Sovereign Debt News Update No. 164: Senegal’s Total Return Swap Deal and the Expansion of Hidden Debt in Africa

By:

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Senegal’s recent debt developments mark a significant shift from conventional sovereign borrowing toward complex financial engineering, with the total return swap emerging at the center of its strategy to manage mounting fiscal pressures. The disclosure that Senegal raised approximately €650 million (US$750 million) through an undisclosed arrangement has drawn attention not only because of its opacity, but because of the specific instrument used. A total return swap (TRS) is not a traditional loan, yet it creates debt like obligations that can remain hidden from official statistics. The TRS transaction occurred just a few months after authorities uncovered about US$7 billion in previously undisclosed debt accumulated by the prior government. This raises serious concerns about transparency, accountability, and the integrity of sovereign debt reporting frameworks. At a time when African countries are under

heightened scrutiny from creditors and international financial institutions, Senegal's reliance on such instruments signals a troubling evolution in how governments may conceal liabilities while attempting to maintain short term fiscal stability. This update examines the structure and implications of Senegal's use of total return swaps, situating it within broader concerns around hidden debt and fiscal governance. It further assesses the risks such instruments pose for debt transparency, sustainability, and equitable treatment in sovereign debt processes.

Understanding the Total Return Swap in a Sovereign Context

The total return swap lies at the heart of Senegal's hidden debt controversy and requires careful unpacking. A total return swap (TRS) is a financial agreement between two parties: the total return payer (typically the asset owner) and the total return receiver (the investor). Under the contract, the total return payer transfers the full economic return of an asset such as bonds, an equity index, or a basket of loans. The return on this asset, such as interest payments and capital gains is transferred to the receiver. In exchange, the receiver makes floating rate payments, usually based on Secured Overnight Financing Rate (SOFR) plus a spread. The total return receiver then gains the asset's income and capital appreciation without direct ownership. As structured finance analysis emphasizes, this separation of economic exposure from legal ownership allows leverage and synthetic financing while obscuring who ultimately bears risk. Conversely, the total return payer shifts the asset's market and credit risks onto the receiver. At the end of the contract, the receiver compensates the payer for any decline in the asset's value or, conversely, benefits from any appreciation. A TRS is therefore classified as a credit derivative and serves as a form of synthetic financing. In essence, a total return swap allows one party to receive the economic benefits of an asset, such as returns on bonds or revenues, without owning that asset outright, in exchange for a stream of payments.

In the sovereign context, this means Senegal was able to obtain immediate liquidity from counterparties while committing to pass on future returns linked to underlying assets or financial flows. Crucially, because this arrangement is structured as a derivative contract rather than a direct loan, it may not be recorded as public debt under standard reporting frameworks. This creates a

significant transparency gap, as the economic reality of the obligation mirrors that of borrowing, even if it is not formally classified as such. Analysts have warned that this blurring of definitions allows governments to accumulate liabilities that remain invisible to both domestic oversight bodies and international creditors.

The Total Return Swap and the Associated Risks

Senegal's use of a total return swap must be understood against the backdrop of tightening global financial conditions and growing debt service pressures. With limited access to international capital markets and rising borrowing costs, the government faced an urgent need to secure liquidity without triggering alarm among investors or breaching debt thresholds. The total return swap offered an attractive solution by providing immediate funds while delaying formal recognition of the liability. This allowed Senegal to avoid default and maintain a semblance of fiscal stability in the short term. The Financial Times reports that that the first arrangement which was signed in May with the Africa Finance Corporation (based in Nigeria), allowed Senegal to access up to €350 million in funding. Under the agreement, the country initially received €105 million (US$113.4 million) in exchange for providing the lender with approximately €150 million in CFA franc-denominated sovereign bonds and committing to interest payments between 3.5% and 4% above a variable benchmark rate. A second deal, signed in June with First Abu Dhabi Bank, enabled Senegal to borrow €300 million (US$346.5 million) over three years. The agreement reportedly granted the bank claims on roughly €400 million (US$462 million) worth of sovereign bonds while charging an interest rate about five percentage points above a variable base rate. These loans are scheduled to mature in 2028.

This approach reflects deeper structural challenges, including dependence on external financing and vulnerability to global market shifts. By opting for a total return swap, Senegal effectively traded transparency for flexibility, a decision that may carry significant long-term consequences for fiscal credibility and debt sustainability. Senegal's use of total return swaps exposes it to a range of compounding financial and contractual risks. The agreements appear to embed severe downside penalties, including provisions that could allow lenders to mark pledged bond collateral to zero in the event of default, potentially

amplifying losses far beyond the initial financing received. The overall scale of exposure is also uncertain, with estimates suggesting that borrowing through such instruments could reach up to US$1 billion in a single year, raising concerns about hidden liabilities and incomplete debt reporting. Additional obligations tied to these arrangements, such as requirements to commit funds toward equity purchases and project financing, further strain fiscal space and divert resources from core budgetary needs. At the same time, rating-linked triggers in the contracts introduce heightened vulnerability to external assessments, allowing lenders to accelerate repayment if Senegal's creditworthiness deteriorates. Credit rating agencies have already downgraded Senegal's sovereign credit profile. Moody's cut the country's rating to Caa1 in October with a negative outlook, while S&P lowered its rating to CCC+ the following month. With these recent downgrades already pushing the country deeper into high-risk territory, these features collectively increase the likelihood of liquidity pressures, disorderly repayment demands, and a rapid escalation of debt distress.

IMF's Reaction and Senegal's Defence

The emergence of Senegal's total return swap has prompted concern among analysts and observers, particularly regarding the implications for debt transparency and governance. While official statements from international financial institutions such as the International Monetary Fund (IMF) have been cautious, there is increasing recognition that derivative based borrowing poses significant challenges to existing frameworks. The IMF has previously emphasized the importance of comprehensive debt reporting, noting that "*full transparency on public debt is critical for effective risk assessment and policy making*." The Senegal case illustrates the limitations of current systems in capturing complex financial arrangements, highlighting the need for updated standards and greater scrutiny.

However, Senegal has strongly defended this approach, rejecting claims that the borrowing was hidden or irregular. The Ministry of Finance has argued that the transactions were part of a deliberate strategy to "*diversify sources and instruments for raising funds*" and to manage the country's financing needs more efficiently. Authorities further maintained that the swap arrangements were conducted "in accordance with market transparency rules" and were in

fact more advantageous than prevailing international market rates, reportedly carrying an interest rate of around 7.1%. The government also emphasized that these operations were executed through domestic bond issuances and derivative structures as part of a broader effort to reduce borrowing costs and expand the investor base. In this sense, Senegal presents the total return swap not as an attempt to conceal liabilities, but as a pragmatic and innovative financing tool deployed under severe fiscal constraints.

Furthermore, IMF stated that while it was aware Senegal had entered into total return swaps, the full terms of these arrangements had not been shared, and it would therefore treat them as external debt in its assessments. In contrast, Senegal's Ministry of Finance maintained that it had already provided information to the Fund, both in writing and through meetings, including details on the mobilization of financing and the TRS operations, highlighting a clear divergence in what constitutes *adequate* disclosure. This discrepancy highlights a clear gap between Senegal's claims of disclosure and the IMF's position, suggesting that while authorities assert they shared information on total return swap operations, the Fund did not receive *sufficient detail* on the terms to fully assess them. It underscores ongoing concerns about transparency, particularly where governments may consider procedural engagement adequate, but creditors require comprehensive and granular disclosure for debt sustainability analysis.

Nevertheless, Senegal's defence has done little to quell concerns, particularly given that key institutions such as the International Monetary Fund were not provided with the full terms of the agreements, raising persistent questions about transparency and accountability in the use of such instruments.

Comparative Insight: Angola and Mozambique

Senegal's resort to a total return swap is not without precedent on the African continent. It is imperative to highlight Angola's recent exploration with total return swaps. As reported in the Sovereign Debt News Update No. 162, Angola stealthily entered into a US$1 billion one-year total return swap with JP Morgan Securities Plc ("JPM") in 2024. In Angola's case, total return swaps were used to monetize future income in exchange for upfront cash, providing short term liquidity while creating longer term obligations. This parallel highlights a

broader trend among resource constrained economies seeking innovative financing solutions in the face of limited market access. However, Angola's experience also underscores the risks associated with such arrangements, including reduced transparency, increased fiscal vulnerability, and challenges in accurately assessing debt levels. The replication of this model in Senegal suggests that total return swaps may become an increasingly common feature of sovereign financing in Africa, raising important questions about regulation and oversight.

Mozambique

The concept of "hidden debt" in Senegal's case makes it imperative to juxtapose it to the infamous Mozambique hidden debt case. While Senegal's use of a total return swap differs in form from the loans involved in the Mozambique hidden debt scandal, the underlying issues of opacity and accountability are closely aligned. In Mozambique, undisclosed loans exceeding US$2 billion were concealed from the public and international partners, leading to a severe fiscal crisis and legal repercussions. Senegal's case represents a more sophisticated iteration of hidden debt, where financial engineering replaces outright concealment. The total return swap allows liabilities to be masked within derivative contracts rather than hidden entirely off the books. This evolution complicates detection and oversight, as such instruments may not trigger the same reporting requirements as traditional loans. Nevertheless, the risks are similar, including erosion of trust, potential for fiscal shocks, and long-term economic consequences. The comparison underscores the need to broaden the definition of public debt to capture derivative based obligations and prevent future crises.

Conclusion

Senegal's use of a total return swap represents a pivotal development in the landscape of African sovereign debt, signaling a shift toward more complex and potentially opaque forms of financing. While the instrument provided short term relief by enabling the government to raise €650 million without immediate disclosure, it also introduced significant risks related to transparency, accountability, and fiscal sustainability. The parallels with Angola and the contrasts with Mozambique highlight both the evolution and persistence of hidden debt challenges across the continent. Moving forward, addressing these

issues will require a concerted effort to strengthen reporting standards, enhance oversight, and ensure that all debt-related obligations are fully captured within official statistics. More importantly, it underscores the need to fix structural weaknesses in the global sovereign debt system, ensuring accessible and transparent financing pathways so that countries are not driven to rely on opaque and risk heavy instruments like total return swaps as improvised responses to deeper constraints.

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