VERITÉ RESEARCH
DEBT UPDATE

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The Verité Research Debt Update provides a regular update for investors, policy makers and analysts, on the latest developments in this space together with commentary and analysis on Sri Lanka's path to resolving its economic crisis since suspending debt repayment in April 2022.

Verité Research is an independent think-tank based in Colombo that provides strategic analysis to high level decision-makers in economics, law, politics, and media.

Lead Authors:

Nishan de Mel
Raj Prabu Rajakulendran
Harshana Wickramaarachchi

Research support:

Emaad Rizwan
Shalomi Liyanage

Editorial support:

Chathuni Pabasara

Series Advisor:

Udara Peiris*

For additional information contact:

debtupdate@veriteresearch.org

**Udara Peiris is also an Associate Professor at Oberlin College and a Global Academic Fellow at Verité Research*

KEY TAKEAWAYS

- **There was an overall 33% reduction in Net Present Value (NPV)** [dated for 31 March 2024] in Sri Lanka's debt restructuring when calculated on the actual post-restructure market discount rates (yields) as stabilised in June 2025 (see box 1).
- **35% of the debt-service-can was kicked down the road.** That is, it was pushed out to be paid beyond 2030 – past the point where the pre-restructure debt was due to be fully repaid. This was in NPV terms (discount rates in box 1). If assessed in nominal value terms, 72% of the payments were pushed out beyond 2030.
- **The debt exchange included a novel Governance-Linked Bond** designed by Verité Research Sri Lanka, and adopted and structured by Sri Lanka's ad-hoc creditor committee, its advisors Rothschild & Co, and the government of Sri Lanka. This bond offers an interest reduction of USD 70 million if 20 specific governance-related actions and KPIs are met over a period of 3 years.
- **Sri Lanka's debt exchange offered two options:** (1) The global option, with 82% take-up, and (2) the local option, with 18% take-up. The final debt exchange resulted in the issuance of five different types of bonds, including state-contingent, step-up, and floating rate bonds.
- **USD 273 million remained unexchanged (2.1%),** due to ongoing litigation with creditor Hamilton Reserve Bank.
- **Sri Lanka took 983 days to complete its ISB debt restructuring;** making it the third longest duration, out of 17 restructuring episodes, in the past decade.

OVERVIEW OF SRI LANKA'S INTERNATIONAL SOVEREIGN BOND DEBT EXCHANGE

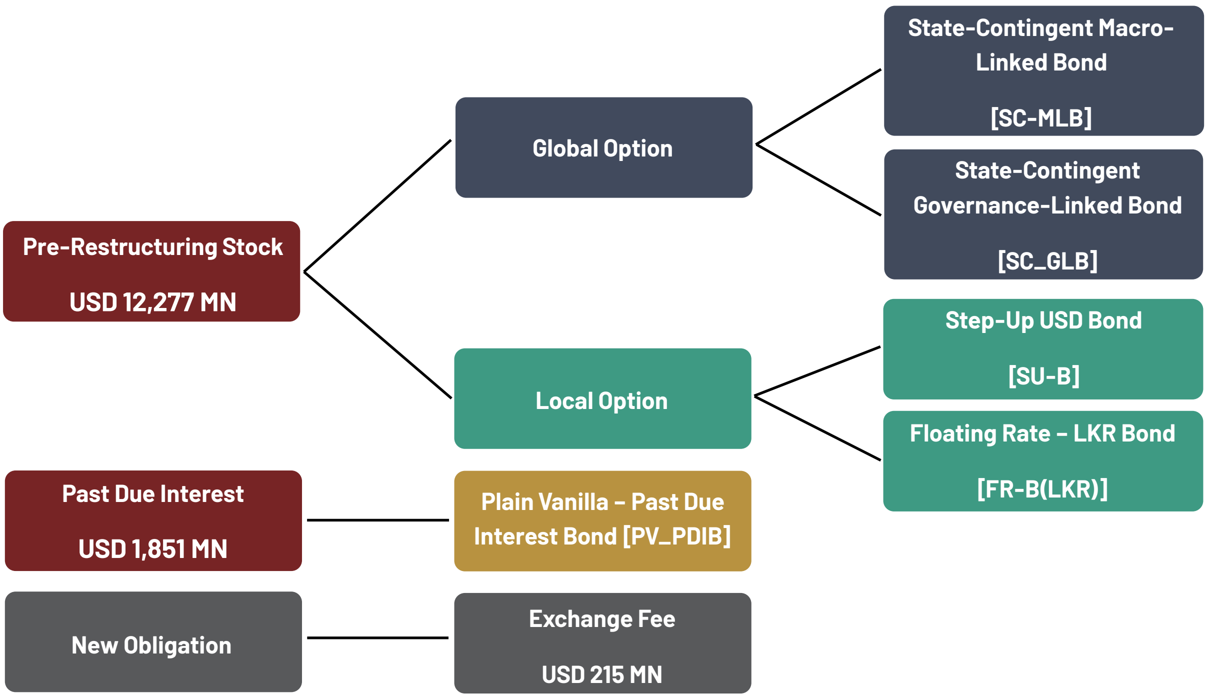
OUTSTANDING FACE VALUE OF DEBT RE-NEGOTIATED	INTEREST ACCRUED DURING THE NEGOTIATION PERIOD	AMOUNT OF OUTSTANDING DEBT NOT RESTRUCTURED	AMOUNT OF OUTSTANDING DEBT RESTRUCTURED
USD 12.5 billion	**USD 1.9 billion**	**USD 273 million** (2.1% of outstanding)[1]	**USD 14.1 billion**

The restructuring was based on the in-principle agreement reached in September 2024[2], offering bondholders two options: a global option and a local option (see Exhibit 1).

The final debt exchange resulted in the issuance of five different types of bonds, listed here in order of issue size (Exhibit 2):

- State-Contingent macro-linked bonds [SC-MLB]
- Plain Vanilla Past Due Interest bond [PV-PDIB]
- State-Contingent governance-linked bond [SC-GLB]
- Step-up USD bond [SU-B]
- Floating Rate LKR bond [FR-B(LKR)]

Exhibit 1: Schematic of Sri Lanka's ISB debt restructure



1 due to ongoing litigation with Hamilton Reserve Bank

2 Singapore Exchange (SGX). "Sri Lanka: Announcement of Agreement in Principle" at https://bit.ly/3Ykrnt4 [last accessed 03 April 2025].

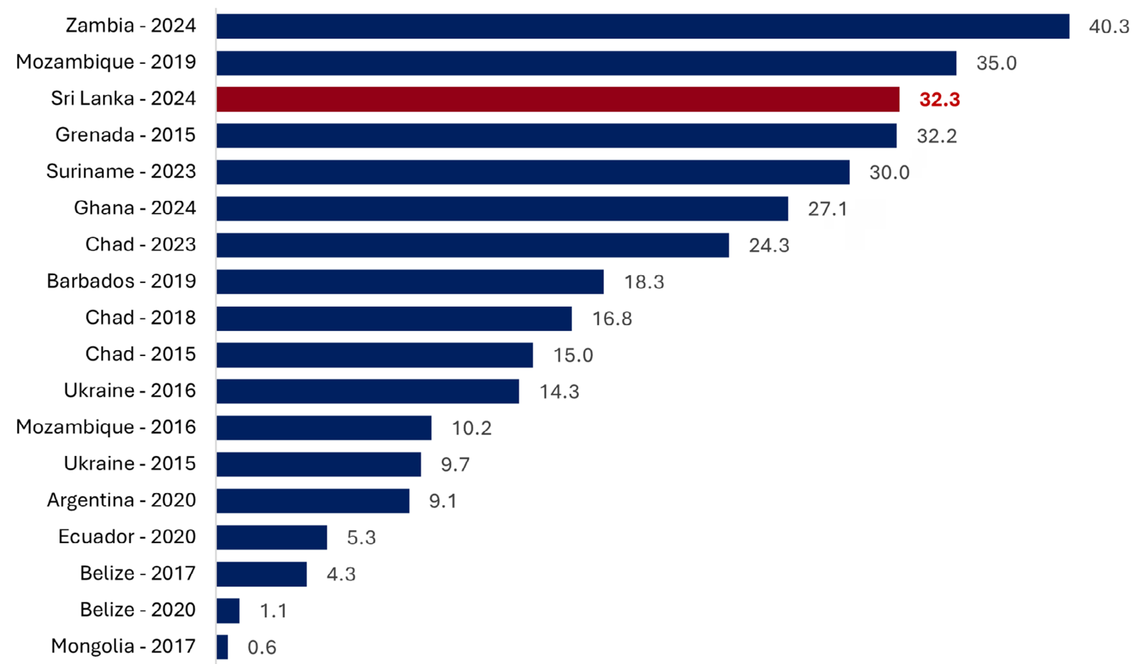
Exhibit 2: Options and outcomes in Sri Lanka's ISB debt restructure

Option	Global Option	Local Option
Percentage	82.1%	17.9%
Instrument	State-Contingent Macro-Linked Bond - [SC-MLB] (56.7%)	Step-up USD Bond - [SU-B] (10.3%)
	State-Contingent Governance-Linked Bond - [SC-GLB] (13.1%)	Floating Rate LKR Bond - [FR-B(LKR)] (4.9%)
	Plain Vanilla Past Due Interest Bond - [PV-PDIB] (12.3%)	Plain Vanilla Past Due Interest Bond - [PV-PDIB] (2.7%)

TIME TAKEN TO RESTRUCTURE

Sri Lanka successfully completed its international sovereign bond (ISB) debt restructure on December 20, 2024, concluding a prolonged process that lasted 983 days since the suspension of debt repayments in April 2022. This extended period places Sri Lanka among the countries with the longest debt restructuring timelines in the past decade, surpassed only by Zambia (40.3 months) and Mozambique (35 months) (see Exhibit 3).

Exhibit 3: Time taken to complete debt restructuring (Figures in number of months)



Source: Analyzed based on data published with Asonuma, Tamon and Christoph Trebesch (2016): "Sovereign Debt Restructurings: Preemptive or Post-Default", Journal of the European Economic Association Vol 15(1),

SUMMARY OF THE DEBT RESTRUCTURING OUTCOME

Exhibit 4: Methods of debt reduction as applied

		Before Restructuring	After Restructuring	Change
Reduction in Face Value (Figures in USD MN)	**Original Face value**	12,277	10,742	-12.5%
	PDI	1,851	1,648	-11.0%
	Total Face Value	14,128	12,390	**12.3%**
Reduction in Coupon Rate (Weighted average coupon rate weighted by both duration and face value)		7.1%	5.3%	**(1.8)**
Maturity Extension (Weighted average duration by face value)		4 years	10 years	**+ 6 years**

The debt relief was achieved through three primary measures, summarized in Exhibit 4:

1. **Reduction in Face Value:** The face value of Sri Lanka's ISBs was reduced by 12.3%, from USD 14,128 million to USD 12,390 million.

2. **Coupon Rate Reduction:** The Weighted Average Coupon Rate (WACR) was reduced by 1.8 percentage points, from 7.1% to 5.3% (weighted by face value and duration).

3. **Maturity Extension:** The average maturity of Sri Lanka's debt was extended by 6 years, from an initial 4 years to a post-restructure maturity of 10 years.

The Net Present Value (NPV) of the debt reduction achieved was 32.9%, [dated for 31 March 2024], when calculated on the actual post-restructure stabilised market discount rates (yields) in June 2025 (see Box 1).

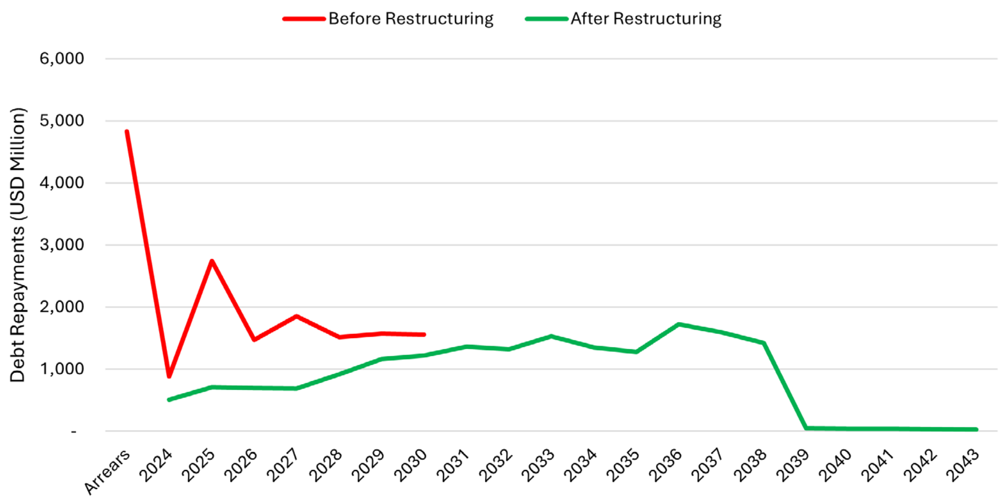
BOX 01 - The following assumptions were made in calculating the NPV Reduction:

- The calculation assumes Scenario 6 for the SC-MLBs (see section on Macro-Linked Bonds for more), which is based on the IMF's analytical assessment of economic projections.
- For USD-denominated bonds, two discount rates were used:
  - For cashflows up to 2030: 7.1%, is the weighted average coupon rate on the pre-restructure stock (see exhibit 4).
  - For cashflows after 2030: the discount rate applied was 8.2%, which is the average reported yield, as stabilised in June 2025, of Sri Lanka's outstanding international bonds maturing after 2030.
- For the LKR-denominated bond, a discount rate of 12% was used, which is the average quoted yield for these bonds in June 2025 by the Central Bank of Sri Lanka. As this is a floating rate bond, the Sri Lanka Standing Lending Facility Rate (SLFR) is assumed to be 8.25% on average until maturity.
- It is assumed that KPIs for the Governance-Linked Bond were met.
- The debt repayment calculations include the USD 215 million that was paid as an exchange fee.

QUANTUM OF THE DEBT-SERVICE-CAN THAT IS KICKED DOWN THE ROAD

Kicking the debt-service-can down the road means creating previously non-existent debt repayment obligations in later periods, in order to reduce the obligations in earlier periods (See exhibit 5).

Exhibit 5: Sri Lanka's ISB repayments before and after restructuring



Sri Lanka's debt, pre-restructuring, was due to be fully paid by 2030. Post-restructuring, it will be fully paid only in 2043. Around one-third of the debt servicing in NPV terms, and about three-fourths in nominal terms, was kicked down the road – that is, beyond the original payment horizon of 2030, when the pre-restructure debt was due to have been fully repaid.

Exhibit 6: Extent of debt service postponement

Figures in USD MN		Old Debt	New Debt	Net Increase (+) or Decrease (-)
Net Present Value*	Upto 2030	13,865.6	4,417.2	(-) 68.1%
	After 2030	-	4,880.3	(+) 35.2%
	Overall	13,865.6	9,297.5	(-) 32.9%
Nominal Terms	Upto 2030	16,413.8	5,887.8	(-) 64.1%
	After 2030	-	11,751.3	(+) 71.6%
	Overall	16,413.8	17,639.0	(+) 7.5%

*See box 1 for discount rates used for the NPV calculation

Net present value (NPV) of the debt-service-can that is kicked down the road

The repayment that is kicked down the road (for after 2030) is 35.2% of the NPV of the pre-restructure dues. Up to 2030, the repayment in NPV terms was reduced by 68.1% of the pre-restructure value (Exhibit 6).

Nominal value of the debt-service-can that is kicked down the road

The repayment that is kicked down the road (for after 2030) in nominal terms is 71.6% of the pre-restructure value. Up to 2030, the repayment in nominal terms was reduced by 64.1% of the pre-restructure value (Exhibit 6).

THE NOVEL GOVERNANCE-LINKED BOND

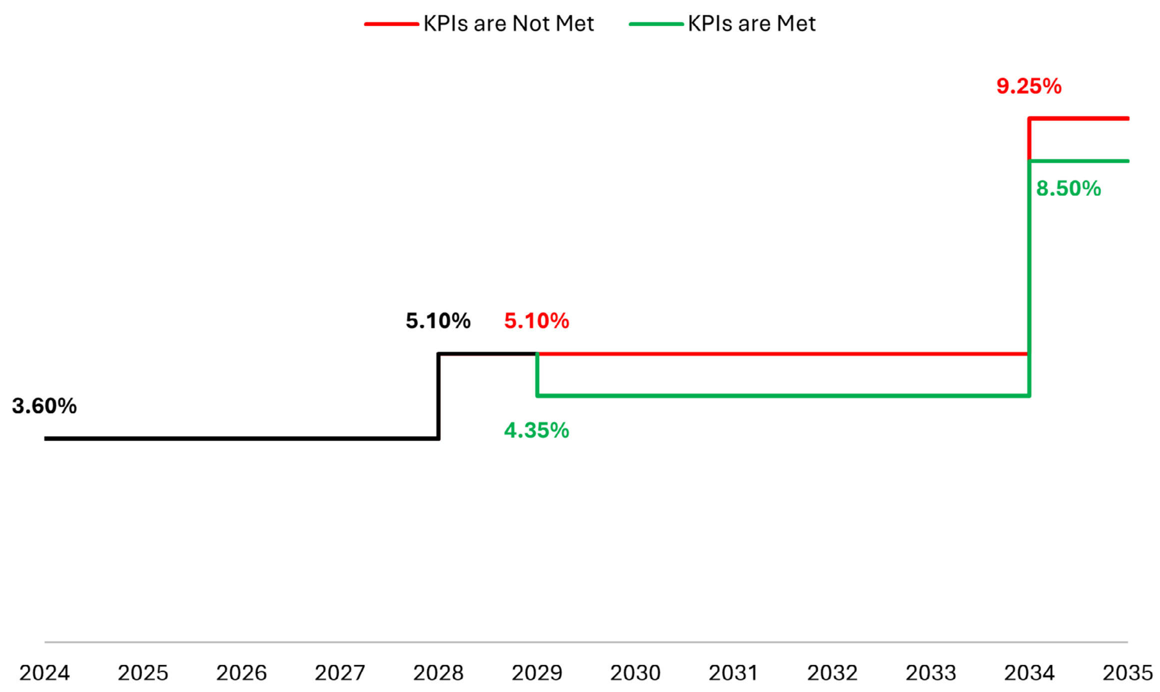
The State-Contingent Governance-Linked Bond [SC-GLB] is a novel financial instrument that ties debt relief to the completion of specific governance actions. This idea was first mooted by Verité Research at DebtCon6 in April 2023, and subsequently developed by Verité Research into a formal design that was incorporated into Sri Lanka's debt restructuring framework by Sri Lanka's ad-hoc creditor committee, its advisors Rothschild & Co, and the government of Sri Lanka.

The SC-GLB offers a coupon step-down of up to 75 basis points (see Exhibit 7). The expected relief from the SC-GLB is a nominal saving of USD 70 million if Sri Lanka successfully meets the governance KPIs by November 2028.

In order to benefit from the coupon step-down, Sri Lanka has to complete 20 discrete, time-sensitive actions over the course of 3 years. All actions and KPIs will be evaluated for compliance on November 15, 2028, although non-compliance can be identified as early as 2025.

This new SC-GLB instrument is expected to be used by new sovereign issuers in emerging and frontier markets in the years to come.

Exhibit 7: Coupon structure of the Governance-Linked Bond



THE MACRO-LINKED BONDS

The State-Contingent Macro-Linked Bond [SC-MLB] adjusts debt relief based on future economic growth. This bond represents the largest share of Sri Lanka's restructured ISB debt, accounting for 56.7% of the total. SC-MLBs are structured to adjust Sri Lanka's debt relief based on two key criteria:

- The average USD value of Sri Lanka's nominal GDP between 2025 and 2027.
- The cumulative real GDP growth between 2024 and 2027.

These two criteria interact to create six potential debt reduction scenarios (S1-S6), ranked from the highest to the lowest level of debt relief (see Exhibit 8). The restructuring agreement frames:

- S1-S2 as scenarios of "economic downturn."
- S3 as the "IMF baseline," expected outcome.
- S4-S6 as "exceeding growth expectations."

Initially, Sri Lanka was expected to land in Scenario 3 (S3), which would have resulted in an NPV reduction of 39.7%. However, based on the latest IMF projections for 2025-2027, Sri Lanka is now expected to land in Scenario 6 (S6), the lowest debt relief scenario in absolute terms, if the country maintains an annual economic growth rate of above 3%[3] (see Exhibit 8).

However, in this scenario, Sri Lanka will be in a better macroeconomic position than was envisaged under the IMF baseline scenario. That is because, while it will receive less debt relief, the stronger economic performance will more than offset the increase in debt service, resulting in a lower debt ratio and a lower debt service burden, relative to GDP, than was projected in the baseline scenario.

Exhibit 8: Structure of the Macro-Linked Bonds

Scenario	Nominal GDP (Average, 2025-2027, USD billion)	Cumulative Real GDP Growth Rate (2024 – 2027)	Avg GDP Growth Rate (2025-27)	NPV Reduction
S1	84.7 or below	Lower than 11.5%	Less than (-) 8.3%	45.4%
S2	86.7 or below	Lower than 11.5%	(-) 8.3% to (-) 7.2%	41.1%
S3 ("IMF Baseline")	86.7 to 94.0	Any	(-) 7.2% to (+) 2.0%	39.7%
S4	94.0 or above	Higher than 11.5%	N/A	35.7%
S5	99.0 or above	Higher than 11.5%	(+) 2.0% to (+) 3.0%	33.5%
S6	107.0 or above	Higher than 11.5%	More than (+) 3.0%	32.9%

THE LOCAL OPTION BONDS

The Local Option accounted for 17.9% of new debt obligations, primarily subscribed to by local banks for their existing ISB holdings. This option included two types of bonds:

1. Step-up USD-denominated bonds [SU-B] - 70% of the bundle, featuring a 10% upfront face-value reduction and a coupon rate increasing from 1% to 3.5% until maturity.

2. Floating Rate LKR-denominated bonds [FR-B(LKR)] - 30% of the bundle, which are floating-rate bonds with payments tied to the Standing Lending Facility rate (SLFR) plus 0.5%.

3 Assuming a deflator of 5% and an annual depreciation rate of 4.2% (based on March 2025, IMF review)

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A | No. 5A, Police Park Place, Colombo 5

T | +94 11-2055544

E | reception@veriteresearch.org