Ukraine has agreed with the Paris club on standstill on the official bilateral debt amounting 3.1 bn until 2027. Therefore, there is currently no payment of interest or redemption on this debt., It is considered a relief, even though it does not comprise a large share of Ukraine's external debt. For the future debt treatment on official external debt the **debt swaps** instrument might be considered as an option.

Debt swaps can be one of the potential mechanisms for debt relief which involves exchanging existing debt (principal and/or interest) for other financial instruments or forms of debt that may have more favourable terms. The analysed cases (Poland, Belize, Barbados, Seychelles, Cape Verde) demonstrate that debt-for-nature/climate swaps can be one of the options that would reduce Ukraine's debt burden and, at the same time, create a fiscal space for green recovery and development.

The evidence shows that debt swaps are rarely instrumental for large amounts of borrowings. However, the Government could still benefit from exploring the possibilities of such an option with some of the debt holders. In particular, this could be Germany which has a debt conversion facility as a component of the development cooperation budget. It allows for annual cancellation of up to 150 million EUR globally, covering only official development assistance claims. The funds from debt conversion can be used across a broad spectrum of German-Ukrainian development cooperation, encompassing social, economic, and environmental objectives.

So, in fact, the debt treatment on official bilateral debt is likely to take place by 2027, when the current standstill agreement with the Paris Club creditors expires in 2027. As aforementioned, it could include debt swaps. Moreover, we expect that part of the debt will be written off.

Box: Debt swaps

According to the previous study by the OECD, tripartite swaps have proven themselves better in countries that had problems with corruption and did not enjoy the trust of creditors. This necessitated the mediating role of an independent party, in particular NGOs. It is likely that in countries where democratization is underway, civil society is being strengthened, and the public administration system is being reformed, there will be no need to remove the management of the cost of restructured debt from government-controlled institutions.

Also, Ukraine will need to ensure the support of financial institutions (European Investment Bank, the World Bank, the DFC etc.) to ensure political risks and financial stability. Political risk insurance has become an important process in international practice in debt swap agreements.

Although it is difficult to give priority to environmental protection or climate projects in wartime conditions, green initiatives should be the subject of attention in the implementation of debt swaps. It is assumed that there will not be enough funding for them in such conditions. In the context of project selection, consider the importance of establishing clear criteria for selecting projects for financing and monitoring their implementation.

The conditions of recovery and stability are key to the successful implementation of debt swaps, and their effectiveness must be demonstrated through transparency and accountability.

External debt to IFIs and the EU



Contrary to the official bilateral debt, Ukraine still fully services all debt to the IFIs, including the IMF and the World Bank. The current IMF program indeed provides loans just enough to refinance the previously received and redeeming tranches.

The interest on the IMF loans has increased sharply for Ukraine as the lending is made over the quota, and Ukraine also pays surcharges on the loans never received (due to unfulfilled structural benchmarks). So, indeed, this part of debt is not cheap for Ukraine now.

Therefore, it would be important for the IMF to consider at least a cancellation of the surcharges within the potential debt relief mechanisms, as the restructuring of the IMF loans is not an option. We think that the new instrument should be considered: the IMF introduces new instrument of standstill on interest and reimbursement for countries under the external threat similar to Ukraine's case.

While Ukraine enjoys the subsidy for the loans received from the EU in 2023 and 2024, it still should fully serve the loans received under previous Macrofinancial assistance programs. Therefore, there is a need to extend interest rate subsidy also for the loans received before as well as ensure longer maturities for them. This requires discussion in the EU and amendments to the EU budget as the Ukraine Facility does not have room for such payments.

External private debt



One of the main objectives of the public debt management policy is to allow Ukraine to return to the market as soon as possible after the end of the war, given the need for financing reconstruction and recovery. At the same time, the private debt treatment now seems inevitable as Ukraine doesn't have enough resources for debt redemption or servicing. Therefore, the private debt restructuring becomes difficult.

Despite the fact that the Ministry of Finance managed to reduce the need for financing for 2024 by almost USD 7 bn to USD 53 bn in comparison with 2023, the need is still significant. But negotiations on debt treatment for Eurobonds are currently debated with little ground for mutual positions between Ukrainian government and private bondholders. The financial needs will be high during next years and, thus, the Government should negotiate for lower payments on debt servicing and redemption to save money for essential defence and social expenditures. The creditors, on the other hand, need to start receiving at least some interest payments and are keen to maximise the net present value of the future cash flows, even while allowing for the maturity extension.

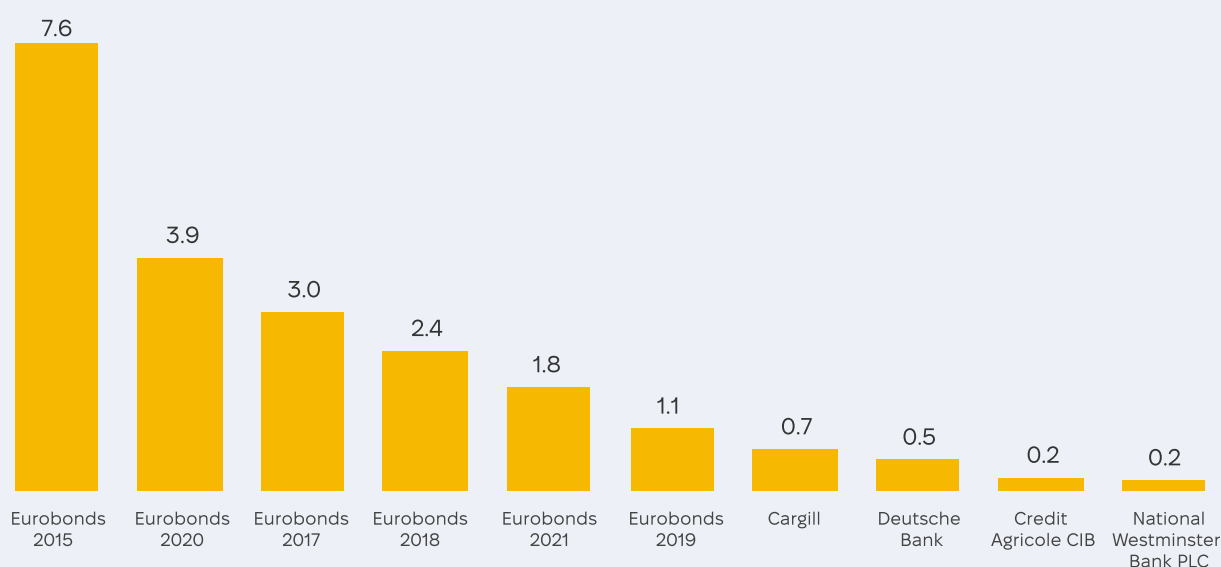
There are two conflicting goals of the private debt restructuring. On the one hand, a restructuring approach should aim at restoring debt sustainability and reducing cash flow pressure for Ukraine. That means that it should ease the debt burden and minimise current payments from the wartime budget and the immediate post-war budget to as much extent as possible.

On the other hand, the restructuring proposal on Eurobonds should provide a possibility to return to the markets as soon as possible after the war ends as it is necessary to cover huge funding needs for financing reconstruction and recovery.

The true art in designing and negotiating the deal would be to find a compromise between these two goals. There is however a recent Ghana restructuring example, which could support the government's position on a larger haircut.

As of the end of April, the current amount of outstanding private external debt is USD 21.3 bn (or UAH 845 bn in equivalent, without taking into account so-called Yanukovich bonds, which are described below), accounting for nearly 14% of total public debt. The largest part of this debt is Eurobonds - USD 19.7 bn. The price of securities at the middle of June 25-28.9 per dollar, depending on the maturity.

Figure 3: State external private debt by instruments as of Apr. 30, 2024, USD bn



Source: Ministry of Finance

Additionally, there is also a guaranteed by state external private debt at USD 2.54 bn (as of end of April 2024). This includes Eurobonds for Ukravtodor and Ukrenergo worth USD 1.53 bn and commercial loans from Chinese banks worth USD 1.02 bn.

While the current restructuring negotiations are shortly assessed below, some other potential options for external private debt restructuring are outlined in Annex 1.

Which options for restructuring are on the table?

The prior option - **standstill extension** on the same terms as official creditors - until 2027 – is not on the table at the moment as the government has made a restructuring proposal, and the creditors have entered the heated negotiations on its terms for restructuring 20% of outstanding Eurobonds.

Currently, there is a significant divergence of restructuring options put on table by the government and by investors. Ukraine has put forward two options for restructuring.

- **The first option** includes vanilla bonds with 40 cents per dollar and a value recovery instrument. The coupon rate of vanilla bonds will be minimal in the short term and will gradually increase thereafter, starting from 1% in 2024-2025 to 6% in 2028 and onwards. An average maturity for the new bonds is 12 years. The value recovery instrument (VRI) will be linked to GDP growth and tax revenues, in comparison to the IMF's baseline scenario. Should this scenario materialise, investors will receive vanilla bonds at 35 cents per dollar in 2027, which would recover part of haircut agreed in 2024. In fact, this gives a haircut of between 25% and 60%, depending on the performance of the Ukrainian economy.
- **The second option** includes only vanilla bonds without VRI with 47.5 cents per dollar and all other parameters (maturity, coupon payments) remaining unchanged.

The bondholders' proposal also includes vanilla bonds and VRI, but with much less favourable for the Government terms. Firstly, the interest rate is set at 7.25% from 2024 onwards and the haircut is just 20%. Additionally, the shorter maturity of the new bonds is an unfavourable aspect for Ukraine, as the offer comprises two series maturing in 2034 and 2035. The IMF has opposed the creditors' proposal, stating that it does not align with Ukraine's IMF debt sustainability targets. Furthermore, official creditors have emphasised that any cash flows during the IMF program period must remain minimal.

It is evident that both offers include VRIs, which is a common feature of current sovereign debt restructurings. For instance, Zambia, Suriname, and Sri Lanka have also employed these instruments in the restructuring of their debt. It should be noted that these instruments are not always beneficial for the country. Historical precedent indicates that the activation of VRIs in Suriname and Zambia might result in minimal debt relief for both countries.

Another potential risk is that the proposals only consider an upside scenario, which may not align with the reality of a worsening economic situation in Ukraine. In the case of a downside scenario, Ukraine may not receive the additional debt relief it requires.

Overall the investors' proposal for Ukrainian debt restructuring is excessively harsh and fails to consider the country's current wartime situation. The creditors' stance could result in Ukraine defaulting if an agreement is not reached by August. Both parties confirmed that negotiations are ongoing and that a mutually acceptable solution can still be reached. Ukraine might be negatively affected by a default on its obligations, so it is hoped that the parties will reach a compromise by August 2024, with the objective of minimising payments in the short term. And a strong argument that could be used in negotiations for more favourable restructuring terms is the recent Ghana private debt restructuring deal, under which investors accepted 37% of debt write-off.

External debt to Russia (Yanukovych Eurobond): write-off on legal grounds of aggression



Ukraine, that time under the pro-Russian Viktor Yanukovych rule, issued the USD 3 bn Eurobond carrying interest at 5% per annum on 24 December 2013 maturing on 21 December 2015. It was serviced up until mid 2015, when the Crimea annexation and war in Donbass has pushed Ukraine to severe financial crisis and forced the government to offer creditors bonds restructuring. While the other bondholders accepted the new terms, Russia has never agreed. The subsequent court proceedings are ongoing since 2016 (and lasted for 8 years already) - Ukraine disputes the enforceability of the Notes while Russia demands to be paid (see more background on courts proceedings in Annex 2). As of early 2024 only the possibility of the court hearing on the matter has been determined and Ukraine was permitted to defend its claim. So at best the situation will not be resolved within the next few years.

The best possible outcome would be the court permission to Ukraine to write the debt off as soon as possible on the grounds of the aggression and countermeasures, and we believe the situation would benefit from the international level discussion within the Ukraine Multi-donor support community to explore legal solutions in advance.

Russian assets as a source of funding Ukraine's war-time budget



One of the possible and highly desirable sources of funding for the war and post-war period is the funds sourced from the aggressor country. **To ensure the access to the russian frozen assets, starting from the taxation of the windfall revenues** and moving to the full confiscation would be the way to fund the needs of Ukraine without creating an unnecessary debt burden for future generations and additional trigger points of fiscal destabilisation, when such debt would become due and payable. The legal, political and economic arguments against the frozen russian assets confiscation must be systematically addressed and the way to use the russian assets for funding Ukraine's war effort and post-war recovery should be found.

The Euroclear, a clearing-house in Belgium, holds some USD 207 bn (€191 billion). The rest of the assets are located in other, not disclosed jurisdictions. Currently the latest G7 meeting (Italy, June 2024) has made a decision to make available for Ukraine approximately USD 50 billion leveraging the extraordinary revenues of the immobilized Russian sovereign assets. The full confiscation of the russian CB's assets allegedly totalling USD 300 bn (the latest available russian statistics data) is the question of more distant future, but is still on the table as one of the options and should be facilitated as urgently and efficiently as possible.

Conclusions



The Medium-Term State Debt Management Strategy for 2024 - 2026 (the Strategy) states that **Ukraine's primary objective is to close its financing gap in order to continue to support the war effort and provide the basis for a rapid reconstruction of the country.** Therefore keeping the focus on attracting grants and low-interest, long-term debt for the war-time and immediately after is paramount. No hostile actions against any creditor (except for the aggressor and related parties) should be taken. This corresponds with the Objective 1 of the strategy - attract long-term concessional funding and maximise share of grants in official sector support. Indeed, Ukraine faces high financial needs as a result of full-scale invasion by Russia.

The analysis brings us to the following consideration on the debt treatment for Ukraine:

- The restructuring of domestic bonds held by commercial banks will create risks for financing market in Ukraine, and thus should not be discussed.
- The options for reprofiling of bonds in the portfolio of the NBU might be considered, but they need be thoroughly assessed so that the NBU will not occur losses;
- Given the need for post-war fast economic recovery, retaining the market access for Ukraine would be very important in order to attract new debt and equity investments. Therefore to keep the dialogue with the private markets to be able to issue new debt as soon as there is a window of opportunity should be the strategic priority.
- The private debt restructuring with the reasonable haircut, extra-long maturity and the minimal coupon payments on par at least on a short-term horizon might be the better option for Ukraine. Indeed, the debt restructuring with a haircut and standstill on coupon for several years would be a great option for Ukraine, but unlikely to be accepted by private bondholders.
- Ukraine would benefit from the negotiation of debt swaps on official debt, even though we expect haircut or partial writing off this debt in 2027, when standstill expires. So, the option of using debt-for-nature/climate swaps with official lenders as auxiliary tool for public debt management should be explored. In particular, there might be negotiated the use of third parties (NGOs, development banks etc.) which have experience with both implementing debt conversions (serving as credit enhancement vehicles) and promoting the dialogue between debtors and creditors (serving as intermediary);
- The negotiations with the IMF on the cancellation of the surcharges on loans would be beneficial for Ukraine's debt sustainability and should be negotiated.
- There is a need to ensure positive net inflow from IFIs, so that the debt and interest repayments are not higher than inflows during the next few crucial years.

Annex 1. Alternative approaches for debt restructuring



Donor guarantees behind Eurobonds restructuring - replacing existing debt with long-term bonds backed by guarantees from our partners.

This option is based on the experience of Brady Bonds (named after Nicholas Brady, then-US Treasury Secretary) were long-term securities, issued primarily by Latin American developing countries in the late 1980s- early 1990s, to tackle their debt crisis. These bonds, with maturities of up to 30 years, were backed by the US Treasury bonds. The initiative aimed to provide highly indebted countries with access to international markets and restore their financial stability.

However, there are at least two factors that differentiate the Ukrainian situation from the classical Brady-bond scheme. First, initially, those bonds were aimed to replace bank loans with liquid newly issued bonds. Ukraine will restructure already existing Eurobonds. The second issue is that under the Brady initiative, indebted countries were buying zero-coupon bonds as collateral for newly issued securities. Ukraine does not have free liquidity to do this, so the possible option is to attract a guarantee from our partners.

So, the suggested for the consideration design of the proposal under this approach might include debt relief instruments like **extended maturities (up to 30 years), haircuts or lower yields.**

The main advantage of this approach is taking legacy debt out of the game, so new investors will not compete with the existing ones for the payments, making new bonds more attractive and therefore helping to return to the market quickly.

The possible external risks for successful debt relief under this approach are the current global economic outlook and high uncertainty in global markets.

Another possible option is creating a **restructuring proposal mirroring the terms and conditions of the EU Facility Program:** a 10-year grace period, long-term loans up to 35 years, but the interest (low and equal to the interest on the EU Facility debt) would still be paid to bondholders. The proposal might also contain a guarantee on the part of the par value of bonds from the US or the G7 as a consortium.

Bonds buy-back would be a favourable option for the government since it would save money for future payments and reduce its debt burden. However, due to current liquidity constraints, finding resources for this operation is difficult. Partner funding may also be challenging as they are not willing to use taxpayers' money for Ukrainian private creditors' payments. The possible solution is to use frozen Russian assets or at least profits from these assets.

In case the Government finds possibilities to execute this scenario, GDP-linked warrants should be considered for buy-back first. Those securities were issued during the previous debt restructuring back in 2015 as a sweetener for investors. Under the issuance terms, Ukraine will face additional payments if the GDP growth rate exceeds 3% and nominal GDP exceeds USD 125 bn. The first payments were

made in 2021 and amounted to USD 40.75 M, the payments in 2023 were rescheduled as a result of negotiations with investors in August 2022. So possible rapid recovery will trigger more budget expenditures for servicing these securities. Worth to mention, that Ukraine already made a buy-back of these warrants twice: in 2020 and right before the full-scale invasion in February 2022. After these operations, MoF holds 20% of GDP warrants.

Annex 2. Yanukovich Eurobond

The bond issuance took place during the period of the Maidan revolution but before the heated events of January, and under the massive unlawful and illegitimate economic and political pressure by the Russian Federation. Russia was issuing threats to Ukraine's territorial integrity and of the use of unlawful force, to deter the administration from signing an Association Agreement with the European Union and to induce acceptance of the Russian Federation's financial support instead. This support came in the form of the Notes. Following the decision by Ukraine not to sign the Association Agreement, protests in Ukraine grew and ultimately President Yanukovich fled to Russia on 21 February 2014. Shortly afterwards, the Russian Federation invaded Crimea and annexed it. Then Russia has interfered militarily and succeeded in destabilising and causing huge destruction across eastern Ukraine. In February 2022 the full-scale Russia's invasion of Ukraine started, ultimately unmasking Russia's intentions behind the previous, semi-curtained steps.

Ukraine has already made three payments under the Notes in the full amount of interest, when in May 2015 the severe financial crisis forced the country to impose a moratorium on some of its debt obligations, including the Notes. While the other private creditors agreed for the Eurobonds restructuring, the exchange offer was not accepted by Russia. On 18 December 2015, Ukraine's CMU adopted a resolution imposing a moratorium on Ukraine's payment obligations under the Notes, effective 20 December 2015. No further payment was made.

The subsequent court proceedings are ongoing since 2016 (and lasted for 8 years already) - Ukraine disputes the enforceability of the Notes while Russia demands to be paid. At this stage (as of March 2024) only the possibility of the court hearing on the matter has been determined and Ukraine was permitted to defend its claim.

On 29 March 2017 the court entered summary judgement against Ukraine holding that there was no compelling reason for a trial. Ukraine has appealed. On 14 September 2018, the Court of Appeal has granted Ukraine a permission to appeal to the Supreme Court. With the latest decision on 15 March 2023 the Supreme Court has allowed the trial, which is to follow in the coming periods. This was a desirable outcome for Ukraine, but the main battle is ahead.

While a lot of Ukraine's pleas were dismissed by the court as unsustainable, the Supreme Court has still confirmed the relevance of one of Ukraine's arguments, giving it enough reasons for a court trial: "Ukraine's defence of duress, so far as based on the threats of the use of physical violence towards Ukraine's armed forces and civilians, and the threats of damage to, or destruction of, Ukrainian property, which were allegedly implicit in the threats allegedly made by Mr Glazyev on behalf of the Russian Federation, cannot be determined without a trial."

All the other Ukraine's arguments were dismissed. The Supreme Court ruled that Ukraine has no arguable case that it lacked capacity to issue the Notes; or that the Notes were issued without authority; or that Ukraine is entitled to withhold payment of the sums due under the Notes as a lawful countermeasure. Ukraine's appeal is therefore dismissed. One of the judges dissenting in part noted in his overview however that the countermeasures defence should also be permitted to proceed.

