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REVIEWS OF THE FUND'S SOVEREIGN ARREARS POLICIES AND PERIMETER—INITIAL CONSIDERATIONS

EXECUTIVE SUMMARY

This paper undertakes a comprehensive review of the Fund's sovereign arrears policies. The Fund's arrears policies are among the key Fund policies related to sovereign debt restructuring, alongside those on debt sustainability, market access, and financing assurances which are interrelated policies and act in concert to ensure that Fund financing is designed to help a member resolve its balance of payments (BOP) problems in a way that adequately safeguards Fund resources and restores the member to medium-term external viability. The arrears policies determine the conditions under which the Fund can provide financial support to a member in the presence of sovereign arrears (namely, the non-payment in full of a sovereign debtor member's ("member" or "debtor") contractual financial obligation under a debt instrument by the contractual due date), and how these arrears are handled when assessing debt sustainability, market access, and financing assurances. It also reviews the Fund's practice applicable to preemptive debt restructurings (before a default occurs and arrears arise) involving privately held claims. Finally, as the creditor landscape has evolved, it has become increasingly clear that the Fund's definitions and practices used to categorize claims for purposes of applying these different arrears policies have become outdated and in need of a review as well.

Staff assesses that the Fund's Lending into sovereign Arrears to private creditors (LIA) policy remains broadly appropriate, while recommending some improvements given the experience gained and the developments observed over the last 19 years with private sector involvement (PSI). These include amendments to the guiding principles underlying "good faith" under the LIA policy, including to simplify requirements for engagement with creditor committees (by eliminating the references to the formal negotiating framework) and to add that any debt restructuring offer by the debtor should be consistent with the program parameters (in line with the Fund's Lending into Arrears to Official Bilateral Creditors (LIOA) policy). Staff also recommends providing additional guidance on the sharing of relevant information with creditors, with a particular focus on debt transparency.

Staff also sees merit in codifying the existing practice guiding the Fund in *preemptive debt restructurings into a Fund policy, together with an amendment focusing on debt transparency.* This staff recommendation reflects the increased use of preemptive debt

restructurings over the last 19 years and input received in outreach with the private sector and other stakeholders. In line with the existing practice, the policy would state that in such settings, the Fund can lend if a credible process for debt restructuring is underway and such debt restructuring will likely deliver an outcome in line with program parameters. Furthermore, the policy would provide that in assessing whether a credible process for debt restructuring is underway, staff would usually expect the member to share relevant information with its creditors along the lines of the guiding principles under the LIA policy.

Given limited experience with the application of the LIOA policy (which was established in 2015), staff does not propose any amendments and only one restatement confirming current practice. The restatement refers to the fact that once a claim is determined to be Official Sector

Involvement (OSI)-related, that determination will carry forward to future Fund arrangements. In light of the recent practice with the G20 Common Framework for debt treatments beyond the DSSI, staff will monitor whether a new representative standing forum may emerge with which the Fund may decide to engage in the future under the LIOA policy.

In light of the significant increase in the number of international financial institutions (IFIs), staff proposes two amendments to the Fund's Nontoleration of Arrears Policy (NTP) with respect to multilateral creditors. Multilateral creditors enjoy a special treatment under the NTP.

However, the value of that special treatment becomes diluted if it is accorded to a large number of IFIs and claims. The Fund does not have a specific list of multilaterals, and instead has looked to a number of factors to judge whether an IFI is a multilateral creditor, including whether it has global (rather than regional) membership, and how it was treated in past debt restructurings. This practice leaves some ambiguity in how claims of new IFIs would be treated. To address this, staff proposes two main changes.

i. First, to amend the definition of claims that are considered "multilateral". Two options are proposed for Executive Board consideration. Option A focuses on IFI claims originating from financing to resolve BOP problems (including financing in the context of a Fund-supported program), thereby supporting the Global Financial Safety Net. Option B would additionally extend to IFI claims that reflect financing of a public good nature, even outside the context of resolving BOP problems. For claims defined as multilateral, the NTP would continue to apply.

ii. Second, to create a policy for arrears on IFI claims *not* classified as multilateral. This would depend on whether the arrears are OSI or non-OSI related. In non-OSI cases, the NTP would apply. In OSI cases, however, such claims would be subject to the LIOA policy—paralleling the treatment received by official bilateral claims.

Finally, recent developments raise questions about the perimeter between official bilateral and private claims, with significant implications for the Fund's arrears policies. In updating the Fund's definition of an official bilateral claim, staff proposes several restatements, as well as two

amendments, in particular: (1) to exclude claims of official bilateral creditors and IFIs subject to vote pooling with the private sector from LIOA treatment, to avoid a situation where holdings of the same instrument could receive different treatment depending on the holder; and (2) to clarify the treatment under the Fund's arrears policies of claims purchased in the secondary market by IFIs.

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Abbreviations and Acronyms

BIS	Bank for International Settlements
BOP	Balance of Payments
BPM6	Balance of Payments Manual
CAC	Collective Action Clause
CF	G20 Common Framework for debt treatments beyond DSSI
CUCB	Currency Union Central Bank
DLP	Debt Limits Policy
DSA	Debt Sustainability Analysis
DSSI	Debt Service Suspension Initiative
ECA	Export Credit Agency
ECB	European Central Bank
ECF	Extended Credit Facility
EFF	Extended Fund Facility
EFSF	European Financial Stability Facility
ESM	European Stability Mechanism
HIPC	Heavily Indebted Poor Countries
ICMA	International Capital Market Association
IFI	International Financial Institution
IIF	Institute of International Finance
IMF	International Monetary Fund
LIA	Lending into Arrears
LIC	Low Income Country
LIOA	Lending into Official Arrears
MDB	Multilateral Development Bank
MDRI	Multilateral Debt Relief Initiative
MPA	Multi-Pronged Approach
NPV	Net Present Value
NTP	Non-Toleration of Arrears Policy
OECD	Organization for Economic Co-operation and Development
OMT	Outright Monetary Transactions
OSI	Official Sector Involvement
PC	Paris Club
PEPP	Pandemic Emergency Purchase Programme
PRGT	Poverty Reduction and Growth Trust
PSI	Private Sector Involvement
PSPP	Public Sector Purchase Programme
RCF	Rapid Credit Facility
RFA	Regional Financing Arrangements
RFI	Rapid Financing Instrument
SBA	Stand-By Arrangement
SMSF	Secondary Market Support Facility

SWF Sovereign Wealth Fund
WB World Bank

INTRODUCTION

1. This paper undertakes a comprehensive review of the Fund's sovereign arrears policies. Recognizing the destructive nature of arrears, since 1970, the Fund has had a policy of non-toleration of arrears (NTP), unless a specific policy applies that enables the Fund to lend into sovereign arrears. These specific policies are those on Lending into sovereign Arrears (LIA) to private creditors—which was adopted in 1989 and last reviewed in 2002—and on Lending into Arrears to Official Bilateral Creditors (LIOA), which was adopted in 2015. As described in more detail below and in Annex III, the application of the specific arrears policies depends on (i) whether a sovereign debtor member (“member” or “debtor”) is in arrears to private sector, official bilateral, or multilateral creditors, and (ii) whether Private Sector Involvement (PSI) and/or Official Sector Involvement (OSI) is needed.^{2, 3}

2. The review seeks to evaluate the application of the sovereign arrears policies and to update these policies to more effectively achieve their objectives in the current sovereign debt landscape. Despite several attempts—most recently in line with the sovereign debt work program endorsed by the Executive Board in May 2013—the LIA policy has not been reviewed since 2002.^{4, 5} The Executive Board established the Fund's LIOA policy in 2015, with an expectation that it would be reviewed in two to three years.^{6, 7} The Fund's NTP has not been reviewed since its establishment in 1970.⁸ In addition, as the creditor landscape has evolved, it has become increasingly clear that the Fund's definitions and practices used to categorize claims for purposes of applying these different arrears policies have become outdated and should be reviewed as well.

²Arrears arise when a debtor does not pay its contractual financial obligation under a debt instrument to a creditor or creditors by the contractual due date including any grace periods and in full.

³“OSI” means that the Fund-supported program does not provide for full repayment of the claim and needs a contribution from the official sector, which can consist of debt relief and new financing (e.g., loans, bond financing, guarantees, and grants). The framework for involving the private sector in crisis resolution, relying as much as possible on market-oriented solutions and voluntary approaches, was endorsed by the IMFC at its meeting in Prague in September 2000 (see IMFC, Communiqué, 2000 and IMF 2001, Report of the Managing Director to the International Monetary and Financial Committee on Private Sector Involvement in the Prevention and Resolution of Financial Crises, IMFC/Doc/4/01/5).

⁴[The Acting Chair's Summing Up—Fund Policy on Lending into Arrears to Private Creditors—Further Consideration of the Good Faith Criterion](#), September 2002 (BUFF/02/142).

⁵[Sovereign Debt Restructuring—Recent Developments and Implications for the Fund's Legal and Policy Framework](#), April 2013. The review of the LIA is the fourth and last leg of the Fund's work program on sovereign debt launched in 2013.

⁶[Reforming the Fund's Policy on Non-Toleration of Arrears to Official Creditors](#), December 2015; [The Chairman's Summing Up—Reforming the Fund's Policy on Non-Toleration of Arrears to Official Creditors](#), December 2015 (BUFF/15/107).

⁷While the 2015 paper establishing the LIOA policy referred to these types of claims as “official claims,” that was a misnomer. The claims covered by the LIOA policy are only a subset of official claims, specifically those held by official bilateral creditors.

⁸[Payments Arrears in Current International Transactions](#), October 1970.

3. The paper is organized as follows. The next section reviews the existing legal and policy framework. The following sections review, in turn, the LIA policy, the framework applicable to preemptive debt restructurings, the LIOA policy, and the NTP for multilaterals and recommend proposed targeted amendments. The paper then tackles the contours of the definitions of direct bilateral claims and multilateral claims. Last, the paper raises issues for discussion and closes with next steps.

EXISTING LEGAL AND POLICY FRAMEWORK

4. Under its Articles of Agreement (the “Articles”), the Fund may only provide financing to assist members to resolve their balance of payments (BOP) problems under adequate safeguards. Article I(v) and Article V, Section 3(a) of the Articles require the Fund to adopt policies that will assist members in resolving their BOP problems and that will establish adequate safeguards for the temporary use of the general resources of the Fund. In other words, Fund financing can only be provided in support of a member’s economic policies that are capable of resolving the member’s BOP problems over a timeframe consistent with the revolving nature of Fund financing aimed at restoring the member to medium external viability.⁹ Debt sustainability, market access, and resolution of arrears are germane to medium-term external viability.¹⁰ The inter-related policies on debt sustainability, financing assurances, market access, and arrears help the Fund achieve these objectives. In order for the Fund to provide financing, it must determine that the requirements under each of these policies have been met.

A. Debt Sustainability, Market Access, and Financing Assurances

5. Debt sustainability, market access, and financing assurances act in concert with the arrears policies in order to ensure a member’s economic program is addressing its BOP problem in a way that safeguards Fund resources.¹¹ An understanding of these policies—described below and in more detail in Annex I—is essential for understanding the Fund’s overall lending framework under which the arrears policies operate.

6. Where a member’s debt is assessed as unsustainable, the Fund is precluded from providing financing unless the member takes steps to restore debt sustainability. A combination of policy adjustment and financing from public and private sources has been sufficient to preserve debt sustainability in the vast majority of Fund-supported programs. The catalytic role

⁹[Guidelines on Conditionality](#), Decision No. 12864-(02/102), September 2002, as amended.

¹⁰[Sovereign Debt Restructuring—Recent Developments and Implications for the Fund's Legal and Policy Framework](#), April 2013.

¹¹These Fund policies apply to Fund members with market access. While many Fund policies equally apply to Poverty Reduction and Growth Trust (PRGT) eligible and non-market access Fund members, additional policies and considerations are also at play for non-market access Fund members which rely exclusively on concessional financing such as under the PRGT.

of Fund financing is however put to the test in cases where members with significant external indebtedness have lost—or are losing—market access.¹²

7. Closely related to the concept of debt sustainability is that of market access.¹³ Fund members relying on market access need to restore investor confidence and establish capacity to regain access to international (and domestic) capital markets in order to maintain or restore debt sustainability. More generally, while a temporary loss of market access may not necessarily imply that debt is unsustainable, a protracted loss of market access would create the presumption that debt may not be sustainable. In practice, whether a member is assessed to have market access will depend on its ability to tap international capital markets on a sustained basis through the contracting of loans and/or issuance of securities across a range of maturities, regardless of the currency denomination of the instruments, and at reasonable interest rates.¹⁴ The Fund's exceptional access policy, *inter alia*, requires that the member has prospects of (re)gaining access to private capital markets within the timeframe Fund resources are outstanding.¹⁵

8. Good prospects of regaining market access and debt sustainability are germane to the observance of the financing assurances policy and Fund-supported programs must be fully financed.¹⁶ Program financing includes assumptions regarding a member's expected financing from private sector creditors (including (re)gaining market access), the clearance of arrears, as well as the envisaged debt restructuring operation. Under the Fund's financing assurances policy, the Fund must be satisfied that program financing is adequate to fill financing gaps during the program period to ensure viability, as well as to ensure that the member is in a position to repay the Fund during the post-program period. Specifically, this requires that in the event that there are gaps with respect to new external financing to be provided by the official sector: (i) "firm commitments" of financing must be in place for the upcoming 12 months of the arrangement, and (ii) "good prospects" that there will be adequate financing for the remaining program period beyond the upcoming 12 months.¹⁷ With respect to the post-program period, staff needs to assess whether the member's prospective policies deliver a projected post-program performance that adequately safeguard repayments to the Fund consistent with a sustainable debt path during the program period. A Fund-supported program in the Fund's General Resources Account (GRA) is designed to

¹²Market access is lost when sovereigns default or stop issuing bonds controlling for financing needs and previous pattern of issuance. See, [The Fund's Lending Framework and Sovereign Debt—Further Considerations](#), April 2015.

¹³*Id.*

¹⁴[The Fund's Lending Framework and Sovereign Debt—Further Considerations](#), April 2015.

¹⁵*Id.*

¹⁶[Sovereign Debt Restructuring—Recent Developments and Implications for the Fund's Legal and Policy Framework](#), April 2013. Because there is no economic program underlying emergency financing, the financing assurances policy is limited in such cases to a judgment that the member will be in a position to repay the Fund.

¹⁷During program reviews, assurances on full financing of successive 12-month periods beyond the initial 12 months (or whatever period is left under the arrangement) must be ascertained. Specifically, the "good prospects" must become "firm commitments" or actual financing.

restore the member to medium term external viability and resolve the BOP problem within the program period.^{18, 19, 20}

9. When debt is unsustainable, but a member is not yet in arrears, the Fund requires assurances that debt sustainability will be restored and the program is fully financed.²¹ While the arrears policies described in the following section may fill this role in cases where the debtor has defaulted on external creditors (see Annex I for further details), the standards for these assurances in *preemptive* debt restructurings derive from the debt sustainability and financing assurances policies. The financing assurances policy does not prescribe the burden sharing between creditors including official and private creditors, provided the member achieves high private sector creditor participation. The form of such assurances depends on the nature of the creditors:

- The Fund requires “specific and credible” assurances on debt relief and/or financing from official bilateral creditors, which can take the form of a communication from the creditor showing an understanding of the debtor member’s situation and a commitment to the needed actions to restore debt sustainability and financing of the Fund-supported program.²² In practice, a similar standard of “specific and credible” assurances on financing applies to new financing being provided by IFIs to help restore debt sustainability and close program financing gaps.
- When a contribution from private creditors is required to restore debt sustainability and to close financing gaps, assurances are derived from the Fund’s judgment that a credible process for debt restructuring is underway and such debt restructuring will likely deliver an outcome in line with program parameters. Relevant considerations to form such judgment include the engagement of legal and financial advisors by the member, the launching of consultations with

¹⁸[2018 Review of Program Design and Conditionality](#), May 2019.

¹⁹For ECF arrangements under the PRGT, the protracted BOP need does not need to be resolved within the program period. However, any financing gaps in the post-program period for ECF arrangements need to be such that, notwithstanding the gaps, the Fund is assured that the member has the capacity to repay the Fund (irrespective of a successor arrangement), and that any gaps are consistent with a sustainable debt path.

²⁰Staff needs to assess that the member has good prospects for (re)gaining access to capital markets at sufficient depth, maturity, and price to ensure capacity to repay the Fund and consistent with a sustainable debt path, taking into account all sovereign maturities falling due in the post-program period during the time repayments to the Fund are outstanding. As long as obligations to the Fund are outstanding, staff needs to judge that there no financing gaps in the post-program period at arrangement approval and each respective program review.

²¹See [Sovereign Debt Restructuring—Recent Developments and Implications for the Fund’s Legal and Policy Framework](#), April 2013, Annex I at para. 4.

²²For Paris Club creditors, these credible and specific assurances on debt relief and/or financing generally take the form of a preliminary indication that the Paris Club is willing to provide debt relief in anticipation of an Agreed Minute.

creditors, and the design of the debt restructuring strategy, including the terms of the new instruments and use of inducements for creditor participation.²³

10. When debt is unsustainable and the member is in arrears to its private creditors, the Fund may consider that debt sustainability will be restored if (i) the member's debt restructuring offer is consistent with the program parameters and (ii) the criteria under the LIA policy are satisfied (as described in detail below).^{24, 25} The criteria under the LIA policy act as a safeguard to give the Fund assurance that if the member is meeting those requirements, a debt restructuring deal will be forthcoming and arrears will be resolved. The Fund may decide that no further "assurances" regarding the restoration of debt sustainability are required. As an additional safeguard, the financing assurances reviews required under the LIA policy allow the Fund to assess the status of debtor-creditor negotiations, and whether further progress is being made to reach agreement on a debt restructuring. If, in the context of such reviews, the Fund determines that the member is no longer in compliance with the LIA policy and a debt restructuring deal is unlikely to be forthcoming, the Fund can decide not to complete the review under the arrangement.

11. When debt is unsustainable and the member is in arrears to its official bilateral creditors, the Fund may consider that debt sustainability will be restored, provided the requirements under the Fund's LIOA policy are satisfied (as described in detail below). However, the requirements under the LIOA policy are more stringent in certain respects: In particular, the application of the LIOA policy is normally dependent on an agreement being reached between the debtor and a (representative) majority of its official bilateral creditors. Therefore, in practice, the LIOA is normally applied to small hold-out creditors. In certain cases, the Fund may proceed to lend under the LIOA policy even in the presence of arrears to a majority creditor or creditors (see discussion in paragraph 52 below). However, given that, in general, a durable solution to a BOP problem requires a debt restructuring which is unlikely to be achieved without the participation of large creditors, the Fund may ultimately judge that despite compliance with the requirements under the LIOA policy, the overall risks to the Fund-supported program are too high to proceed.

²³The debt restructuring should normally be undertaken before the approval of the Fund arrangement. However, there may be circumstances under which more flexibility is warranted, such that the conclusion of the debt operation is contemplated at a later date—normally by the first review under the Fund arrangement. Against this background, it would not be necessary to hold up Fund support until there is complete clarity regarding the terms of this financing. See, [The Acting Chair's Summing up—The Fund's Lending Framework and Sovereign Debt—Further Considerations](#), January 2016 (BUFF/16/9, Cor. 1).

²⁴This includes cases where, under the exceptional access policy, debt sustainability must be restored with a high probability. If the member's offer has not yet been made, the Fund could proceed if an offer consistent with debt sustainability is expected to be forthcoming.

²⁵In this regard, the safeguards under the LIA policy also give the Fund assurances that market access will be restored. The LIA policy is predicated on the basis that if the criteria are met, orderly relations between the debtor and its creditor(s) are being restored. As such, this would also mean that in due course, market access will be restored.

B. Arrears Policies

12. When a member is in arrears to external creditors at the time Fund financing is requested (for instance, at either approval of or a review under an arrangement), the arrears policies (LIA or LIOA) must be satisfied for the Fund to lend.^{26, 27} Recognizing the destructive nature of external payments arrears to both national and international prosperity (see Article I(v)), the Fund encourages members to stay current on their obligations to the extent possible. However, where that is not possible, the arrears policies give the Fund the possibility to continue providing financing in the face of difficulties that may emerge for the member in securing an agreement with its creditors on terms consistent with the parameters of the Fund-supported program, provided the Fund judges that the member meets the requirements under these policies. At the same time, the arrears policies provide creditors with comfort that the debt relief or financing sought by the member from its creditors is consistent with a balance between financing and adjustment that has been endorsed by the Fund.

Private

13. The LIA policy governs Fund lending in the face of arrears to external private creditors and on other types of external debt claims.²⁸ The LIA policy was initially established to apply to sovereign arrears to external creditors on bank loans and was extended to also address sovereign arrears to other private creditors, including bondholders, and non-sovereign arrears that arise from the imposition of exchange controls (see Box 1 and Annex III).

²⁶The Fund takes a claim-by-claim determination whether the LIA or the preemptive restructuring practice applies; therefore, the LIA only applies on an external debt claim in arrears. "External" is defined in terms of residency of the creditor.

²⁷The Fund's arrears policies do not apply to arrears in dispute. Under this practice, where the Fund accepts a member's representation that the validity or amount of a debt claim is in dispute, such disputed claim does not give rise to arrears for Fund purposes. However, such claims are taken into account (as a contingent claim) for purposes of determining whether adequate assurances exist for the financing of a Fund-supported program and the Fund DSA. See [Sovereign Debt Restructuring—Recent Developments and Implications for the Fund's Legal and Policy Framework](#), April 2013, Annex I, at fn. 11.

²⁸The Fund's LIA policy has never formally defined the scope of "payments arrears." However, the evolution of the arrears policies and their coverage is informative. Accordingly, the Executive Board has applied the LIA policy to obligations arising from "commercial financial obligations of a contractual nature" that are not paid when due (taking into account any contractual grace periods). For example, arrears on bank loans, suppliers' credits (i.e., where the creditor contractually defers payment, or the good/service does not need to be paid on delivery), and since 1999 bonds have been included in the scope of the LIA policy. However, the LIA policy has not been applied more broadly to arrears on non-debt obligations (e.g., financial obligations originating from an arbitral award, unpaid dues, payment on delivery).

Box 1. Lending Into Sovereign Arrears (LIA) Policy

Under the LIA policy, the Fund may provide financing despite sovereign arrears to private creditors on a case by case basis and only where (i) prompt Fund support is considered essential for the successful implementation of the member's adjustment program, and (ii) the member is pursuing appropriate policies and it is making a good faith effort to reach a collaborative agreement with its private creditors (or to facilitate a collaborative agreement between private debtors and creditors and a good prospect exists for the removal of exchange controls).¹

The assessment of "good faith" is guided by the following principles:²

- First, when a member has reached a judgment that a restructuring of its debt is necessary, it should engage in an early dialogue with its creditors, which should continue until the restructuring is complete.
- Second, the member should share relevant, non-confidential information with all creditors on a timely basis, which would normally include:
 - i. an explanation of the economic problems and financial circumstances that justify a debt restructuring;
 - ii. a briefing on the broad outlines of a viable economic program to address the underlying problems and its implications on the broad financial parameters shaping the envelope of resources available for restructured claims;
 - iii. and the provision of a comprehensive picture of the proposed treatment of all claims on the sovereign, including those of official bilateral creditors, and the elaboration of the basis on which the debt restructuring would restore medium term sustainability, bearing in mind that not all categories of claims may need to be restructured.
- Third, the member should provide creditors with an early opportunity to give input on the design of restructuring strategies and the design of individual instruments.
- Finally, in cases in which an organized negotiating framework is warranted by the complexity of the case and by the fact that creditors have been able to form a representative committee on a timely basis, there would be an expectation that the member would enter into good faith negotiations with this committee, though the unique characteristics of each case would also be considered.³ This formal negotiating framework would include, *inter alia*, the sharing of confidential information needed to enable creditors to make informed decisions on the terms of a restructuring, and the agreement to a standstill on litigation during the restructuring process by the creditors represented in the committee.

With respect to the imposition of exchange controls (jurisdictional arrears), the LIA provides the following guidance:⁴ Fund lending into non-sovereign arrears stemming from the imposition of exchange controls should be on a case-by-case basis and only where:

- i. prompt Fund support is considered essential for the successful implementation of the member's adjustment program; and
- ii. the member is pursuing appropriate policies, is making a good faith effort to facilitate a collaborative agreement between private debtors and their creditors, and a good prospect exists for the removal of exchange controls.

Box 1. Lending Into Sovereign Arrears (LIA) Policy (concluded)

In emergency situations, such as for requests of the Rapid Credit Facility (RCF) and the Rapid Financing Instrument (RFI), the LIA policy applies with flexibility in the wake of conflicts and natural disasters.⁵

¹[The Acting Chair's Summing Up—Fund Policy on Lending into Arrears to Private Creditors—Further Consideration of the Good Faith Criterion](#), September 2002 (BUFF/02/142).

²Where the LIA policy applies, each purchase/disbursement under a Fund arrangement is subject to a financing assurances review in which the Executive Board considers, inter alia, whether adequate safeguards remain in place for further use of the Fund's resources, and whether the member's adjustment efforts are undermined by developments in debtor-creditor relations.

³[The Acting Chair's Summing Up—Fund Policy on Lending into Arrears to Private Creditors—Further Consideration of the Good Faith Criterion](#), September 2002 (BUFF/02/142).

⁴[The Acting Chair's Summing up—Fund Policy on Arrears to Private Creditors—Further Considerations](#), June 1999 (BUFF/99/71).

⁵The Acting Chair's Summing Up—The Fund's Engagement in Fragile States and Post-Conflict Countries—A Review of Experience—Issues and Options, March 2009 (BUFF/08/42).

Official Bilateral

14. Arrears on claims held by official bilateral creditors are subject to different policies depending on the nature of the claim. Official bilateral creditors hold a variety of claims on other sovereigns, reflecting the many functions such creditors play in the international financial architecture. These claims are held in different forms and are extended or purchased for different public-policy reasons. However, the Fund's arrears policies give preferential treatment to only the subset of these claims that are Direct Bilateral Claims, i.e., claims that are (a) held by a government, or an agency acting on behalf of a government; and (b) originate from an underlying transaction where the creditor government, or an agency acting on behalf of the government, provided or guaranteed financing to the borrowing member.^{29, 30} While other types of official financing are also critical to the operation of domestic and international financial systems, the Fund has recognized this specific type of financing as closely tied to the Fund's operations as it provides critical contributions to Fund-supported programs, constitutes BOP support, and often is extended during crises when the private sector becomes unwilling to provide support. Another type of important official financing is central bank swap lines which may be part of the Global Financial Safety Net or direct sovereign-to-sovereign BOP financing. Where such central bank swaps are extended on behalf of the government, they are a Direct Bilateral Claim and subject to the Fund's arrears policies.

15. As set forth in paragraph 1 above, the treatment afforded under the arrears policies to Direct Bilateral Claims depends on whether contributions from the official sector (Official

²⁹[Reforming the Fund's Policy on Non-Toleration of Arrears to Official Creditors](#), December 2015.

³⁰Claims guaranteed by governments or agencies acting on their behalf are provided this preferential treatment once the guarantee has been called. *Id.* Debt claims as well as other sovereign-to-sovereign financial claims such as a payment on delivery, and debt-related arbitral awards are covered.

Sector Involvement or OSI) are required under the Fund-supported program.³¹ In non-OSI cases, the Fund's NTP applies to arrears on Direct Bilateral Claims—i.e., the Fund may only provide financing if the creditor's Executive Director acquiesces or does not object to the Fund approving financing. In OSI cases, the LIOA policy applies to these claims (Box 2). Claims held by official bilateral creditors on sovereigns that are not Direct Bilateral Claims are treated under the LIA policy in practice (Box 1).

Box 2. Lending Into Arrears to Official Bilateral Creditors (LIOA) Policy

The LIOA policy allows Fund financing despite sovereign arrears to official bilateral creditors on Direct Bilateral Claims in carefully circumscribed circumstances.¹ The LIOA policy was introduced in 2015 "to ensure that, where a restructuring is deemed necessary, collective action among official bilateral creditors is encouraged and the provision of Fund support is not held up by the unwillingness of holdout creditors to join an effort that is supported by an adequately representative group of creditors."² Under the LIOA policy, the Fund may provide financing despite arrears on Direct Bilateral Claims where:

- There is a representative Paris Club agreement (i.e., providing a majority of the total financing contributions—meaning new financing and/or debt relief—required from official bilateral creditors over the program period). In such cases, based on the Paris Club's comparability of treatment principle, arrears are considered eliminated ("deemed away") for purposes of the LIOA policy for both participating and non-participating creditors when financing assurances are received from the Paris Club in anticipation of an Agreed Minute. The Executive Board has indicated,^{3, 4} however, that "should another representative standing forum emerge, the Fund would be open to engaging with such a forum." Affording another representative standing forum similar status to the Paris Club under the LIOA policy would require an Executive Board decision;
- Creditor consent has been provided, in the absence of a representative Paris Club Agreement; or
 In the absence of a representative Paris Club agreement or creditor consent⁵, if the following three criteria hold: (i) prompt financial support from the Fund is considered essential, and the member is pursuing appropriate policies; (ii) the debtor is making good faith efforts to reach agreement with the creditor on a contribution consistent with the parameters of the Fund-supported program—i.e., that the absence of an agreement is due to the unwillingness of the creditor to provide such a contribution; and (iii) the decision to provide financing despite the arrears would not have an undue negative effect on the Fund's ability to mobilize official financing packages in future cases. The Executive Board has provided guidance on how to apply the second and third criteria. The assessment of "good faith" will take into account, *inter alia*, whether the debtor:
 - i. has approached the creditor to which it owes arrears either bilaterally or through a relevant grouping of official bilateral creditors;
 - ii. has offered to engage in substantive dialogue with the creditor and has sought a collaborative process with the creditor to reach agreement;
 - iii. has provided the creditor relevant information on a timely basis consistent with the Fund's policy on confidentiality of information; and
 - iv. has offered the creditor terms that are consistent with the parameters of the Fund-supported program and consistent with the contributions from other official bilateral creditors.

³¹"Contribution" here comprises, and is limited to, debt relief and new financing (e.g., loans, bond financing, guarantees, and grants).

Box 2. Lending Into Arrears to Official Bilateral Creditors (LIOA) Policy (concluded)

- In assessing the third criterion, the Fund will consider the signal that such a decision would send to official bilateral creditors as a group, given the specific circumstances of the case. This criterion would normally not be satisfied where the creditor or group of creditors that has not reached agreement with the debtor accounts for an adequately representative share. Separately, an assessment of whether the third criterion is satisfied would take into consideration the creditor's track record of providing contributions in past debt restructurings under Fund-supported programs, even if the creditor does not account for an adequately representative share of total financing contributions.

In emergency situations, where the extraordinary demands on the affected government are such that there is insufficient time for the debtor to undertake good faith efforts to reach agreement with its creditors, the Fund may provide financing under the RCF or the RFI despite arrears owed to official bilateral creditors and without assessing whether the three criteria above have been satisfied or obtaining the creditor's consent.

¹[Reforming the Fund's Policy on Non-Tolerance of Arrears to Official Creditors](#), December 2015.

²[The Chairman's Summing Up—Reforming the Fund's Policy on Non-Tolerance of Arrears to Official Creditors](#), December 2015 (BUFF/15/107).

³To the extent that arrears are not rescheduled by the deadline set forth in the Agreed Minute, the arrears are considered to arise anew for program purposes, unless the Fund considers that the member is exercising its best efforts to conclude the bilateral agreement in line with the terms of the Agreed Minute.

⁴This special recognition of agreements reached in the Paris Club is based on long-standing Fund policy and close coordination with the Paris Club. [The Acting Chairman's Summing Up on the Role of the Fund in the Settlement of Disputes Between Members Relating to External Financial Obligations](#), July 1984 (BUFF/84/107); IMF, [Prevention and Resolution of Sovereign Debt Crises](#), Selected Legal and Institutional Papers Series, 2018.

⁵Creditors generally provide explicit consent prior to the circulation of the staff report for use of Fund resources to the Executive Board. However, where the relevant Executive Director has, despite repeated inquiries, not received a response from the creditor authorities, staff follows a less stringent "deemed consent" approach, under which consent is assumed absent the receipt of an objection. [Application of the Fund's Policy on Arrears to Official Bilateral Creditors—Modalities of Creditor Consent](#), FO/DIS/17/46, April 2017.

Multilateral

16. Multilateral creditors play an important role in the international financial architecture.

They are better placed than official bilateral creditors to pool risk, internalize global externalities, and overcome collective action problems. Their role is widely recognized by the international creditor community, including the Fund, which accords certain multilateral claims special treatment. The rationale for this treatment is based on the Articles, which require the Fund to assist its members in solving BOP problems without resorting to measures destructive of national or international prosperity (Article I(v)). The Fund's NTP provides special protection to claims of multilateral institutions arising from activities that help the Fund achieve this objective.

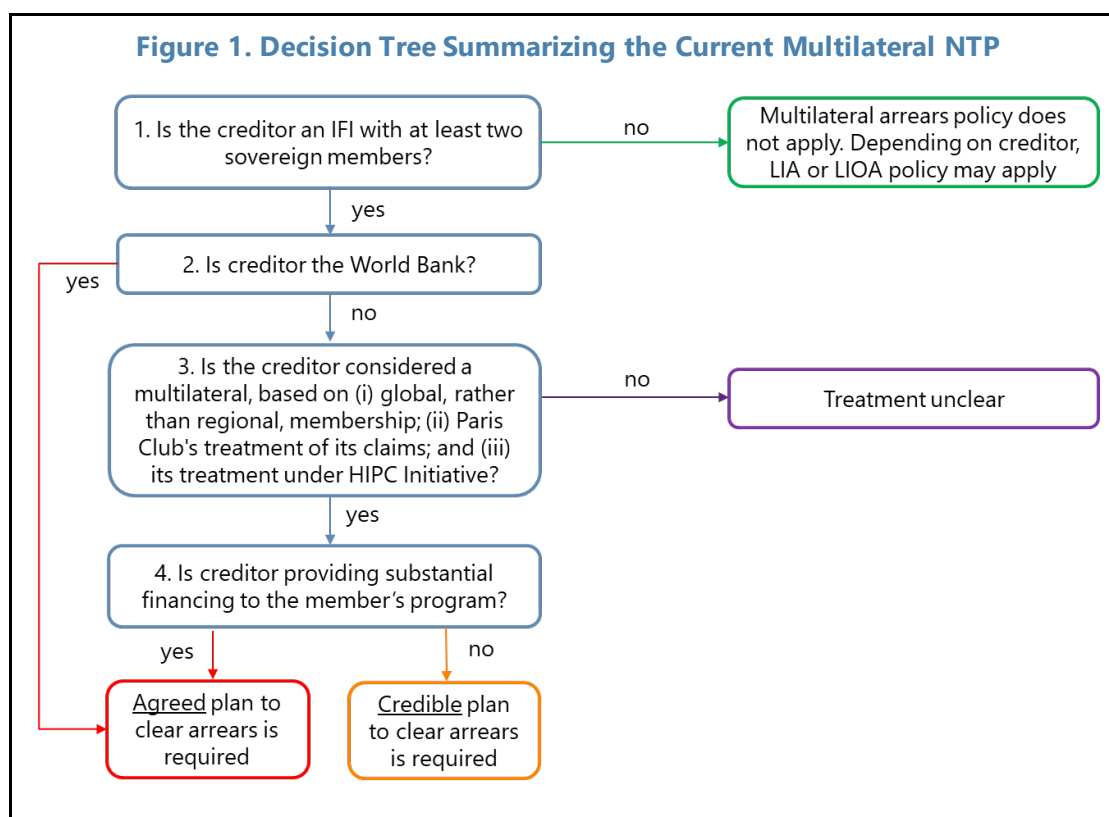
17. Arrears on claims held by multilateral creditors are subject to the NTP (Figure 1).³²

Fund-supported programs have long required the resolution of existing arrears and the non-accumulation of new arrears during the program period with respect to multilateral creditors.³³ The Fund does not have a clear definition of a multilateral creditor or an agreed list of such institutions. Instead, the Fund considers a number of factors in making such a judgment, including (i) global, rather than regional, membership of the institution, (ii) the Paris Club's treatment of the institution and the institution's participation in the Paris Club, and (iii) the treatment of the institution under the Heavily Indebted Poor Countries (HIPC) initiative. It should be noted that while membership with at least two sovereign members is a necessary condition, an institution is more likely to be considered multilateral if it has global rather than regional membership. In practice, arrears to multilateral creditors are considered resolved if, in the Fund's judgment, the debtor has a credible plan and projected financing to eliminate arrears over a defined period (Credible Plan). Such a plan must be credible to Fund staff—and ultimately the Executive Board—but the creditor's concurrence is not required. However, for the World Bank or multilaterals providing substantial financing (i.e., net positive BOP financing) to the Fund-supported program, the creditor's agreement with the arrears clearance plan over a defined period has generally been required (Agreed Plan).³⁴ The current NTP is silent on the treatment of claims to international financial institutions (IFIs) that are not considered "multilateral creditors".

³²While the current policy explicitly looks at the status of the institution, in practice, it also takes into account the type of claim held by the multilateral institution. Claims related to IFI financing, of a global public good nature, even outside the context of resolving BOP problems, have been protected by the NTP while arrears on other types of claims—such as membership fees—have been considered to fall outside the NTP. Most overdue membership fees are owed to multilateral non-financing institutions—and key IFIs do not impose membership fees—so non-payment does not affect a country's ability to access external financing. Further, in most cases, amounts of overdue fees are de minimis—i.e., not large enough to affect the country's ability to tap external financing.

³³[Payments Arrears in Current International Transactions](#), October 1970.

³⁴For the World Bank, this treatment is based on the 1989 IMF-World Bank Concordat, [Bank-Fund Collaboration in Assisting Member Countries](#), March 1989.

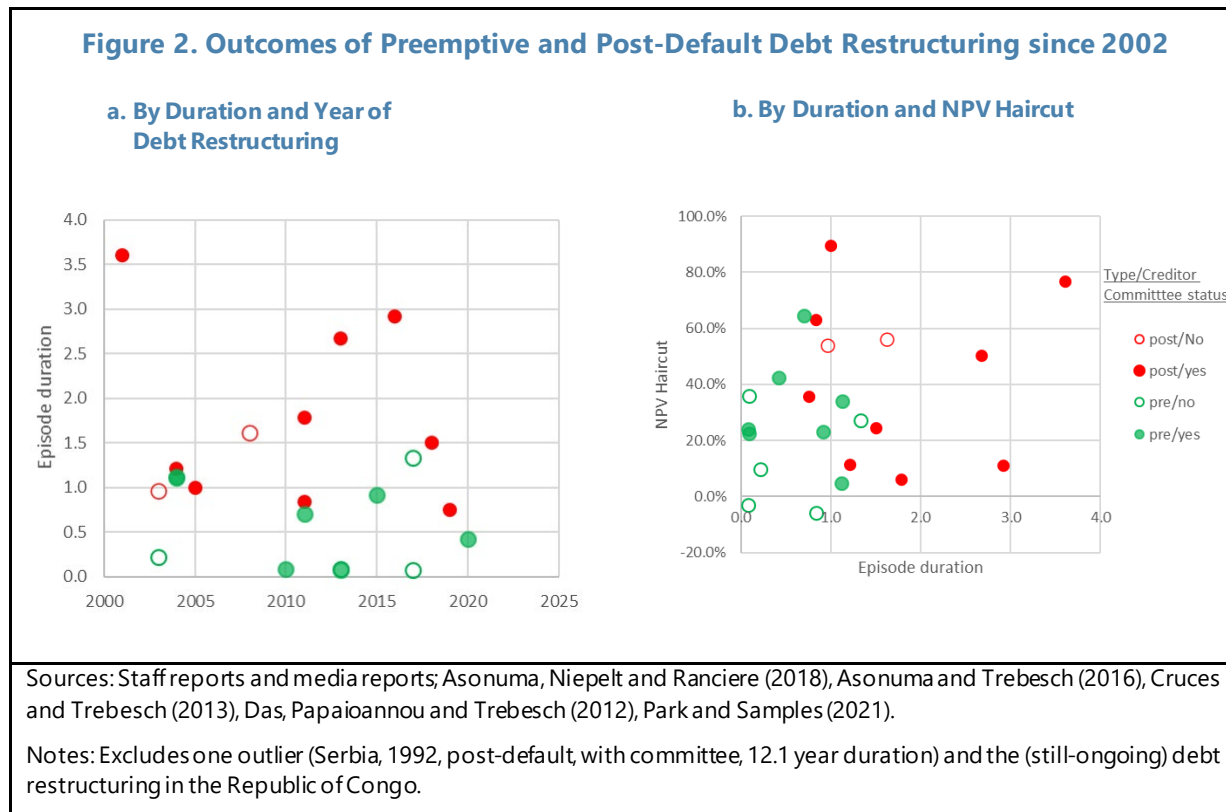


LENDING INTO ARREARS POLICY

18. Fund staff reviewed 24 sovereign debt restructuring cases involving private-sector creditors since 2002 and reached out to stakeholders in early 2021. Staff reviewed all preemptive and post-default PSIs that occurred in the context of financing from the Fund (including both Fund-supported programs and emergency financing requests), and four cases without a Fund arrangement, since 2002 (Figure 2, Annex II).³⁵ In addition, staff held consultations with stakeholders representing a variety of private sector investors, financial and legal advisors, and public-sector representatives.

³⁵The preemptive debt restructuring cases include Chad (2018), Cyprus (2013), Ecuador (2020), Greece (2012), Grenada (2005), Jamaica (2010), Jamaica (2013), Mozambique (2016), Mongolia (2018), Ukraine (2015), and Uruguay (2003), all with a Fund arrangement. In addition, staff reviewed the preemptive PSIs of Belize in 2007, 2013, and 2017 outside the context of a Fund arrangement. The post-default cases, subject to the LIA policy, include, Argentina (2005/2010), Côte d'Ivoire (2010), Dominica (2006), Dominican Republic (2005), Grenada (2015), Iraq (2006), Mozambique (2019), Republic of Congo (2019), Serbia and Montenegro (2010), Seychelles (2010), and St. Kitts and Nevis (2012). Staff also reviewed the post-default restructuring in Argentina (2020), outside a Fund-supported program. Separately, the LIA policy was applied in a number of cases that did not involve a significant PSI, including cases involving legacy claims from an earlier PSI (e.g., Argentina, 2018), and cases where PSI represented a small share of overall debt relief (e.g., Antigua and Barbuda, 2010), or no PSI was envisaged (e.g., Gabon, 2017).

A. Review of Post-Default Debt Restructuring Cases Since 2002



19. In most post-default debt restructuring cases reviewed, arrears were resolved shortly after the successful completion of the debt exchange. Most post-default debt restructurings during the review period had either full or very high creditor participation rates (in some instances only after the application of Collective Action Clauses (CACs)). When full participation was not initially achieved, several countries opted to clear the arrears to remaining holdouts. The main exceptions involving more protracted arrears to holdouts were Argentina and Iraq following their debt restructurings in 2005 and 2006, respectively. In Argentina, the 2005 exchange achieved only 76 percent participation, with additional creditors participating in a reopened exchange in 2010 and a further settlement with most remaining holdouts in 2016, but \$1.2 billion of arrears to residual holdouts remained outstanding by the time of the 2018 Stand-By Arrangement (SBA). Iraq's initial (2006) debt exchange attracted higher participation (96 percent), and a reopening of the exchange in 2008 resolved a further \$500m of arrears, but some residual arrears remained until after the conclusion of the 2010 SBA.³⁶

20. Stakeholders generally found the LIA policy to be broadly appropriate. In general, the Fund's involvement was welcomed, as it was viewed to enhance the credibility of the debt

³⁶Commercial creditor participation in the HIPC Initiative has been weak, and there are several ongoing lawsuits. See Table AIII16 in the [Heavily Indebted Poor Countries \(HIPC\) Initiative and Multilateral Debt Relief Initiative \(MDRI\)—Statistical Update](#), August 2019 (SM/19/200).

restructuring process, and the LIA policy's good faith requirement incentivizes debtors to engage with creditors in a timely and constructive manner. That said, there was some criticism of the implementation of the "good faith" requirement, with some stakeholders arguing that a higher bar would be appropriate, while others contended that the Fund should not try to referee the process of debtor-creditor engagement. Stakeholders also noted that every debt restructuring poses unique challenges and that the precise modalities of creditor-debtor engagement can vary. Hence, it was largely acknowledged that the current policy, which allows for a flexible case-by-case approach, seems appropriate. However, a few issues were noted, as described below.

Early Dialogue

21. Dialogue with private creditors typically began much earlier, and the completion of discussions, was faster in preemptive than post-default cases. The average time between the announcement of the debt restructuring and the start of dialogue with private creditors in preemptive cases was two months, less than half the average time observed in post-default cases (five months). Overall, the duration varied more among post-default cases: while some debtors initiated negotiations almost immediately, others kept creditors waiting for over a year. Similarly, the average time between announcement and the completion of the debt restructuring in preemptive cases was much shorter, only about a third of the average time for post-default cases. This difference could reflect the complexity of some post-default cases (i.e., a selection effect: more complex cases are more likely to both involve default and take longer to resolve), but also stronger incentives to reach an agreement in preemptive cases due to the threat of a default. However, as further described below, there is no evidence to suggest there were substantial differences in the "quality" or the form of dialogue between the two cases.

Form of Engagement

22. In the cases reviewed, creditor committees were somewhat more common in post-default cases, but there was no clear relationship between the existence of a recognized creditor committee and the duration of debt restructurings. Committees appear to have been formed more frequently in post-default cases, including around 80 percent of cases reviewed, compared to just over half in preemptive debt restructurings. In post-default cases, the duration of the debt restructuring was somewhat longer with a committee relative to those conducted by means of bilateral dialogue. However, causality is not clear, since creditors may have stronger incentives to form committees in complex/difficult debt restructurings.

23. High participation was also achieved in the absence of creditor committees. In the cases reviewed, overall creditor participation levels were high, both in preemptive and post-default cases, and the existence of a creditor committee did not seem to have had much impact.

24. The lack of a distinct link between creditor committees and creditor participation was mirrored in stakeholders' call for a case-by-case approach. There was consensus among stakeholders that creditor committees can be useful, and strong support for engagement with creditor committees where they exist. However, committees were not seen as a prerequisite for

efficiency, and other forms of dialogue, including bilateral negotiations or with facilitating agents, can also be effective depending on the types of claims involved. Stakeholders noted that every debt restructuring poses unique challenges, and the precise modalities of debtor-creditor engagement can, and should, vary accordingly; that timely engagement rather than its form is paramount; that forming committees also comes with monetary costs and other complications that may prevent some creditors from participating; and that high participation has also been achieved without committees.

25. In practice, while debtors generally engaged with creditor committees, very few bonds include clauses requiring them to do so. The inclusion of such creditor engagement clauses has been advocated by the Institute of International Finance (IIF), and they are included as optional clauses in the form of enhanced CACs published by the International Capital Markets Association (ICMA). A frequent argument is that some creditors, such as some asset managers acting on behalf of bondholders, do not have budgets for covering committee costs, leading to less representative or multiple committees (or no committees at all). On this basis, some stakeholders have also argued that Fund policy should encourage creditor engagement clauses, which generally include provisions obligating debtors to pay for creditor committee costs.³⁷ During the 2014 Executive Board's discussion of the ICMA model clauses on CACs, the Executive Board did not endorse creditor engagement clauses, leaving the modality of creditor engagement and related fees for the debtor and its creditors to agree.³⁸ Staff sees no reason to recommend a change in this position.

26. Stakeholders argued—and staff agrees—that the “complexity” limitation for creditor committees under the LIA (see Box 1) should be dropped, while cautioning that determinations of committee “representativeness” need to be case specific. Stakeholders recommended engagement with creditor committees more broadly, noting that “complexity” could be regarded as too subjective. Further, stakeholders generally recognized that it would be difficult to objectively define “representativeness,” which has several dimensions and could depend on the debt portfolio to be restructured. More broadly, they were of the view that the Fund should not become overly prescriptive on *de minimis* thresholds, as what matters for the sovereign is to find a counterpart whose interests are broadly aligned with most creditors. It should be anticipated that in some cases there would be multiple committees, and in this case, it was suggested that creditor committees could organize themselves so that the debtor would engage with a steering committee. While some stakeholders expressed concern with the splitting of creditors into several committees, others argued that the existence of multiple committees did not prevent creditors from reaching an

³⁷See DeSieno (2016) for a statement of this argument. However, to the extent that there is an efficiency argument for debtor funding of committee costs (such as a coordination failure on the side of creditors), nothing prevents the debtor from offering such funding. To the extent that there is not, such funding would not be in the interest of the debtor (nor possibly that of some creditors), and Fund policy requiring the debtor to shoulder this funding would be inappropriate.

³⁸See Strengthening the Contractual Framework to Address Collective Action Problems in Sovereign Debt Restructuring, Minutes of Executive Board Meeting 14/92-2, October 2014.

agreement with the sovereign. Indeed, recent debt restructurings with Argentina (2020) and Ecuador (2020) both involved multiple committees.

Information Sharing and Opportunity for Input

27. In both preemptive and post-default cases reviewed, debtors routinely shared non-confidential information, and creditors appeared to have been given an opportunity to give input on the design of the debt restructuring. Staff reports indicate that non-confidential information was generally shared by the debtor with its creditors. This was also recognized by private creditors, although they noted that some information that they found essential, notably the full set of assumptions underlying the debt sustainability analysis, are not typically shared. Although staff reports are rarely explicit on the exact details of interactions with creditors, in most cases, this information sharing by debtors seems to have also lent creditors an opportunity to provide input on the design of debt restructuring instruments.

28. Stakeholders called for updates to the expectations for information sharing under “good faith” to reflect developments since this principle was defined. In terms of information sharing, private creditors suggested deleting the term “non-confidential” after “relevant”. They consider that the term “relevant” alone would be more descriptive and coherent in practice. In the context of the LIA policy, information sharing is divided into non-confidential information, which the debtor should share with all creditors, and confidential information, which the debtor only needs to share in the context of a negotiated framework subject to safeguards. In this regard, “confidential” refers to “market sensitive” information, the sharing of which is regulated by securities rules and restricts the trading of securities. Private creditors pointed to two problems with the current LIA policy’s treatment of information: First, the terms “confidential” and “non-confidential” can be misunderstood. In particular, debtors may hide behind the principle that only non-confidential information is to be shared with all creditors, by defining all sorts of information that is actually not market sensitive as “confidential”. Second, creditor committee members may want to continue trading while they are negotiating. However, if they receive confidential (market sensitive) information via the committee, they may violate securities law if they traded. Private creditors further asserted that they have developed mechanisms for sharing market sensitive information consistent with that framework. In terms of relevant information, participants mentioned that the following would be important: (i) the exchange of current macroeconomic and debt data, (ii) disclosure of the proposed treatment for different creditor classes, and (iii) transparency around macro policy assumptions (to the extent such information can be disclosed).

Flexibility in Emergency Financing Cases

29. While the LIA policy applies flexibly in emergency financing situations, in practice this flexibility appears not to have been needed in the cases reviewed. Four emergency financing requests involving LIA were identified,³⁹ but in each case the debtor had taken actions that were

³⁹Iraq (EPCA, 2006), Mali (2012, RCF), Ecuador (2016, RFI), Mozambique (2019, RCF).

sufficient to support a determination that the authorities were engaged in “good faith” negotiations in line with the LIA policy.

B. Review of Application of LIA Policy to Jurisdictional Arrears

30. There have been few cases where the LIA policy has applied to non-sovereign arrears that arose because of the imposition of exchange controls (jurisdictional arrears). While jurisdictional arrears were the sole focus of the NTP in its original formulation (Annex III), such arrears now constitute only a small subset of cases to which the LIA policy applies. Staff identified three such cases since 2002: Iceland (2008); Latvia (2008); and São Tomé and Príncipe (2019). In each case, the LIA policy was applied to require both the member to make a good faith effort to facilitate a collaborative agreement between private debtors and creditors on the resolution of arrears and the existence of good prospects for the removal of the exchange controls giving rise to the arrears. Exchange controls were removed in both Iceland and Latvia, leading to a resolution of the arrears. Exchange controls remain in São Tomé and Príncipe, and the Executive Board has approved their temporary retention under the ongoing Fund-supported program.

31. Staff proposes no amendments to the LIA policy with respect to jurisdictional arrears. In this small set of cases, the LIA policy continues to help draw attention to the issue of arrears arising from the imposition of exchange controls, which continue to be an important focus of the Fund’s mandate. The LIA policy operates in tandem with Article VIII, Section 2(a) to convey a consistent message on the need to eliminate exchange controls—and their consequent arrears—to the extent possible.

C. Recommendations

32. Overall, staff considers the LIA policy to be well balanced and that there is no need for a major overhaul of the policy. However, some amendments, and updates are warranted, given the experience gained and the developments observed over the last 19 years of PSI.

Update Elements of “Good Faith” Engagement

33. The principles for assessing “good faith” engagement outlined in 2002 remain broadly appropriate but could be amended, updated, and sharpened in several respects:

- **To provide guidance on what constitutes “relevant” information, with a focus on debt transparency.** Specifically, staff proposes that the Fund specify that the relevant information to be shared with creditors would be expected to include a comprehensive picture of the government debt stock and its terms (in the aggregate) in line with the recent changes adopted under the Fund’s Debt Limits Policy (DLP).⁴⁰ The suggested elements of this disclosure could be aligned with what the member would/could be required to disclose in Fund program documents under the DLP (Box 3): creditor composition, major subcategories of instruments

⁴⁰[Reform of the Policy on Public Debt Limits in IMF-Supported Programs](#), November 2020 (SM/20/157).

(with information on the main financial terms), upcoming debt service, and collateralized debt.^{41, 42}

- To replace the two-track approach on confidential (formal negotiating framework) and non-confidential information (all cases) with an expectation to share all relevant information with creditors.** As noted above, the distinction between confidential (i.e., market sensitive) and non-confidential information is no longer as meaningful; private creditors have developed modalities to deal with market sensitive information even outside of a formal negotiating framework, while in some cases members of a creditor committee may prefer not to be privy to confidential information to avoid being subject to trading restrictions. As such, staff proposes that the existing two-track approach be replaced with a generalized expectation that the creditor should share relevant information (thereby eliminating the formal negotiating framework, including the expectation to enter into formal negotiations with a representative committee if timely formed in complex cases), subject to appropriate safeguards agreed between the parties where this information is market sensitive. This would also bring the LIA policy into closer alignment with “good faith” under the LIOA policy, which includes sharing of “relevant information.” Any information that the Fund produces (such as a Debt Sustainability Analysis (DSA) or a set of macroeconomic projections against which policies are assessed) continues to be confidential and subject to the Fund’s confidentiality rules, which prohibit sharing unless the Fund has published it or consented to its disclosure subject to safeguards.
- To add the element that the debtor’s offer needs to be consistent with the parameters of the Fund-supported program.** The existing “good faith” principles focus on procedural elements of debtor-creditor engagement, but it is important to recognize that in practice, good faith engagement also depends on the financial terms of a debt restructuring proposal. In particular, “good faith” engagement would require that a debt restructuring proposal be broadly in line with what is needed to restore debt sustainability, as reflected in the parameters of the Fund-supported program. While this issue is currently addressed indirectly by the Fund’s other policies on debt sustainability,⁴³ staff proposes to explicitly include an expectation as a fourth guiding principle of good faith, that the debtor offer a debt restructuring proposal consistent with the parameters of the Fund-supported program. Again, this amendment would bring the LIA policy into closer alignment with the LIOA policy and would be consistent with the need to ensure that a debt restructuring will restore sustainability and has a reasonable prospect of succeeding.

⁴¹[Guidance Note on Implementing the Debt Limits Policy in Fund-Supported Programs](#), May 2021 (SM/21/60).

⁴²It would be expected that aggregated debt data would include all relevant debt. To the extent that certain debt is covered by confidentiality clauses, a full breakdown may not be feasible and only the sharing of relevant aggregated data would be expected.

⁴³For example, an offer that falls short of program parameters would not typically be consistent with an assessment that debt sustainability will be restored, while a proposal that is seeking “excessive” relief (e.g., a large NPV haircut) would undermine the high creditor participation needed.

Box 3. Other Fund Workstreams on Debt Transparency

The Fund is addressing the need to support debt transparency through ongoing reforms to the policy frameworks for both program conditionality and surveillance:

- The recent reform of the Debt Limits Policy (DLP) introduces an explicit expectation that critical debt data disclosure gaps be addressed upfront in Fund-supported programs. The new DLP also introduces a new standardized debt holder profile table, to be included in all Fund-program documents. Similarly, the Fund introduced new safeguards requirements for access to the resources of the PRGT in March 2021, including a requirement for enhanced discussion of the structure of public debt for programs involving high access and for countries whose external risk rating is 'high' or 'in debt distress'.
- The Fund is also considering expanding debt reporting requirements in the review of the data provision to the Fund for surveillance purposes to better identify fiscal risks. Recent updates to the Fund's DSA frameworks also address debt coverage and disclosure.
- The 2017 Review of the IMF-World Bank Debt Sustainability Framework for Low Income Countries features an expectation that DSAs should have a near-complete coverage of public debt, supported by standardized reporting of the sub-sectors included and excluded from the DSA and a new contingent liability stress test to assess risks from omitted sectors.¹

The 2021 Review of the Debt Sustainability Framework for Market-Access Countries enhances reporting of debt profile vulnerabilities, including through a breakdown of debt by instrument type and by holder profile.² Bank and Fund staff are supporting official and private sector transparency initiatives:

- **For official creditors, World Bank and Fund staff are supporting G20 efforts on sustainable finance and transparency.** The G-20's Operational Guidelines for Sustainable Financing—Diagnostic Tool identifies shortcomings in official creditor practices including on transparency, and a second round of voluntary self-assessment using the Diagnostic Tool is currently under way.³
- **For private creditors, Fund staff are supporting IIF/OECD work on debt transparency.** Staff participate in a user's group and the Advisory Board involving the World Bank, IMF, BIS, and the IIF to support OECD's development and hosting of a data repository, analysis and reporting of private sector foreign-currency lending to sovereigns (or borrowers with public guarantees) in PRGT-eligible countries.
- **The Fund and Bank are actively working to address debt vulnerabilities in LICs with the implementation of a multi-pronged approach (MPA) since fall 2018.** The MPA covers efforts to support improved debt monitoring, wider debt data coverage and transparency, stronger debt management capacity building, and outreach to creditors.
- **Finally, the Fund's work program includes a Board paper to better understand the incentives for limited debt transparency by debtors and creditors.** The paper envisages to focus on policies, including domestic legal frameworks, international standards, and best practices in debt data recording, reporting and disclosure that could lead to greater debt transparency.

¹[Review of the Debt Sustainability Framework for Low Income Countries: Proposed Reforms](#), October 2017.

²[Review of the Debt Sustainability Framework for Market Access Countries](#), February 2021.

³[G20 Operational Guidelines for Sustainable Financing—Diagnostic Tool](#), November 2019.

- **To play a stronger role in encouraging early dialogue and clear communication by the debtor on the perimeter of claims of a PSI.** Given the many unknowns private creditors have to factor in during a debt restructuring, the sooner the debtor can specify the perimeter of

claims subject to PSI (including claims held on non-government public sector entities), the sooner those creditors can make progress toward an agreement among themselves and with the debtor. Although providing this clarity is the debtor's responsibility, the Fund could establish an expectation on the debtor to do this at the outset of the debt restructuring process. This expectation will also help the Fund establish the requisite assurances under the financing assurances or LIA policy that the debt restructuring will restore debt sustainability. However, this would need to be carefully balanced against the Fund's approach against micromanaging the debt restructuring process. Beyond establishing an expectation as part of the assessment of good faith, it would seem the Fund cannot (and should not) do more. The perimeter of claims that a government chooses to set for a PSI and/or the terms demanded from various private creditors is not something the Fund can or should get involved in. Creditors can exert leverage on the debtors through several channels, and it is not for the Fund to get involved in debt restructuring negotiations (except that for instance, the Fund staff could, at the member's request, explain the Fund's policies and/or the assumptions underlying the member's macro forecast and Fund program parameters as well as the DSA).

Sharpen the Expected Engagement with Creditor Committees in Two Respects

34. As noted above, staff recommends that the expectation of engagement with a creditor committee under a formal negotiating framework be eliminated. However, as a factor staff would consider in assessing good faith, a member would still be expected to engage with a creditor committee or creditor committees when the criteria under the LIA policy are met, with the two below amendments.

35. Because the "complexity" of a case is difficult to determine and not a critical element, staff recommends that this element not be retained under the LIA policy. The LIA policy currently sets the expectation that engagement with creditor committees should only occur "when warranted by the complexity of the case." Three reasons underpin staff's recommendation. First, given that each debt restructuring is unique and presents its own challenges, it is difficult to judge in practice whether one is truly more complex than another. Indeed, even where creditor committees were considered representative in Fund-supported programs, there has been very little discussion of whether the complexity of the case merited such a committee. Second, enforcement of the "complexity" requirement could undermine the objective of encouraging debtor-creditor engagement. In other words, the Fund should not sanction a debtor's disregard of a representative creditor committee simply because a debt restructuring is not deemed complex enough. Third, the factors for determining complexity suggested by the 2002 Board Paper—the number and diversity of creditors, the range of instruments covered by the debt restructuring, the prevalence of inter-creditor equity issues, and the size of the prospective haircut—are generally echoed in the determination of whether a creditor committee is sufficiently representative.⁴⁴ Thus, it is somewhat redundant to require a judgment on complexity. Given the underlying objective of furthering debtor-creditor engagement and the overlap between the elements, staff considers that it is not

⁴⁴[Fund Policy on Lending into Arrears to Private Creditors—Further Consideration of the Good Faith Criterion](#), July 2002.

necessary for the Fund to judge whether the complexity of a case merits the use of a creditor committee.

36. However, staff recommends retaining the expectation that the debtor would engage with a representative creditor committee or representative creditor committees; the below factors could be considered in determining “representativeness.”⁴⁵ Specifically, staff proposes that a representative creditor committee may be expected:

- To represent a substantial portion of the principal covered by the debt restructuring. While staff continues to consider that it is not appropriate to set binding numerical thresholds, as case-specific circumstances can vary significantly (see Annex II), it would appear useful to specify that in cases where bonds contain aggregated CACs,⁴⁶ creditor committees representing a share of claims sufficient to block the activation of these CACs would typically be considered to meet this test.
- To reflect the diverse financial and economic interests of the creditors whose claims are to be restructured—for example, in terms of the different instruments to be restructured, geographical location and nature of the holders (e.g., in terms of retail and institutional investors, large and small bondholders, special purpose vehicles with control or ownership of bonds, influential financial institutions, and hold-to-maturity and distressed debt purchasers). However, no group’s refusal to join the committee should act as a veto on the formation of a representative committee.
- To have the support of the creditor groups that it purports to represent. As noted in the 2002 Board Paper, because committees are expected to function in a purely advisory capacity under the LIA policy, the verification of claims as a precondition for negotiations has not been a serious issue, as reputational risk to the participants has generally disciplined the process. However, direct participation by the largest creditors could be encouraged. For creditor representatives, the Fund could consider whether there is evidence that the participant represents the group it purports to represent, including in cases where some creditors are constrained in their ability to participate directly.

37. In cases where creditors form multiple committees, some engagement with committees that individually or collectively meet the above factors would generally be warranted. Entering into detailed negotiations with multiple committees may not always be

⁴⁵The Executive Board has already provided factors that can be considered flexibly on a case-by-case basis. While declining to set a numerical threshold for determining representativeness, the 2002 paper suggested that consideration could be given on a case-by-case basis to factors such as (a) the proportion of principal held by creditors that have signaled their support for the committee, and (b) the coverage of major types of creditors represented in the committee. *Id.* at para. 44 (noting also that participation might be expected to be higher among institutional rather than retail investors). In discussing this criterion, Executive Directors recognized the importance of flexibility and judgment. See [The Acting Chair’s Summing Up—Fund Policy on Lending into Arrears to Private Creditors—Further Consideration of the Good Faith Criterion](#), September 2002 (BUFF/02/142).

⁴⁶Aggregated thresholds for approval in enhanced CACs are 66 2/3 percent across series (in two-limb aggregated voting) or 75 percent across series for single-limb aggregated voting.

feasible, nor may it be necessary in the case of smaller, non-representative committees. In such cases, the debtor may prefer to engage with the committee that appears most representative (or if relevant, a steering group with representation from the different committees). However, where other committees hold a sizeable share of claims, debtors could still be expected to engage with those committees, including to supply relevant information at the committees' request. This would particularly be the case when there are several sizeable committees of which none is individually representative, but which are collectively representative.

Restate the Use of Flexibility in Emergency Financing Cases

38. Staff proposes to restate the circumstances in which the LIA policy can be applied flexibly for emergency financing requests in line with the LIOA policy. While the review indicates that the need for flexibility under the LIA policy has so far been limited, staff continues to see circumstances in which this could become relevant in the future. In particular, it would appear sensible to align the expectations for the use of flexibility with the LIOA policy, under which flexibility is reserved for emergency situations, such as in the aftermath of a natural disaster, where the extraordinary demands on the affected government are such that there is insufficient time for it, as the debtor, to undertake good faith efforts to reach agreement with its creditors. In addition, it would be expected that the Fund's support provided to the debtor in such cases would help advance normalization of relations with private creditors and the resolution of arrears, so that the approval of any subsequent Fund arrangement for the member would again be subject to the LIA policy.

Provide Further Guidance on Implementation in Staff Reports

39. Staff will provide more precise guidance in a staff guidance note on how to assess, and document in the staff report compliance with the good faith criterion. Enhanced transparency and evenhandedness can be better achieved through standardized documentation in staff reports.⁴⁷ Staff will also provide further guidance on the Fund's role in sovereign debt restructuring.

LIA policy versus IIF Principles for Stable Capital Flows and Fair Debt Restructuring

40. While there are overlaps between the Fund's current LIA policy and the IIF Principles as well as their Addendum, there are a number of important differences (see Box 4); therefore, staff continues to take the view that it would not be appropriate to endorse the IIF Principles and their Addendum. First, the IIF Principles unreservedly encourage early negotiations

⁴⁷Sovereign arrears to private creditors may arise for reasons unrelated to the need for debt restructuring, such as administrative issues on the debtor side and/or difficulties in affecting payments. In such cases, in practice, the standard "good faith" principles have been applied to the extent relevant as the debtor needs to engage its creditor(s) to resolve the arrears. Where payments are in arrears due to factors outside the debtor's control, such as international sanctions, the policy was generally considered met and the Fund could lend when payments were made into escrow. This is the approach that has been taken in cases where arrears have accumulated to official creditors due to sanctions (e.g., Mali 2013; Honduras 2011).

with a committee after a default, while the current LIA policy provides for formal negotiations only if the case is complex, the committee is representative, and has been established on a timely basis. Second, the IIF Principles call on the resumption of partial debt service and recommend including official bilateral creditors in the debt restructuring while the LIA policy remains silent on these issues. Third, in contrast to the Addendum, the Fund's policy does not foresee a formal involvement of the private sector in DSA preparations and leaves the specificities of creditor committee design, including costs, as well as the debt restructuring strategy and perimeter to negotiations between creditors and debtors.

Box 4. IIF Principles for Stable Capital Flows and Fair Debt Restructuring

- **The Institute of International Finance's (IIF) "Principles for Stable Capital Flows and Fair Debt Restructuring" (the "Principles") establish best practices for the consultation between debtors and creditors in sovereign debt restructurings.** The Principles were announced by the G20 in its Berlin Communique in 2004 and have since been applied in several debt restructuring operations. The Fund has neither been involved in the Principles' establishment nor formally endorsed them.
- **The Principles are non-binding rules aimed at facilitating a voluntary, market-based debt restructuring process based on good faith and ensuring the fair treatment of all affected creditors.** They are used on a case-by-case basis and apply equally to preemptive and post-default debt restructurings. They consist of the following four key principles, which are further broken down into specific rules of conduct that build on international best practices:
 - Transparency and timely flow of information: The Principles call on debtors to disclose relevant information to creditors, including specific disclosure in a debt restructuring context relating to maturity and interest rate structures, the proposed treatment of such obligations, and the central aspects of economic policies and programs.
 - Close debtor-creditor dialogue and cooperation to avoid debt restructuring: Debtors and creditors should be in a regular dialogue regarding information and data on key economic and financial policies and performance, notably through investor relation channels, policy action and feedback, as well as consultations. In a debt restructuring, creditors should consider appropriate requests for the voluntary, temporary rollover of short-term maturities on public and private sector obligations, if necessary to avoid a broad debt restructuring.
 - Good-faith actions: Creditors and debtors should engage in a debt restructuring that is voluntary and based on good faith, and cooperate in order to identify the best means to bring the debtor member back to sustainable BOP while preserving and protecting asset value during debt restructurings. The Principles emphasize the sanctity of contracts, call on debtors and creditors to rely upon the Fund in its traditional role, and support the establishment of creditor committees, the costs of which are usually borne by the debtor member.

Box 4. IIF Principles for Stable Capital Flows and Fair Debt Restructuring (concluded)

- **Fair treatment:** Borrowing countries should avoid unfair discrimination among affected creditors.
- **Following the Greek sovereign debt restructuring of 2012, the IIF published an Addendum to the Principles (the “Addendum”) to make further recommendations taking account of specific issues in restructurings of mature market countries’ debts.** The Addendum inter alia clarifies the meaning of “good faith actions”, calls for early restoration of market access, and recommends early discussions between representative creditor committees as well as greater private sector involvement in DSAs.

PREEMPTIVE DEBT RESTRUCTURING PRACTICE

A. Review of Practice in Preemptive Debt Restructuring Cases

41. In general, preemptive debt restructurings are associated with better outcomes for the debtor member and creditors.⁴⁸ These debt restructurings tend to be shorter in duration, achieve higher creditor participation, have lower haircuts and lead to better post-restructuring growth outcomes to the debtor than post-default debt restructurings. As noted above, the Fund advises members to remain current on all debt obligations to the extent possible. Thus, where a debt restructuring is needed, a member should seek to initiate a preemptive debt restructuring and continue to service the original claims during the debt restructuring process. In the context of financial support from the Fund, avoiding a default is important both because a default may exacerbate the immediate economic and financial dislocation and because it may undermine the member’s capacity to re-access international private capital markets in the medium term, which is a key requirement for Fund financing.

42. Unlike post-default settings, to which the LIA policy applies, the Fund does not have a formal policy linking Fund support to a specified standard for creditor engagement in preemptive debt restructuring negotiations. This was achieved by adopting the LIA, which only tolerated arrears to private sector creditors in PSI cases under specific limited circumstances.⁴⁹ Absent arrears, this motivation for laying out a standard of creditor engagement guiding the Fund’s decision to lend does not apply. Furthermore, in 2002, staff expressed concern that establishment of a formal Fund framework establishing minimum engagement expectations would be too

⁴⁸See [The International Architecture for Resolving Sovereign Debt Involving Private-Sector Creditors—Recent Developments, Challenges, And Reform Options](#), October 2020.

⁴⁹[Executive] Directors stressed that in promoting orderly financial relations, every effort must be made to avoid arrears, which could not be condoned or anticipated by the Fund in the design of programs. Nevertheless, an accumulation of arrears to banks may have to be tolerated where negotiations continue and the country’s financing situation does not allow them to be avoided”, [Summing Up by the Chairman—Fund Involvement in the Debt Strategy](#), May 1989 (EBM/89/61), at p. 4.

cumbersome in preemptive cases, running counter to the objective of swiftly concluding negotiations that would avert default.⁵⁰

43. However, experience since 2002 indicates that debtor-creditor engagement in successful preemptive debt restructurings is similar to that in post-default debt restructurings. Since 2002, 20 preemptive sovereign debt restructuring episodes have taken place. The average time to conclude the preemptive operations ranged from 1 to 17 months with an average of 7.6 months (see Table 1). A review of cases since 2002 shows that creditor committees have been as frequent in preemptive as in post-default cases. Market participants have expressed the view that they consider preemptive cases with elevated debt vulnerabilities had a similar level of engagement as post-default cases.

Table 1. Episodes of Preemptive Restructuring of Public Marketable Debt, 2002-2021¹

Country	Start of default or debt restructuring process ^{2, 3}	End of debt restructuring process ⁴	Length of process (in months)	Presence of a committee	Participation rate
Moldova	Jun-2002	Oct-2002	6	[...]	100%
Uruguay	Mar-2003	May-2003	4	[...]	93%
Nicaragua	Jul-2003	Jul-2003	1	[...]	[...]
Dominican Republic	Apr-2004	May-2005	15	[...]	97%
Grenada	Oct-2004	Nov-2005	15	[...]	94%
Belize	Aug-2006	Feb-2007	8	Yes	98.1%
Nicaragua	Jun-2008	Jul-2008	2	[...]	[...]
Jamaica	Jan-2010	Feb-2010	2	[...]	99.2%
St. Kitts and Nevis	Jun-2011	Apr-2012	11	[...]	100%
Greece	Jul-2011	Mar-2012	10	Yes	96.9%
Belize	Aug-2012	Mar-2013	7	Yes	100%
Jamaica	Feb-2013	Mar-2013	2	No	99%
Cyprus	Jun-2013	Jul-2013	2	No	100%
Chad	Sep-2014	Dec-2015	16	[...]	[...]
Ukraine	Jan-2015	Apr-2016	16	Yes	50%
Mozambique	Jun-2015	Apr-2016	11	Yes	85%
Belize	Nov-2016	Mar-2017	5	Yes	100%
Mongolia	Feb-2017	Mar-2017	2	No	90% ⁵
Chad	Feb-2017	Jun-2018	17	[...]	100%
Ecuador	Mar-2020	Aug-2020	6	Yes	100%

⁵⁰[Fund Policy on Lending into Arrears to Private Creditors—Further Consideration of the Good Faith Criterion](#), July 2002.

**Table 1. Episodes of Preemptive Restructuring of Public Marketable Debt, 2002-2021¹
(concluded)**

Sources: Asonuma and Trebesch (2016); IMF (2015); IMF (2020); Moody's (2020); IMF country reports; and country authorities' websites.

¹Note: Ongoing cases as of March-2021 have been excluded.

²Restructurings are defined as "preemptive" if (i) no debt service payments are missed (no legal default) or (ii) some debt service payments are missed, but only temporarily and after the start of formal or informal negotiations with creditor representatives (no unilateral default). "Post-default" debt restructurings are all other cases, in which debt service payments are missed unilaterally and without the agreement of creditors.

³The start of a default/restructuring process is defined as the default month or the month in which a distressed debt restructuring was announced. When both a default and an announcement take place, the earliest date is used.

⁴The end of a debt restructuring is defined as the month of the final agreement or the implementation of the debt exchange.

⁵83 percent participation rate of existing holders, or over 90 percent excluding US-based investors who could not participate for legal reasons.

44. On rare occasions, preemptive sovereign debt restructurings have also taken place outside Fund-supported programs. For example, the Fund played the role of an independent and neutral party in Belize's 2007, 2013, and 2016 preemptive debt restructurings. The 2006 Article IV consultation documents and staff's debt sustainability assessment and cash flow analysis played a central role in setting the parameter for the 2007 debt restructuring. In December 2006, at the request of the Belizean authorities, the Fund's Managing Director issued an assessment letter to the international financial community, right after the exchange launch, encouraging high participation.⁵¹ Similarly, Fund staff were in close contact with the authorities and financial advisors in the 2013 debt restructuring. Technical assistance on debt management also helped build relevant institutional capacity.

45. Fund policies and practices have helped promote engagement during preemptive sovereign debt restructurings. First, the current LIA policy incentivizes the debtor to engage with its creditors in preemptive situations given the knowledge that a post-default debt restructuring would carry strong expectations concerning the debtor through the LIA policy. Second, the Fund's current *practice* in preemptive debt restructuring cases, which requires a process that credibly delivers a debt restructuring outcome in line with program parameters, has generally looked to guiding principles for engagement broadly similar to those listed in Box 1 in order to assess the credibility of the process. Given that speed is of the essence to avoid a default, where conditionality has been employed in preemptive cases, the current practice has normally required debt operations to be completed or if justified by the circumstances of the specific case, more advanced before approving the request for an arrangement than is typically the case in post-default settings. However, the application of this approach has varied in practice.⁵²

⁵¹[Assessment Letter for the International Financial Community](#), December 2006.

⁵²In post-default cases, programs have generally allowed more time for the debt restructuring to be completed, with conditionality consisting of intermediate steps towards finalizing the debt operation. See: [The Fund's Lending Framework and Sovereign Debt—Further Considerations](#), April 2015.

B. Recommendations

46. Staff sees the current practice as broadly appropriate in preemptive debt restructuring cases. Any attempts to improve the status quo need to take into account that preemptive cases are different from post-default debt restructurings in that time is of the essence. It is in the interest of both the debtor and the creditors to avoid a default and the associated large costs and inefficiencies. Accordingly, any policy should continue to allow for flexibility such that its application does not result in a delay of the debt restructuring and the incurrence of arrears.

47. Staff nevertheless sees merit in codifying the existing practice into a Fund policy with some enhancements to guide creditors, debtors, and the Fund in preemptive debt restructuring cases and to enhance clarity, certainty, and transparency. Codifying the existing practice into a Fund policy amounts to a transparent commitment of the Fund to decide when a preemptive debt restructuring is credible taking into account a range of factors as discussed below. This can provide certainty to help guide creditors and debtor in their negotiations and accelerate their conclusion. The codification also creates an opportunity to highlight a particular ingredient of the preemptive debt restructuring process which the Fund has increasingly viewed as important: the need for debt transparency on the side of the debtor. It should be noted that, relative to the LIA policy that applies to post-default cases, the practice in preemptive cases provides fewer guiding principles and greater flexibility in order to encourage efficient resolution of debt issues without default.

Codification of Current Practice into a Fund Policy with Enhanced Debt Transparency

48. Staff recommends codifying the current practice into a Fund policy requiring that the Fund assesses that a credible process for debt restructuring is underway and such debt restructuring will likely deliver an outcome in line with program requirements. Relevant considerations to form such judgment would continue to include the engagement of legal and financial advisors by the member, the launching of consultations with creditors, and the design of the debt restructuring strategy, including the terms of the new instruments and use of inducements for creditor participation. To inform its judgment, staff may consider a range of factors, including (but not limited to) the stage of the negotiations, the private sectors' share of the overall financing envelope, and the strength of the creditors' position given, e.g., the existence of collateral.

49. In addition, staff recommends adding an expectation of enhanced transparency and information sharing. Staff proposes that, for the reasons explained in paragraph 33, the Fund policy on preemptive debt restructurings also include an expectation that relevant information—as defined under the LIA policy—be shared on a timely basis.

LENDING INTO OFFICIAL BILATERAL ARREARS

A. Review of Cases with Arrears to Official Bilateral Creditors Since 2015

50. Staff reviewed the 34 arrangements or outright disbursements during which arrears to official bilateral creditors arose since the establishment of the LIOA policy in 2015 (Table 2).⁵³ Several of these cases required the application of multiple strands of the LIOA policy over the course of the Fund-supported program.⁵⁴

- Of the 34 cases, 11 had “non-OSI arrears”—i.e., the program anticipated full repayment of the claim without the need for a contribution from official bilateral creditors. In all such cases, the Fund was able to provide financing, as the creditors’ Executive Directors acquiesced or did not object at the time of the Executive Board meetings. In these cases, staff has typically complemented the debtors’ efforts by reaching out to the creditors’ Executive Director’s office in advance.
- In 26 cases, there were arrears on claims where OSI was expected under the macro-framework. It was for these cases, where a debt restructuring is deemed necessary, that the LIOA policy was established to encourage collective action among official bilateral creditors and to ensure that the provision of Fund support is not held up by the unwillingness of hold-out creditors to join an effort that is supported by an adequately representative group of creditors. In all cases, the Fund was able to provide financing. Of these 26 cases, 13 had claims covered by a representative Paris Club agreement, allowing remaining arrears to official bilateral creditors to be deemed away. In 10 cases, creditors provided explicit consent to Fund financing despite the arrears. The three criteria under the LIOA policy were only applied in seven cases involving four debtors; the criteria were judged to be met in each case. Of the seven cases, three involved a national security dispute between the debtor and creditor and one involved non-recognition of the creditor government; these issues fall outside the influence of the arrears policies. In the remaining three cases, which involve two debtors and a single creditor, creditor consent was sought but not provided by the time of the relevant Executive Board meetings. Over the course of the arrangements, this was both due to the creditor ultimately providing no response at times,⁵⁵ as well as to affirmative objections from the creditor at other times.

⁵³Where there is a representative Paris Club agreement and the member continues to make best efforts to conclude bilateral agreements, only the first arrangement after 2015 has been included.

⁵⁴For example, in one case a creditor provided consent to proceed with a review under the arrangement; at the next review, however, the creditor did not provide such consent. Another example would be where arrears arose on claims that both pre-date and post-date a representative Paris Club agreement which are subject to the LIOA (former) and the NTP (latter).

⁵⁵“Deemed consent” did not apply in these cases because the creditor authorities were responsive and sought additional time to consider the request, though they ultimately provided no substantive response.

Table 2. Arrears to Official Bilateral Creditors—Application of Arrears Policies

Debtor	Facility, Approval	non-OSI	OSI			
			Representative Paris Club agreement	Consent	Three criteria	Emergency Financing
Afghanistan	ECF, 2016		x			
Barbados	EFF, 2018			x		
Burkina Faso	ECF, 2016		x			
Central African Republic	ECF, 2019			x	x	
Central African Republic	ECF, 2017	x		x	x	
Chad	ECF 2017	x				
Chad	RCF, 2020	x				
Comoros	RCF, 2020	x				
Dem. Rep. Of Congo	ECF, 2019		x	x		
Djibouti	RCF, 2020					x
Ethiopia	EFF/ECF, 2019		x			
Gabon	EFF, 2017	x				
Gabon	RFI, 2020	x				
The Gambia	RCF, 2017			x		x
The Gambia	ECF, 2020				x	
Grenada	ECF, 2016		x	x		
Grenada	RCF, 2020			x	x	x
Guinea	ECF, 2017		x			
Guinea	ECF, 2016	x				
Guinea-Bissau	ECF, 2016			x		
Guinea-Bissau	RCF, 2021	x		x		
Iraq	SBA, 2016		x			
Jamaica	EFF, 2016		x			
Jordan	EFF, 2016		x			
Mongolia	EFF, 2017			x		
Mozambique	RCF, 2019		x			
Mozambique	RCF, 2020	x				
Sao Tome and Principe	ECF, 2019	x	x			
Serbia	SBA, 2016		x			
Somalia	EFF/ECF, 2020		x			
Suriname	SBA, 2016	x				
Ukraine	EFF, 2016				x	
Ukraine	SBA, 2019				x	
Ukraine	SBA, 2020				x	

- Four cases involved OSI-related arrears in emergency financing requests under the RCF or RFI. One of these (Djibouti 2020) was determined to fit the exceptional circumstances under the LIOA policy that allowed flexible application: it advanced on the basis of the authorities' expected application for relief under the DSSI. In Grenada (2020), the flexibility was not used given that debtor-creditor discussions had already been long underway by the time of the request. Similarly, in The Gambia (2017) and Guinea-Bissau (2021), creditor consent was

obtained given that arrears pre-dated HIPC and debt restructuring discussions were already underway.

B. Recommendations

51. The LIOA policy appears to have worked well. Importantly, arrears to hold-out official bilateral creditors have not prevented Fund financing, which is the main objective of the policy. Feedback from outreach to both debtor and creditor members has been overwhelmingly positive, indicating that the policy provides an opportunity for engagement on arrears and that it strikes the right balance between discouraging arrears and preventing holdout creditors from vetoing Fund financing. The fact that arrears have been addressed through collective action or debtor-creditor agreement in the large majority of cases is positive.⁵⁶ It is difficult to draw broad lessons from the few cases where the Fund has had to resort to applying the three criteria.

52. Some stakeholders have asked for further clarification of the language on the LIOA policy's third criterion. The summing up states that, the third criterion—i.e., whether the Fund's decision to lend into arrears to an official bilateral creditor would have an undue negative effect on the Fund's ability to mobilize official financing packages in future cases—"would normally not be satisfied where the creditor or group of creditors that has not reached agreement with the debtor accounts for an adequately representative share."⁵⁷ This admonition is in line with the intended use of the LIOA policy to ensure Fund financing supported by "an adequately representative group of creditors" is not vetoed by "hold-out creditors."⁵⁸ In practical terms, the use of "normally" indicates some degree of discretion to rebut the presumption not to lend into arrears to a majority creditor or group of creditors. In this regard, any evaluation of this criterion in these abnormal circumstances should be in line with the Fund's mandate and based exclusively on a determination as to whether the Fund's decision to provide financing despite the arrears would have an undue negative effect on the Fund's ability to mobilize official financing packages in future cases. The Fund would still need to assess that the third criterion under the LIOA policy is satisfied. In general, however, a durable solution to a BOP problem that requires a debt restructuring is unlikely to be achievable without the participation of large creditors.

OSI-Related Arrears

53. As to the treatment of arrears that persist over multiple Fund-supported programs, once a claim has been determined to be OSI related, such determination is permanent under the current policy. The LIOA policy notes that "the regularization of arrears is an objective of any Fund-supported program and important for the functioning of the international financial system at

⁵⁶The ultimate resolution of arrears depends on the debtor and its creditors. Staff does not have information on the evolution of arrears stocks over time.

⁵⁷[The Chairman's Summing Up—Reforming the Fund's Policy on Non-Toleration of Arrears to Official Creditors](#), December 2015 (BUFF/15/107).

⁵⁸*Id.*

large.”⁵⁹ However, arrears occasionally persist beyond the length of a Fund-supported program and must again be addressed in the context of a successor arrangement. In such cases, the question arises as to whether the necessity for OSI must be assessed anew in the context of the new program. While the LIOA policy does not explicitly mention this, in practice, new Fund-supported programs have incorporated the assumption that old OSI-related claims would be restructured in line with the terms stipulated in the original Fund-supported program. The Fund took the same approach with respect to HIPC legacy arrears. The alternative approach would create perverse incentives: the prospect of having claims reclassified as non-OSI as the debtor’s situation improves could incentivize official creditors to hold out for eventual full repayment, free riding on the creditors who accepted a debt restructuring. Staff therefore proposes to restate that, once a claim has been determined to be OSI related, such determination is permanent.⁶⁰ However, in line with current practice, a claim that was originally non-OSI related may be recategorized as OSI related if required by economic developments.

The Common Framework as a Potential New Representative Standing Forum

54. The Common Framework (CF) has arisen as a new modality for collective action among official bilateral creditors.⁶¹ The CF is a set of principles and processes which the G-20 countries and the Paris Club endorsed in November 2020 to facilitate timely and orderly debt treatment for 73 low-income countries eligible for the Debt Service Suspension Initiative.^{62, 63} However, with the first debt treatments under consideration, the CF may emerge as a commonly used approach for eligible members’ debt treatments. As noted above in Box 2, the LIOA policy provides a special status only to the Paris Club—due to its status as a long-standing representative forum for official creditor coordination and its track record of support for Fund arrangements—such that adequately representative Paris Club agreements can “deem away” arrears to non-participating official creditors.⁶⁴ Thus, adequately representative CF treatments can only “deem away” arrears to non-participants when Paris Club creditors participate (in such cases, both the non-Paris Club and Paris Club financing under the CF would count to determine representativeness, as is currently the case in Paris Club Plus treatments).

55. While the Executive Board has indicated an openness to according another “representative standing forum” a status under the LIOA policy equivalent to that of the Paris Club, it is currently uncertain how the CF and its role in the international sovereign debt architecture will evolve. As the CF comprises the main G20 creditors, the CF is representative.

⁵⁹*Id.*

⁶⁰Similarly, if arrears are deemed away on the basis that a Paris Club agreement is representative, there would be no need to reassess such representativeness in subsequent programs.

⁶¹[Extraordinary G20 Finance Ministers and Central Bank Governors’ Meeting](#), Statement, November 13, 2020.

⁶²*Id.*

⁶³Beaumont and Hakura (2021).

⁶⁴[The Chairman’s Summing Up—Reforming the Fund’s Policy on Non-tolerance of Arrears to Official Creditors](#), December 2015 (BUFF/15/107).

However, a new creditor committee is established in response to each request for a debt treatment, a process that requires case-by-case approvals from some official creditors. Moreover, unlike the Paris Club, the CF does not allow for a regular ex ante monitoring of developments in debtor members, which can facilitate timely financing assurances when needed. Further, at this time, a single country case (Chad⁶⁵) has received official sector financing assurances under the CF, and the treatment is still to be implemented. Both G-20/Paris Club members and Fund staff must gain more experience with successful CF debt treatments in order to establish the procedures necessary for the Fund's application of its arrears and financing assurances policies. Staff will monitor the CF's evolution closely and if appropriate will revert to the Executive Board with a stand-alone proposal to amend the LIOA policy.

POLICY ON NON-TOLERATION OF ARREARS TO INTERNATIONAL FINANCIAL INSTITUTIONS

56. The proliferation of new IFIs has rendered the current approach for identifying multilateral creditors increasingly outdated. With the exception of the World Bank, the designation of the claim holder as "multilateral" under the current approach is based on judgment informed by factors including global membership, and treatment by the Paris Club and under HIPC. Some institutions, such as the long-established multilateral development banks (MDBs) with global membership, are clearly multilateral creditors under the current approach. However, an increasing share of financing to developing countries is extended by IFIs that may or may not have a global membership. Recent Fund policy papers have documented the growing share of these creditors in lower-income economies' debt stocks.⁶⁶ While this share remains relatively modest on average, exposures are large in some members with high debt vulnerabilities. The number of such institutions has also been proliferating in recent years. It is difficult to apply the existing criteria to new institutions since the HIPC process concluded for most members about 10 years ago and the Paris Club has recently only rarely provided a treatment outside the HIPC/MDRI initiatives.

57. In practice, staff faced few challenges in cases in which arrears to multilaterals were present. In most cases, a Credible Plan was assessed to be in place to enable the Fund to proceed. Arrears to the World Bank and multilaterals providing substantial financing (where the Agreed Plan would have applied) were rare. However, given the emergence and proliferation of new IFIs, staff faced issues on classification related to financing assurances and program design.

Recommendations

58. The treatment of IFI claims under the Fund's NTP should be clarified. The policy should continue to avoid a specific, closed list of IFIs whose claims would receive special protection under

⁶⁵ [Fourth Meeting of the Creditor Committee for Chad under the Common Framework](#), June 2021.

⁶⁶ [Macroeconomic Developments and Prospects in Low-Income Developing Countries](#), February 2018; [The Evolution of Public Debt Vulnerabilities in Lower Income Economies](#), December 2019.

the NTP, as it needs to be open to new IFIs whose claims may merit protection for the same reasons as for the claims of long-established, global multilaterals. The ambiguity regarding claims held by IFIs was less consequential prior to 2015, as the Fund's NTP applied to sovereign arrears on all external claims except those held by private creditors (see Annex III). However, with the establishment of the LIOA policy, the NTP now effectively covers only multilateral claims and Direct Bilateral Claims in respect of which payment in full is contemplated under the program (non-OSI-related Direct Bilateral Claims). Thus, it is increasingly important that both the types of institutions considered "multilateral creditors" and the treatment of their claims be characterized unambiguously.

59. Further, any proposals should ensure that the special treatment of claims held by multilateral creditors not be diluted. The value of that special treatment is reduced as the number of institutions receiving that treatment increases. The current policy, and its ambiguities, will be difficult to sustain going forward as the number of active IFIs increases.

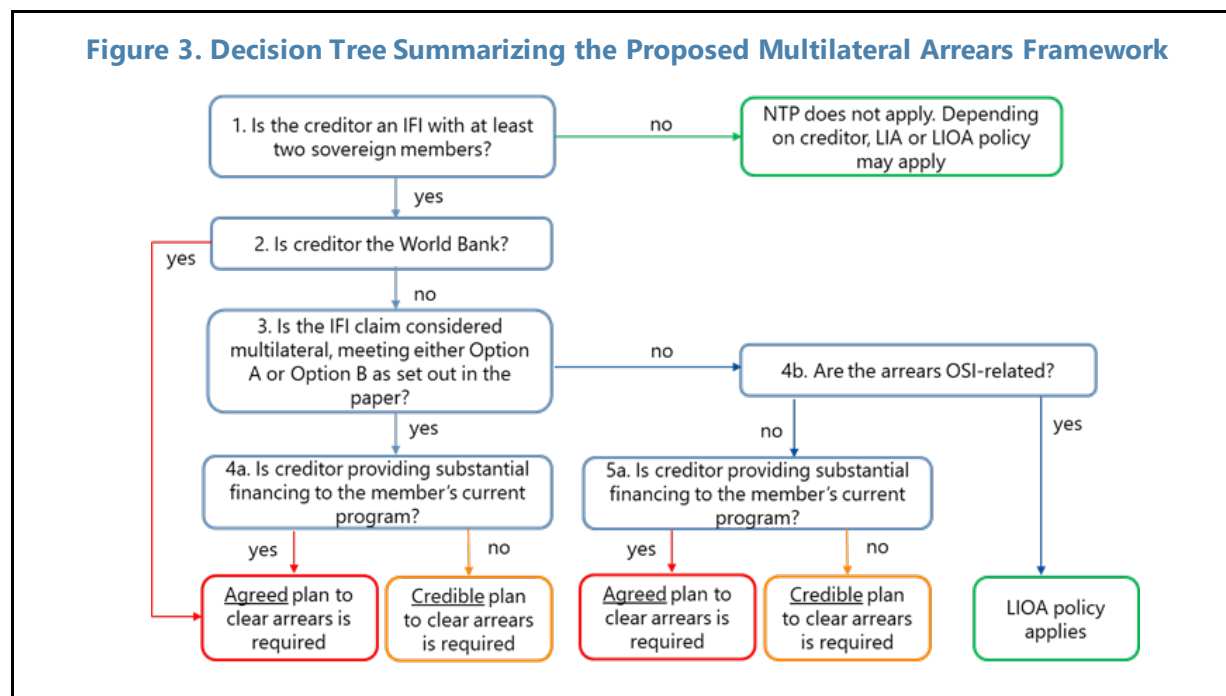
60. Against this backdrop, staff proposes two main changes to its framework for treating IFI claims which leave the current approach largely intact and provide clarity for IFI claims that are not multilateral claims (see Figure 3).⁶⁷ Importantly, these proposals only address the treatment of claims under the Fund's arrears policies and should not have implications for the de facto preferred creditor status (PCS) that certain IFIs may enjoy.⁶⁸ Specifically, staff proposes:

- First, to amend the definition of claims considered "multilateral". Two options, described below, are provided for Executive Directors' consideration. Option A focuses on IFI claims originating from financing provided to resolve BOP problems (including financing in the context of a Fund-supported program). The logic of this option is that the NTP should promote IFI activities that support the Global Financial Safety Net. Option B encompasses Option A, but also confers multilateral status on claims of IFIs that reliably provide financing of a public good nature, even outside the resolution of BOP problems (for example, project lending). As is the case under the current approach, the logic of this option is that the NTP should also promote stable capital flows supporting global public goods.

⁶⁷As stated in paragraph 17, the current NTP does not apply to claims not related to financing of a public good nature, even outside the context of resolving BOP problems (such as membership fees). These claims are outside of the scope of the Fund's NTP.

⁶⁸The basis for the de facto PCS is recognition of the public good nature of Fund and certain other IFI financing by the international creditor community through official bilateral creditors' voluntary forbearance in the context of debt restructuring, which private creditors have largely recognized as well. This should not be affected by how a particular creditor is treated for the purposes of the Fund's arrears policies.⁶⁹In a given case, the determination of whether OSI is required would apply to claims held by both official bilateral creditors and IFI claims. The Fund would not micromanage from which creditors the debtor seeks contributions. "Contribution" here comprises, and is limited to, debt relief and new financing (e.g., loans, bond financing, guarantees, and grants).

- Second, to create a policy for arrears on IFI claims *not* classified as multilateral claims. With reference to Figure 1, this can be thought of as removing the present ambiguity on how non-multilateral IFI claims are treated. The treatment would depend on whether the arrears are OSI or non-OSI related.⁶⁹ In non-OSI cases, the NTP would continue to apply to non-multilateral IFI claims. In OSI cases, however, non-multilateral IFI claims would be subject to the LIOA policy—paralleling the treatment received by official bilateral claims, and requiring an amendment of the LIOA policy.



61. As is clear from comparing Figure 1 and Figure 3, the treatment of World Bank and multilateral claims is unchanged under the proposed new framework.

For World Bank claims, an Agreed Plan would always be required. For multilateral claims, an Agreed Plan would be required if the multilateral provides substantial financing in the context of a Fund-supported program, while a Credible Plan would be required if it does not.

Treatment of IFI Claims Under the Proposed New Framework

Agreed Plan: required for (i) arrears on claims held by the World Bank; (ii) arrears on claims of IFIs providing substantial financing to a current Fund-supported program, if the claim is either non-OSI related, or (even if it is OSI-related) if it is considered multilateral according to either of the two proposed options A or B as presented below.

Credible Plan: required for arrears on claims of IFIs not providing substantial financing to a current Fund-supported program, if the claim is either non-OSI related, or (even if it is OSI-related) if it is considered multilateral according to either of the two proposed options A or B as presented below.

LIOA: applies only in OSI cases, to arrears on IFI claims not considered multilateral

⁶⁹In a given case, the determination of whether OSI is required would apply to claims held by both official bilateral creditors and IFI claims. The Fund would not micromanage from which creditors the debtor seeks contributions. “Contribution” here comprises, and is limited to, debt relief and new financing (e.g., loans, bond financing, guarantees, and grants).

Proposed Amendment 1: Definition of Multilateral Claims

62. To define multilateral claims which would receive special treatment even in OSI cases, staff proposes two options for Executive Board consideration. As already mentioned in the previous paragraph, each option corresponds to a specific concept of what the Fund's NTP with respect to multilateral creditors should be attempting to achieve. Under Option A, the aim is to encourage multilateral lending that—like use of Fund resources—is aimed at resolving BOP problems. Hence, this option focuses on providing special treatment for claims that were acquired when providing financing to resolve a member's BOP problem. Option B additionally takes on a broader objective: to encourage the reliable provision of financing with a public good nature even outside of resolving a BOP problem. Both options can be thought of as being broadly analogous to the logic of the LIOA policy, in that both respond to the question whether lending into arrears would have an undue negative effect of the Fund's ability to mobilize official financing packages in future cases, with Option A focusing on financing that resolves a BOP problem in which members depend on official financing, and Option B extending beyond Option A to provision of financing with a public good nature more broadly.

Option A: All claims of regional financing arrangements (RFAs) and any claims incurred by IFIs as a result of past substantial financing to Fund-supported programs

63. Much like the Fund, RFAs are set up for the purpose of undertaking financing to resolve a member's BOP problem, while claims of any IFI (RFA or not) acquired in the process of providing financing to Fund-supported programs directly help the Fund to resolve the member's BOP problem.⁷⁰ As such, the Fund's NTP should strive to protect such claims. Providing special protection to claims acquired by any IFI in the process of providing financing to Fund-supported programs would help magnify the Fund's catalytic role by encouraging substantial financing to Fund-supported programs from IFI creditors.⁷¹

⁷⁰More precisely, the Fund defines RFAs as "a finance mechanism backed by pooled resources through which a group of countries pledge common financial support to a fellow member in the event of external liquidity needs for balance of payment (BoP) difficulties." See [Collaboration Between Regional Financing Arrangements and the IMF](#), July 2017, at p. 6.

⁷¹For the purposes of applying the NTP, it is important to define multilateral *claims* rather than multilateral institutions, as the NTP seeks to protect specific claims that are in arrears. Even under the present policy, the NTP applies to claims (as explained in footnote 31, not all claims of institutions considered multilateral under the current policy are protected). This said, the nature of the IFI holding the claim plays an important role in deciding whether a claim is considered multilateral or not. This is true under the current policy and it remains the case in the proposal below. Under Option A (paragraph 63), if a (BOP-related) debt claim is held by an RFA, this would be a sufficient (but not necessary) condition for the claim to be considered multilateral. Under Option B (paragraphs 64 and 65), the nature of the creditor institution also matters. While not a sufficient condition, global membership is one criterion that the Fund would consider in deciding whether a claim is multilateral.

Option B: Claims covered in Option A plus claims of IFIs that reliably provide financing of a public good nature, even outside the context of resolving BOP problems

64. In addition to protecting the claims covered in Option A, this option would provide special treatment based on the propensity of the creditor to reliably provide financing of a public good nature, even outside the context of resolving BOP problems. The current criteria used to identify multilateral creditors has led to the general protection of claims of long-established MDBs. Such MDBs, like the Fund, are likely to pursue the global common interest, albeit through different financial activities. The Fund could continue to focus on protecting these activities—which can take the form both of financial contributions to Fund-supported programs and of policy or project lending outside the context of Fund-supported programs—thereby helping to lower the credit risk of claims arising from them. At the same time, Fund policies should not discriminate against new and regional multilateral creditors providing similar financing. This could be achieved by focusing on the following criteria:

- i. The claim holder's track record in reliably providing financing of a public good nature, even outside the context of resolving BOP problems, including (but not limited to) substantial financing to Fund supported programs. For example, to qualify for Credible Plan treatment in OSI cases, a new MDB with global membership would require some track record. The latter would need to be defined to ensure that it does not include creditors that are no longer active in providing financing of a public good nature. This could be achieved by focusing on a rolling average of financing contributions over the last 5 years.
- ii. Whether the claim holder is an IFI with global membership, based on an assessment of whether the IFI has more than half of the number of Fund members, a membership in excess of half of the Fund's total voting power, or non-regional members. Apart from the World Bank, this criterion is currently only met by seven IFIs (see Table 3). The rationale for this consideration is that the wider the membership of the IFI, the more likely it is to provide financing of a public good nature, and the wider the range of Fund members that could be affected if that BOP financing were to be adversely impacted.

65. While staff will assess both of these criteria, some trade-offs between the two would be allowed. Specifically, claims held by regional IFIs could be considered multilateral, but only if the regional IFI in question has an extensive track record of reliably providing financing of a public good nature, even outside the context of resolving BOP problems. In assessing such track record, the Fund would look to the nature of the regional IFI past financing as well as the length of time during which the financing was provided. Relevant considerations would include whether substantial financing to Fund supported programs was provided, the regional institution's share of financing contribution, and the number of Fund supported programs to which the institution could have provided substantial financing and actually did provide substantial financing. For example, regional IFIs that have provided a large share of the financing of Fund-supported programs, a relatively short track record could be considered extensive, while a much longer track record would be required for other regional IFIs. Conversely, while claims by IFIs with global membership would

not be automatically considered multilateral, the track record needed to establish the provision of financing with a public good nature would need to be less extensive.

Table 3. Twenty-Five Supranational Institutions with the Broadest Memberships

Institution	Type	Members' share of Fund votes	Member Countries	Non-Regional Members	Outstanding Assets (MDBs + ECB) ¹ /Max lending capacity (RFAs) ² , USD bn
<i>International Monetary Fund</i>		100.0	190	n/a	1,008.5
<i>World Bank Group</i>	MDB	100.0	189	n/a	644.8
<i>Int. Fund for Agricultural Development</i>	MDB	95.4	177	n/a	9.9
<i>Bank for International Settlements</i>	Other	86.4	61	n/a	504.7
<i>European Bank for Reconstruction and Development</i>	MDB	77.8	69	23	85.1
<i>African Development Bank</i>	MDB	76.3	82	28	58.1
<i>Asian Development Bank</i>	MDB	72.2	68	20	276.1
<i>Inter-American Development Bank</i>	MDB	68.5	48	38	151.7
<i>Asian Infrastructure Investment Bank</i>	MDB	62.7	83	38	32.1
<i>Council of Europe Development Bank</i>	MDB	28.4	41	0	34.1
<i>Caribbean Development Bank</i>	MDB	26.7	28	5	2.1
<i>European Investment Bank</i>	MDB	25.6	27	0	674.5
<i>European Financial Stability Mechanism</i>	RFA	25.6	27	0	71.3
<i>European Central Bank</i>	CUCB	21.5	19	0	693.6
<i>European Stability Mechanism</i>	RFA	21.5	19	0	594.3
<i>West African Development Bank</i>	MDB	20.2	14	6	6.0
<i>Chiang Mai Initiative Multilateralisation</i>	RFA	18.2	13	0	240.0
<i>New Development Bank</i>	MDB	14.2	5	n/a	18.8
<i>BRICS Contingent Reserve Arrangement</i>	RFA	14.2	5	n/a	100.0
<i>Islamic Development Bank</i>	MDB	12.4	57	n/a	33.9
<i>CAF - Development Bank of Latin America</i>	MDB	10.0	19	2	46.8
<i>The Trade and Development Bank</i>	MDB	8.3	22	4	6.7
<i>OPEC Fund for International Development</i>	MDB	7.4	12	n/a	5.9
<i>Arab Monetary Fund</i>	RFA	6.0	22	0	4.0
<i>Arab Bank for Economic Development in Africa</i>	MDB	5.7	18	0	5.2

Sources: Institutions' websites and Staff Calculations.

¹Based on most recent audited financial statements

²Converted to USD at exchange rates of June 30, 2021.

66. The staff's preferred approach is Option A, because it is more closely linked to the Fund's mandate, which is to assist a member to resolve its BOP problems rather than to maximize stable multilateral BOP flows. Option A limits the set of claims to which the Fund would provide special protections to those inextricably tied to the Fund's mandate and lending practices. This said, there are other types of IFI lending that provide important public goods and that Fund policy could aim to protect. The trade-off is that the wider the range of IFI flows the arrears policy protects, the more diluted the value of that protection becomes. This said, both Options would arguably meet the (minimum) requirement of preventing excessive dilution of special treatment (so long as "track record" is conservatively defined in Option B).

Proposed Amendment 2: Circumstances justifying Agreed Plan or Credible Plan Treatment of Non-Multilateral IFI Claims

67. In non-OSI cases, it is proposed to apply either “Agreed Plan” or “Credible Plan” treatment to arrears on non-multilateral IFI claims depending on whether the IFI provides substantial financing to a Fund supported program. In non-OSI cases, non-multilateral IFI claims would receive the same treatment as multilateral IFI claims, i.e., Agreed Plan if the IFI contributes substantial financing to the member’s Fund-supported program and Credible Plan if it does not.

68. The motivation for the proposal is closely related to the purposes of the Fund as well as the logic of the lending into arrears policies. In non-OSI cases, an IFI helps the Fund discharge its mandate to assist a member in resolving its BOP problem by contributing to close a financing gap for a Fund supported program. Conditional on this contribution, the precise character of the institution should not be relevant. This justifies the same treatment for all IFIs, namely, Agreed Plan if the IFI provides substantial financing and Credible Plan if it does not.⁷²

Proposed Amendment 3. Application of the LIOA policy to OSI-related arrears on claims held by IFIs not considered multilateral claims

69. Staff proposes that the LIOA policy be amended to apply to OSI-related arrears on non-multilateral IFI claims. To the extent the IFI provides substantial financing to the Fund supported program, such financing would be taken into account for purposes of the IFI’s contribution to the OSI much like for official bilateral creditors.⁷³ The LIOA policy would be amended to provide for the possibility of either consent or the application of the three criteria under the LIOA policy in case of OSI-related arrears on non-multilateral IFI claims. The modalities for consent would follow the LIOA policy by analogy, whereby one Executive Director designated by the IFI holding the non-multilateral claim would provide such consent. The three criteria under the LIOA policy would also apply, with appropriate adaptations.

70. In addition, for those OSI-related arrears to IFIs, staff proposes to mirror the flexibility in extraordinary circumstances for emergency financing cases in line with the LIOA policy. While the review indicated that the need for flexibility has so far been limited, staff continues to see circumstances in which this could become relevant. In particular, it would appear sensible to reserve such flexibility for emergency situations, such as in the aftermath of a natural disaster, where the extraordinary demands on the affected government are such that there is insufficient time for the debtor to undertake efforts to engaged in good faith under the LIOA policy.

⁷²Note that it would be inconsistent to give the claims of IFIs with sovereign members worse treatment than that the NTP accords its individual sovereign members. Credible Plan treatment is regarded as roughly equivalent to non-toleration of arrears under the NTP. Hence, Credible Plan sets a floor for the treatment of IFI claims in non-OSI cases.

⁷³ The contribution sought from non-multilateral IFIs could differ from the contribution provided by official bilateral creditors, provided the overall OSI contribution is consistent with program parameters.

TREATMENT OF CERTAIN CLAIMS UNDER THE FUND'S ARREARS POLICIES

71. Recent developments have raised some questions about the adequacy of the Fund's approach for dealing with new instruments of official sector financing (such as bonds). These new instruments underline the difficulty of delineating commercial from public-policy activities of different types of public sector creditors.

- The 2015 case of the Russian-held Ukraine Eurobond issued to its National Wealth Fund prompted discussions about whether such bonded debt should be excluded from the Fund's definition of Direct Bilateral Claims. The Executive Board confirmed that such bonded claim was official in December 2015.⁷⁴ The episode, however, brought into focus the issue that, had the facts been slightly different (e.g., the bond had more than one holder), official bondholders could have been in a "common voting pool" with private bondholders due to the existence of CACs. This could have potentially complicated both PSI and OSI, given the protections/seniority enjoyed by official creditors under the Fund's arrears policies. Therefore, the systemic implications of including bonds with common voting pools within the Fund's definition of official claims need to be examined.
- Over the last decade or so, the stock of sovereign bonds held for various purposes (such as commercial or monetary policy) by external public-sector entities of official bilateral creditors (such as sovereign wealth funds) has surged. The volume of such claims may now be multiples of the stock of official bilateral loans. Thus far, these claims have generally been presumed not to have been acquired by the official bilateral creditor government or on its behalf and, therefore, as set forth in paragraph 15, have been treated subject to the LIA policy. However, for consistency across different types of entities and instruments, there is scope for specifying how such judgments are made.
- Some RFAs as well as the ECB explicitly recognize secondary market bond purchases as an instrument to maintain or restore orderly bond market conditions in member countries. Unlike bond purchases by the above-described official bilateral entities, which typically pursue commercial objectives, these purchases serve public policy objectives and constitute BOP support, as they offset or help prevent outflows of private capital.⁷⁵ As such, they constitute BOP financing-related claims.

⁷⁴[Status of Ukraine's Eurobond Held by the Russian Federation](#), December 2015.

⁷⁵At least two multilateral creditors—the European Stability Mechanism (ESM) and the European Central Bank (ECB)—currently have policies or facilities that envisage such intervention: in the case of the ESM, the Secondary Market Support Facility (SMSF); in the case of the ECB, Outright Monetary Transactions (OMT). None of these have so far been used. However, the ECB has acquired claims on its members through secondary market bond purchases for monetary policy reasons, through its public sector asset purchase programs (the PSPP and the PEPP; see Box 5). See <https://www.ecb.europa.eu/mopo/implement/app/html/index.en.html>.

- The classification of certain claims held by state-owned development banks and lending institutions has not been consistent. In some cases, those claims have been classified as official (lending on behalf of the government); in others, as private. This inconsistency undermines certainty about the perimeter of Direct Bilateral Claims. One example is the Debt Service Suspension Initiative (DSSI), in which issues of classification of public development banks arose.

72. Separately, private creditor groups have raised the issue of uncertainty over the perimeter of Direct Bilateral Claims in recent major PSIs. In staff's consultations with private stakeholders, the latter generally recognized the "seniority" of Direct Bilateral Claims that are held for public policy reasons. However, many felt discomfort with (i) the ambiguity surrounding the perimeter of Direct Bilateral Claims in restructurings (Greece 2012, Ukraine 2015) and recent G20 initiatives (DSSI 2020); and (ii) delays by the debtor in setting the perimeter of the debt restructuring. They expressed a strong desire for clearer rules of the game.

Recommendations

73. Staff proposes two amendments and three restatements, as follows:

Proposed Amendment 1. Pooled Voting Mechanism

74. At the time the perimeter of Direct Bilateral Claims was last discussed in 2015, staff considered two polar proposals from Fund members in regard to official claims (i.e., held by official bilateral creditors) held in the

Direct Bilateral Claims are those claims that are (a) held by a government, or an agency acting on behalf of a government; and (b) originate from an underlying transaction where the creditor government, or an agency acting on behalf of the government, provided or guaranteed financing to the borrowing member.

form of bonds. At one end, the possibility was raised of treating all bonds held by sovereigns—including those held for commercial purposes—as Direct Bilateral Claims in debt restructurings. The ensuing discussion clarified that this is not a viable option, because it would give unwarranted seniority to a very large stock of otherwise commercially-motivated claims, with adverse implications for markets' pricing of sovereign risk, and governments' ability to undertake a sufficiently deep debt restructurings to solve their debt problems. A related concern is that this approach would imply that bonds held by sovereign wealth funds (SWFs) could be given Direct Bilateral Claims status, which would seem to run counter to the Santiago Principles.⁷⁶

75. At the other end, some Fund members argued for withholding Direct-Bilateral-Claim status from all bonds, including those purchased for public-policy reasons. These shareholders contended that the bondholder could try to seek a treatment in the Paris Club as an official creditor while retaining the option to participate in the PSI ("double dipping"). The tradability and collective payment aspects of bonds were also raised as unique characteristics that could warrant different

⁷⁶The Santiago Principles promote transparency, good governance, accountability and prudent investment practices whilst encouraging a more open dialogue and deeper understanding of SWF activities. See [Santiago Principles, International Forum of Sovereign Wealth Funds](#).

treatment. While staff did not, and does not, support an instrument-based carve-out, this proposition raises a few issues that deserve further discussion.

76. As a general matter, under the Fund's instrument-neutral approach to defining Direct Bilateral Claims, an exclusion based on the particular form of instrument is inherently arbitrary. The features present in a bond are similarly present in other types of official financing and may also be present in future instruments that may have similar features as bonds but are not called bonds. Specifically:

- **Double dipping**—Bonds are not the only form of debt that has multiple avenues of enforceability. For example, bilateral loans are designed to be legally enforceable. Although debt restructurings, as a matter of practice, are generally done through the Paris Club or bilaterally, official creditors always retain the option of going through the judicial system.
- **Tradability**—Bonds are not the only form of debt that can be traded on the market. For instance, official creditors retain the ability to sell off virtually every bilateral loan.
- **Collective payment mechanism**—While bonds are instruments that have majority restructuring provision for payment terms, they are not the only form of debt that has a collective payment mechanism that would require the same payment to be made to all holders, whether official or private.⁷⁷ However, most syndicated loans currently do not have majority restructuring provisions for payment terms.⁷⁸

77. This said, bonded debt instruments do highlight an important concern regarding vote pooling and the uncertainty this can create for both PSI and OSI. Where the official bilateral creditor is part of more than one voting pool (e.g., holds an instrument subject to the same CAC as private bondholders and is also a member of the Paris Club or the Common Framework), this can complicate both restructuring processes. In particular, there would be uncertainty over the perimeter of debt covered in each process, restructuring terms (which depend partly on perimeter), and the prospects of reaching agreement (which would depend on where/how the official creditor votes). Moreover, the official creditor could use the ability it has to complicate the two processes to try and secure better terms from the debtor. Thus, the pooling of official and private claims could complicate PSIs and be costly for the debtor and the system overall.

78. Staff hence proposes to remove from the definition of Direct Bilateral Claims and IFI/multilateral claims all claims that are contractually part of a pooled voting mechanism with private creditors. While this criterion would apply to any debt instrument, including

⁷⁷For example, syndicated loans have sharing provisions that require equal payment to all holders.

⁷⁸See [The International Architecture for Resolving Sovereign Debt Involving Private-Sector Creditors—Recent Developments, Challenges, And Reform Options](#), October 2020.

syndicated loans,⁷⁹ its application is immediately apparent with respect to bonds with CACs. This approach would disqualify all bonds with any CACs, including enhanced CACs or traditional CACs from being treated as Direct Bilateral Claims, when a private creditor acquires any bond covered by the enhanced CACs, or a portion of the series in the case of single-series CACs. For example, bonds with single-series CACs could be treated as Direct Bilateral Claims only on the strict condition that the creditor government (or an agency acting on its behalf) maintains continuous and full ownership of the entire bond series. If any part of the series were to be acquired by a private creditor, the entire series would be treated as a private claim.^{80,81}

79. To operationalize this criterion, the Fund would rely in the first instance on the creditor's representation of continuous and full ownership. The Fund could challenge that representation but would give the creditor the benefit of any reasonable doubt. To forestall any disagreements with respect to the continuous ownership of the claims, borrowers could be encouraged to include disclosure provisions in the debt contract mandating the trustee to inform the debtor if a transfer of ownership occurs. Another potential (but likely rare) complication could occur if a debtor reopens the issuance and sells such bonds to private creditors. This would cause vote-pooling even absent any action by the official bilateral creditor. To solve this, contractual provisions could be included to prevent the bond series from being re-opened. For existing debt, bonds that are currently held in their entirety by an official bilateral creditor would not lose their official-bilateral-claim status should the debtor choose to re-open the bond issuance and the bilateral creditor continues to hold the entire issuance.

80. The risk that this approach could incentivize the issuance of bonds without CACs and undermine the Fund's objectives on wider use of these provisions is limited. Staff's view is that official finance (whether in the form of bonds or not) is normally motivated by public-policy objectives. Accordingly, it is unlikely that official bilateral creditors will actually sell their official holdings on the secondary market. Indeed, insofar as the official bonds carry terms that are concessional, a sale of the bonds would result in a loss for the official creditor. The likely loss would be even greater when approaching a restructuring scenario, especially relative to what the official creditor may recoup in a bilateral, Paris Club, or CF process.

⁷⁹As set forth in paragraph 76, most syndicated loans currently do not have majority voting provisions to amend payment terms. Therefore, the issue of vote pooling is currently much less prevalent for syndicated loans than for bonds with CACs.

⁸⁰Such an amendment would also reflect the Paris Club principle that sovereign creditors are generally expected to maintain control over their official claims (i.e., an unconditional right to take action on these claims, without reference to third parties that could influence the restructuring of these claims).

⁸¹Bonds without CACs that are held by the private and official sector may not lead to vote pooling problems. Accordingly, the part held by the official sector could be considered a Direct Bilateral Claim.

81. The same rationale as described above also applies to instruments held by IFIs that are vote pooled with the private sector. Therefore, staff recommends to also exclude instruments that are vote pooled with the private sector from the special treatment provided to IFI claims.⁸²

Proposed Amendment 2. Treatment of Secondary Market Purchases by IFIs

82. In principle, IFI support of Fund members in BOP crises could take the form of bond purchases in the secondary market.⁸³ In some crisis settings—namely, when debtors have not yet lost access to capital markets, or when private sector borrowing costs are linked to secondary market yields—secondary market bond purchases conducted by IFIs could be an efficient form of BOP support. Facilities or purchase programs that are set up to undertake such purchases should be considered part of the GFSN. Hence, bonds purchased in the secondary market under such facilities merit special treatment under the Fund's arrears policies, just like direct crisis lending to a sovereign would merit special treatment. This logic generally extends to sovereign bonds acquired under purchase programs of currency union central banks (Box 5).

83. This said, some IFIs may take the view that these types of secondary market purchases aimed at stabilizing bond markets should be treated *pari passu* with private claims.⁸⁴ One rationale is that large-scale bond purchases by an IFI in the secondary market could have effects in both directions. On the one hand, it raises demand for and prices of bonds purchased, through a variety of channels.⁸⁵ On the other, to the extent that the IFI is considered a de-facto preferred creditor, it may de-facto subordinate existing private bondholders, leading to pressure on secondary market prices. Because the latter would contravene the objective of stabilizing bond markets, IFIs may choose to declare that they will not attempt to assert any preferred creditor status with respect to bonds purchased in the secondary markets.

84. Staff proposes to clarify that the treatment of such claims under the NTP should take into account the IFI's own stated treatment of the claim. Specifically, if the creditor takes the view that the claim should be treated *pari passu* with privately-held claims, the Fund would defer to the IFI by giving the claim the same treatment under its arrears policies that it would give to a privately-held claim—i.e., the LIA policy would apply. If, however, the IFI asserts preferred status with respect to bonds purchased in the secondary market, and if its function in conducting such purchases is considered an important component of the GFSN (as explained above), then the Fund would give the claim the special protections described above for IFI claims.⁸⁶ Importantly, as explained previously, staff proposes that any vote-pooled claims with the private sector would still

⁸²Arrears on such claims would be treated under the LIA policy.

⁸³IFIs discussed in this section may hold multilateral claims as defined for purposes of the NTP.

⁸⁴This is true for the ECB's OMT. See [Technical features of Outright Monetary Transactions](#), September 2012.

⁸⁵See Trebesch and Zettelmeyer (2018) for a discussion and evidence on ECB secondary market purchases of Greek bonds.

⁸⁶The Fund would rely on the IFI's assertion at the time of the application of the arrears policy.

be treated under the LIA policy, regardless of the IFI's assertions, for the reasons discussed in paragraphs 77-81.

Box 5. Treatment of Decentralized Currency Union Central Bank Claims Purchased in the Secondary Market

Central banks conduct monetary policy by purchasing bonds in the secondary markets. If undertaken by a decentralized currency union central bank (CUCB), the Balance of Payments Manual (BPM6) would classify such purchases as cross-border transactions. Claims acquired through such transactions would be considered external claims.¹

The question is whether such claims should be considered a form of BOP financing and could hence merit special treatment under the Fund's arrears policies. For the ECB, bonds acquired under its Outright Monetary Transactions (OMT) would clearly fall in this category, as the OMT is designed to address a crisis situation that can be expected to exact heavy pressure on the BOP. With respect to sovereign bonds purchased in the secondary markets under other ECB programs, such as the Public Sector Purchase Programme (PSPP) or the Pandemic Emergency Purchase Programme (PEPP), the answer is less obvious, because these programs constitute monetary policy instruments. But they also have an impact on BOP—both directly, and by helping euro-area members maintain access to cross-border market finance. This is particularly clear in the case of the PEPP, which was designed to deal with a crisis situation, and contributed to orderly market conditions for all euro-area members. It is hence proposed that the Fund take the view that bond purchases conducted under any of these programs contributed (to a greater or lesser degree) to forestalling or resolving BOP problems. Hence claims arising from such purchases are eligible for special treatment under the Fund's arrears policies subject to the relevant conditions, as outlined in paragraph 84.

¹BPM6 recommends that transactions of residents with the CUCB, where the CUCB is acting on its own account should be considered as cross-border and thus be recorded in the national BOP. "Own account" transactions are defined to include net positions of the country vis-à-vis the CUCB (BPM6, A3.37). This would include bonds of a member purchased by the CUCB (a net liability to the CUCB). "Own account" can be interpreted as the risks and the rewards involved in such transactions and positions are held by the CUCB.

Restatement 1. Secondary Market Purchases by Official Bilateral Creditors

85. Secondary market purchases by official bilateral creditors do *not* qualify as Direct Bilateral Claims under the current LIOA policy and staff does not propose any amendments.

By its terms, the definition limits Direct Bilateral Claims to those reflecting the *provision* of direct financing to the debtor government. Thus, only primary market purchases by the creditor government or entities acting on its behalf could qualify. Claims acquired in the secondary market by the government or entities acting on its behalf would be subject to the LIA policy (like all residual claims) since they do not provide new direct "financing" to the debtor. Furthermore, unlike secondary market purchases of bonds by IFIs, there is no sense that these purchases are conducted with the intent of providing BOP support. Rather, their motives tend to be commercial.

Restatement 2. Budgetary Process

86. A few further restatements to the definition of Direct Bilateral Claims appear to be warranted, starting with which entities are "government" creditors. As already highlighted,

public-sector entities like SWFs and state-owned banks have emerged as major creditors to other governments.

87. There is currently some ambiguity of whether to treat the claims held by these entities as part of the creditor government's claims and thus eligible for Direct-Bilateral-Claim status with respect to the Fund's arrears policies. Staff proposes to restate that public entities that form part of the member's budgetary process are classified as part of government. The ambit of claims subject to the arrears policies has been kept narrow on the *debtor* side, and staff's restatement would imply a similarly narrow application on the *creditor* side. The definition of what is considered a government claim from the debtor's side is limited to claims of those public sector entities whose financial operations *form part of the member's budgetary process* (Box 6). Staff proposes for operational purposes to focus on a 'budgetary process' test on the creditor side as well. Almost all SWFs and state-owned banks would likely fail this test.

Box 6. Defining the Budgetary Process

For the purposes of the Fund's arrears policies, arrears of a public-sector entity constitute sovereign arrears of the member only when the financial operations of the entity form part of the member's budgetary process. The approach of treating arrears of certain public-sector entities as "sovereign" was first established in 1980.^{1/} It draws the distinction between "sovereign arrears"—i.e., arrears of the government and of government entities whose financial operations form part of the member's budgetary process—and arrears of "public sector entities independent of the government's day-to-day budgetary controls" that result from government-imposed limitations on the availability of foreign exchange or on payments.

There is no precise definition in the Fund's policy of when "financial operations [of an entity] form part of a member's budgetary process". Rather, it is recognized that the financial arrangements of public entities and the relationship of these entities to the central government may differ between members and need to be examined on a case-by-case basis.^{2/} Accordingly, the assessment of whether an entity's financial operations form part of the budgetary process of the member is country-specific and based on the domestic budgetary law framework and its interpretation. In particular, ad hoc budgetary support or (occasional) coverages of losses may not indicate that the entity forms part of the budgetary process. Similarly, profit transfer from a state-owned enterprise to the central government would also not mean that the entity forms part of the budgetary process. In contrast, an entity that is a direct budgetary unit or that receives direct moneys from the budget would form part of the budgetary process.

^{1/}Review of Fund Policies and Procedures on Payment Arrears, August 1980 (EBS/80/190), at p. 9.

^{2/}*Id.*

Restatement 3. Acting on Behalf of the Government

88. Claims held by a creditor entity outside the "budgetary process" could still be considered Direct Bilateral Claims if they were acquired explicitly "on behalf of" the government. The obvious example would include guarantees/indemnifications issued explicitly on behalf of the government by export credit agencies (ECAs) that reside outside the budgetary

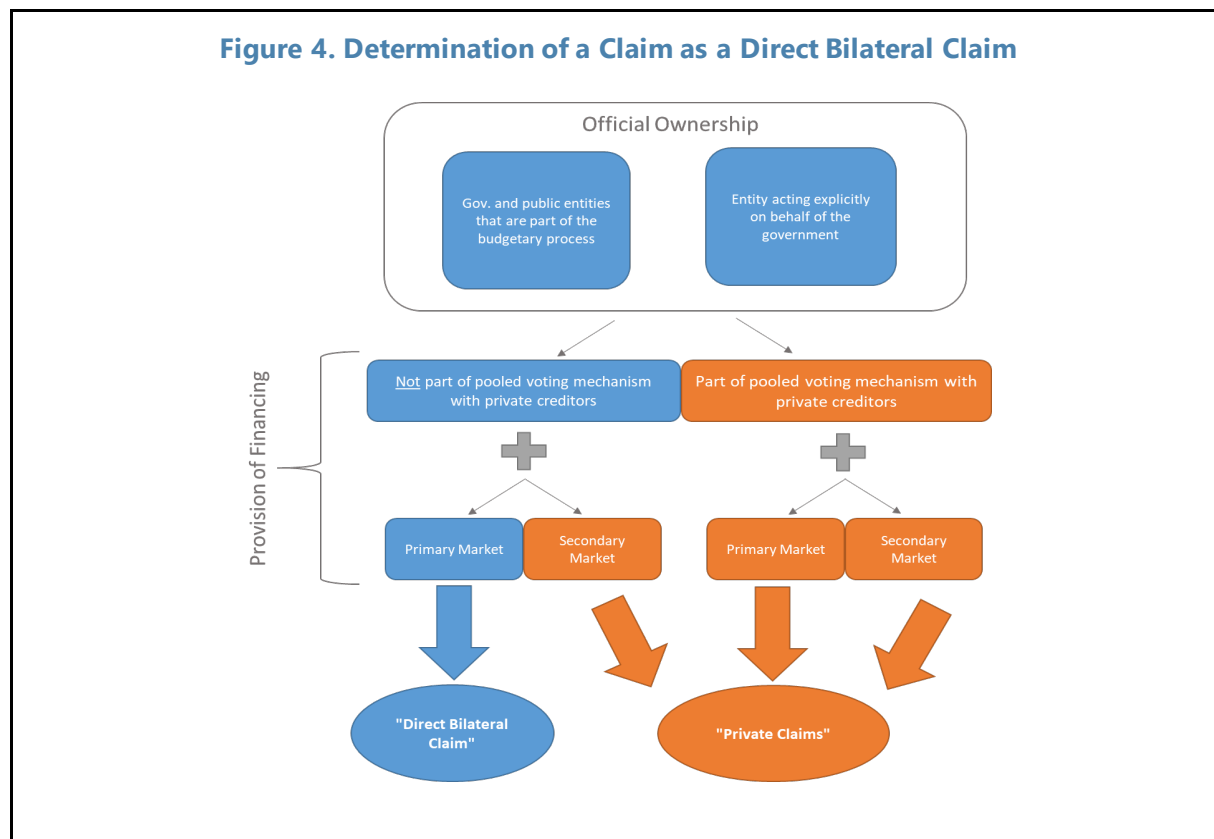
process.⁸⁷ Central bank swaps for BOP support could also qualify as Direct Bilateral Claims to the extent the central bank were to act on behalf of the government. In these cases, while the creditor member's representation—including at the Paris Club—on whether the entity acted on the government's behalf would be important, the member could be asked to provide supporting evidence where Fund staff deem necessary.

89. Staff proposes restating that an assessment of whether an entity is acting “on behalf of the government” needs to take into account the totality of circumstances of a specific case. The creditor's consistent representation on whether the entity acted on the government's behalf would need to be supported by unambiguous documentary evidence. In particular, important elements to consider would be the governance structure of the entity; whether the claim in question originated from explicit directions from the government; and—where relevant—the terms of the financing provided. In this context, claims held or guaranteed/indemnified by ECAs would normally pass this test, given that these institutions benefit from a sovereign mandate and have consistently co-operated in sovereign debt restructurings at the Paris Club. However, a claim-by-claim analysis will always be required.

90. The Fund's definition of Direct Bilateral Claims does not need to always align with claims treated in the Paris Club or under other representative creditors fora (such as the DSSI). While the Fund uses a claim-by-claim analysis to determine the classification of claims for purposes of Fund policies, the Paris Club often uses an institution-by-institution approach to encompass a broader scope of claims in its treatments for efficiency reasons. While it is important to maintain a close alignment between the Fund's definition and the Paris Club practice, exact one-to-one mapping may not be necessary. In fact, treatment has differed on the margins in the past without any material complications.

91. These amendments and restatements would not constitute a major departure from current practice. Most claims that have typically been treated in the Paris Club (development assistance, BOP support, the bulk of ECA guarantees) would continue to be classified as Direct Bilateral Claims. However, these proposals would clarify the treatment of some types of financing that have so far not been subject to an assessment against the Fund's definition of a Direct Bilateral Claim but that are becoming more important. For example, central bank swaps would be classified as Direct Bilateral Claims to the extent the central bank acts on behalf of the government; while secondary market purchases of sovereign bonds for portfolio or reserve management purposes by central banks and SWFs would not.

⁸⁷See also the Russian National Wealth Fund's claim on Ukraine, which was acquired on the explicit direction of the Russian government. [Status of Ukraine's Eurobond Held by the Russian Federation](#), December 2015.

Figure 4. Determination of a Claim as a Direct Bilateral Claim


NEXT STEPS AND ISSUES FOR DISCUSSION

92. Staff proposes to seek Executive Directors' views on the proposals set out in this paper in an informal meeting to engage on September 20, 2021. Staff will reflect Executive Directors' views in a final paper, which will be discussed in a formal Executive Board meeting at which a summing up would set out the amended Fund arrears policies.

93. Directors may wish to consider the following issues for discussion:

- Do Directors agree that the LIA policy remains broadly appropriate? Do Directors agree with staff's proposals to amend, update and sharpen the LIA policy's guiding principles on good faith (including eliminating the formal negating framework), to eliminate complexity and sharpen representatives related to creditor committees set forth in paragraphs 32-38?
- Do Directors agree with staff's proposal to codify the current practice into a Fund policy with respect to preemptive debt restructurings with enhanced debt transparency expectations described in paragraphs 46-49?
- Do Directors agree that the LIOA policy remains broadly appropriate, and no amendments are necessary?

- Do Directors agree with staff's three proposed amendments to the NTP and the LIOA, including the definition of multilateral claims? Do Directors agree with staff's preference for Option A regarding the treatment of OSI-related claims to IFIs set forth in paragraphs 58-70? Do Directors agree with staff's proposed amendment on the treatment of arrears on secondary market purchases held by IFIs?
- Do Directors agree with staff's two proposed amendments and the three restatements with respect to the definition of Direct Bilateral Claims as described in paragraphs 73, 78-81, 84-91?

Annex I. The Fund's Policies on Debt Sustainability, Market Access, Financing Assurances, and External Arrears

1. **Under Articles I(v) and V, 3(a) of the Articles of Agreement, Fund financing can only be provided under adequate safeguards in support of a member's economic policies that are capable of resolving the member's balance of payments problem over a timeframe consistent with the revolving nature of Fund financing and restore the member to medium-term external viability.** To ensure Fund financing adheres to this standard, the Fund has established inter-related policies on debt sustainability, market access, financing assurances, and lending into arrears. This annex describes these policies, with particular focus on sovereign debt restructuring situations.

A. Debt Sustainability

2. **When a member requests Fund financing, the Fund assesses whether the member's policies are consistent with preserving debt sustainability.**¹ This assessment is based on a debt sustainability analysis (DSA) that is forward looking—i.e., it takes into account steps being taken by the member to restore sustainability over the medium term—and incorporates alternative scenarios and stress tests.² The Fund is precluded from providing financing (including emergency assistance—see Box 3) where the member's debt is assessed to be unsustainable, unless the member takes steps to restore debt sustainability.³

If debt is unsustainable, the Fund is precluded from providing financing unless the member takes steps to restore debt sustainability.

3. **Fund-supported programs seek to strike an appropriate balance between adjustment and financing.** Financing, including from the Fund, helps to smooth a member's adjustment and making it less costly for both the member concerned and the international community. Fund financing is usually only a fraction of total financing. Other creditors, official or private, are generally expected to contribute to the financing of the program as well.⁴

¹Debt is considered sustainable when a borrower is expected to be able to continue servicing its debts without an unrealistically large correction to its income and expenditure.

²As noted above, Fund financing must be provided in a manner that establishes adequate safeguards on the temporary use of the general resources of the Fund. Accordingly, one of the reasons why judgments regarding debt sustainability need to focus on the medium-term scenario (rather than just the program period) is that a determination must be made that the member has the capacity to repay the Fund, taking into consideration the maturity of all indebtedness, including indebtedness to the Fund.

³See, e.g., Lessons from the Crisis in Argentina, October 2003 (SM/03/345); [Sovereign Debt Restructuring—Recent Developments and Implications for the Fund's Legal and Policy Framework](#) (2013 Paper), April 2013.

⁴OSI can be in the form of new financing, swaps, and debt relief. Private sector involvement takes various forms. It is typically reflected in assumptions about private sector capital flows (and their composition, e.g., bonds, bank loans and their characteristics) and rollover by creditors, based on the expected impact of the Fund-supported program on private sector sentiment. It can also be made more formal, such as the commitment by banks to maintain exposure.

4. **If debt is unsustainable (i.e., the Fund determines that debt sustainability cannot be preserved through credible and sustainable policy adjustment), the Fund is precluded from providing financing unless the member takes steps to restore sustainability.**⁵ These steps could themselves restore sustainability (e.g., the provision of new concessional financing or the completion of a debt operation) or, where upfront restoration of sustainability is not feasible, could provide the Fund with the requisite assurances that the member is on track to restore sustainability. Two types of assurances are possible under this latter scenario: (1) where grants or highly concessional financing is sought from donors, assurances can be sought directly from the donors as to the amount and timing of the contribution; or (2) where the financing involves rescheduling—a change in contractual terms—the form of assurances depends on the nature of creditors, whether Paris Club or non-Paris Club official creditors, or private creditors (Box AI.1). The treatment of Paris Club creditors is a product of the long relationship of the Fund with the Paris Club (Box AI.2).

Box AI.1. Assurances on Debt Sustainability¹

When assurances with respect to contributions to restore debt sustainability are required from **Paris Club official bilateral creditors**, such assurances are provided by a Club meeting to provide a preliminary indication that the Club is willing to provide debt relief in anticipation of an Agreed Minute. Such a meeting can be arranged on reasonably short notice. If the contributions from Paris Club creditors are representative (i.e., a majority of contributions required from official bilateral creditors over the program period), due to comparability of treatment provisions in Paris Club Agreed Minutes, and due to the Fund's arrears policies (allowing non-participating creditors to be "deemed away" for the purposes of the Fund's arrears policies, and thus giving the authorities leverage), other creditors can be assumed to provide debt relief on the same terms as the Paris Club.

When **non-Paris Club official creditors** constitute the key group, "specific and credible" assurances on financing/debt relief are required from the creditors such that debt sustainability is restored and the Fund-supported program is fully financed. This has been understood to mean a communication from a sufficiently high-ranking official authorized under domestic law to commit the creditor. This communication should show an understanding of the debtor member's situation and the needed actions to restore debt sustainability. The actual debt restructuring can come later. This parallels what is asked of Paris Club creditors.

When a contribution from **private creditors** is required to restore debt sustainability, assurances are derived from a staff's judgment that a credible process for debt restructuring is underway and such restructuring will likely deliver an outcome in line with program requirements. Relevant considerations include the engagement of legal and financial advisors by the member, the launching of consultations with creditors, and the design of a debt restructuring strategy, including the terms of the new instruments and use of inducements for creditor participation. When creditors with greater leverage are involved (e.g., foreign law-governed debt, collateralized claims, or blocking positions to neutralize collective action clauses), the process would need to be further along to provide sufficient assurances. The Fund has indeed in some cases decided to approve financing only after completion of a debt exchange.

¹While assurances are typically not conveyed verbatim to the Executive Board, the Executive Board must be informed of their existence and their substance in order to make an informed decision on Fund financing.

⁵Under the exceptional access policy, a higher degree of probability is required for the Fund to proceed with approval of an arrangement in cases of unsustainable debt: The steps taken by the member must render debt sustainable with high probability. [Access Policy and Limits in the Credit Tranches and Under the Extended Fund Facility and on Overall Access to the Fund's General Resources, and Exceptional Access Policy—Review and Modification](#), Decision No. 14064-(08/18), February 2008, as amended, paragraph 3(b).

Box. AI.2 Evolution of Paris Club's Debt Treatment and Coordination with the Fund

The Paris Club was established in 1956¹, with the original aims of preventing sovereign debt defaults and ensuring full repayment of debt. The Paris Club generally relied on debt reschedulings that were short-term and structured at market rates, which aimed to give countries time to recover and repay their debts.² Follow-up reschedulings were often required.

The Fund and the Paris Club adapted their practices over time, notably during the sovereign debt crisis of the 1980s.³ The oil price shocks of 1973 and 1979 generated huge trade surpluses for the oil-rich, and corresponding deficits for the oil-poor. This in turn led to high inflation, increased global liquidity and rising global indebtedness, leading to multiple sovereign debt crises. The debt crisis necessitated changes to approaches in providing debt relief, and the Fund began to work towards longer-term solutions to the debt crisis. Similarly, the Paris Club had started to provide rescheduling of debt on "exceptional terms," which was required for certain countries with large financing gaps. Exceptional terms generally included rescheduling at below-market rates, with grace periods and maturity periods that were longer than the norm.

Since 1988, the Paris Club can provide debt write-offs to low-income countries and played a key role in the implementation of the HIPC Initiative. While "exceptional" treatment of debt reflected a more concessional approach towards debtor countries, it was still anchored within a rescheduling framework. During a G-7 meeting in Venice in 1987, developed countries began to acknowledge the need for additional debt relief for poorer countries. This led to the development of the "Toronto Terms"⁴ in 1988, which allowed debt reduction of up to 33 percent for the poorest countries, with longer repayment periods or lowered interest rates on remaining debt. The development of the "Toronto Terms" spurred the development of further terms for debt reduction, culminating with wide-scale debt relief under the HIPC Initiative. Under the "Cologne Terms"⁵, countries eligible for the HIPC Initiative were granted debt cancellation of up to 90%. The Paris Club played a critical role in the implementation of the HIPC Initiative for low-income countries.

In 2003, the Paris Club adopted a new protocol – the "Evian Approach" – in considering debt relief for non-HIPC countries. The "Evian Approach"⁶ does not provide standardized terms of treatment, but a case-by-case approach, incorporating debt sustainability considerations and the financial needs of the debtor. For countries facing a liquidity issue, reschedulings could be considered. For countries facing a solvency issue, comprehensive debt treatment—which could include principal or NPV reduction, in addition to reschedulings—could be granted at different stages, tied to a debtor country's compliance with multiple Fund-supported programs.

The evolution of the Paris Club's approach to debt treatments, from providing only reschedulings to offering debt reduction to both HIPC and non-HIPC countries, dovetails with Fund's focus on debt sustainability. The Fund expressly recognized debt sustainability as a key safeguard in 2002.⁷ Even prior to 2002, the Fund's focus was on restoring the member to medium term external viability – a concept linked to debt sustainability – as articulated through the financing assurances policy.⁸ Given the adoption of the "Evian Approach" and "Cologne Terms" in the Paris Club, debt sustainability, in combination with Fund-supported programs, will be a key factor driving the analysis in providing debt relief.

Box. AI.2 Evolution of Paris Club's Debt Treatment and Coordination with the Fund (concluded)

¹The website of the Paris Club also provides an overview of its history and development:

<https://clubdeparis.org/en/communications/page/historical-development>.

²See Cheng, Diaz-Cassou, and Erce (2018); Cosio-Pascal (2008).

³For a fuller description of the sovereign debt crisis of the 1980s, see IMF, [Prevention and Resolution of Sovereign Debt Crises](#), Selected Legal and Institutional Papers Series, 2018.

⁴See <https://clubdeparis.org/en/communications/page/toronto-terms>.

⁵See <https://clubdeparis.org/en/communications/page/cologne-terms>.

⁶See <https://clubdeparis.org/en/communications/page/evian-approach>.

⁷This was first articulated when the Exceptional Access Policy was developed 2002, whereby one of the criteria for exceptional access is that there is a high probability that debt will remain sustainable, based on rigorous and systemic analysis. Access Policy in Capital Account Crises, July 2002 (SM/02/246).

⁸While the concept of debt sustainability was not used then, the Fund recognized that there were members which had unsustainable debt. See page 7 of The Fund's Policy on Financing Assurances, April 1989 (EBS/89/79): "It is now clear that, for certain members, the restoration of balance of payments viability will require some debt or debt-service reduction in the medium-term. In these cases, the provision of new money on commercial terms to the exclusion of debt reduction would not be consistent with a return to viability or the repayment of the Fund."

Box AI.3. Debt Sustainability in Emergency Financing Cases

Requests for emergency lending (RFIs or RCFs) in an unsustainable debt situation can be particularly difficult for the Fund, as it often entails a natural or health disaster layered on top of a debt crisis.

While Fund assistance is needed urgently, upfront financing without safeguards can make the situation worse if the money is used to pay off existing creditors, doing nothing to help with the disaster, and making the resolution of the debt situation more difficult.

The debt sustainability requirement could be met in some cases if the Fund has adequate assurances that the member is on track to restore sustainability, e.g., through a debt restructuring.¹ Assurances from creditors about actions to restore debt sustainability remain critical, and the standards for such assurances (Box AI.1) continue to apply. A case-by-case assessment would be needed.

In very rare cases (Iraq 2004 and Lebanon 2006), the Fund found that the requirement for adequate assurances (that the member is on track to restore sustainability) was met through assurances from official bilateral creditors to restore debt sustainability against the backdrop of concerted international action. Specifically, management consulted through the relevant Executive Directors with the majority of the relevant member's official bilateral creditors. In those cases, the creditors (i) recognized the Fund's preferred creditor status in respect of the relevant member's purchase under the emergency assistance, (ii) were willing to make their best efforts—given the relevant member's continuing cooperation with the Fund—to provide debt relief on appropriate terms to ensure timely repayment to the Fund of the amounts provided under the emergency assistance, in accordance with the Fund's preferred creditor status; and (iii) confirmed that, during the period of the emergency assistance, a deferral would be in place with respect to those obligations of the relevant member that are falling due to them.

¹/ 2013 Paper.

B. Market Access

5. **Closely related to the concept of debt sustainability is that of market access.** The Fund's exceptional access policy, *inter alia*, requires that the member has prospects of (re)gaining access to private capital markets within the timeframe Fund resources are outstanding. To address its underlying problems and achieve medium-term external viability, a member needs to restore investor confidence and establish capacity to regain access to international private capital.

6. **More generally, while a temporary loss of market access may not necessarily imply that debt is unsustainable, a protracted loss of market access would create the presumption that debt may not be sustainable.** In practice, whether a country is assessed to have market access will depend on its ability to tap international capital on a sustained basis through the contracting of loans and/or issuance of securities across a range of maturities, regardless of the currency denomination of the instruments, and at reasonable interest rates.

C. Financing Assurances Policy

7. **The Fund's financing assurances policy aims at ensuring consistency of Fund financing with the member's return to medium-term external viability to give the Fund assurances that it can be repaid by the member within the medium term.** The financing assurances policy was developed during the 1980s debt crisis, when commercial banks were trying to limit their exposure to heavily indebted countries, and the Fund could no longer assume that these banks would be willing to assist spontaneously in the financing of Fund-supported programs for these countries. The policy initially required that, as prior condition to the availability of Fund assistance, other creditors (official and private) needed to furnish specific assurances that they would provide the necessary support (either through new loans or refinancing) to fill the estimated gaps in the financing of the program on terms consistent with the member's return to external viability.⁶ In the late 1980s, the Fund recognized that strict adherence to the receipt of explicit financing assurances effectively gave commercial banks a veto over Fund financing, thereby undermining the Fund's ability to provide timely assistance to members that were making efforts to address their balance of payments problems. To realign the policy with its underlying objectives, the Fund modified the financing assurances policy to allow the approval of an arrangement before banks had provided assurances as to their willingness to support a financing package consistent with the assumptions of the program.⁷

⁶In practice, the Fund required a formal confirmation from a critical mass of banks through their advisory committees. A critical mass was considered to be the level of participation that made the implementation of financing agreement virtually certain. The share of banks that constituted a critical mass was a matter of judgment on a case-by-case basis, but generally over 90 percent.

⁷To address concerns about the adequacy of safeguards, the modified policy provides that such approval can be granted only in cases where (i) prompt Fund support is judged to be essential for program implementation, (ii) negotiations between the member and its creditors have begun, and (iii) it can be expected that a financing package consistent with external viability will be agreed within a reasonable period of time. Progress in the negotiations with bank creditors would be closely monitored. See [Summing Up by the Chairman on Fund Involvement in the Debt Strategy](#), May 1989 (EBM/89/61). This modification also necessitated a revision of the arrears policy by introducing the LIA policy to allow for the accumulation of arrears to external private creditors (see Annex III).

8. **Under the financing assurances policy, the Fund needs to be satisfied that program financing is adequate to fill financing gaps:** (i) during the program period to ensure viability as well as (ii) to ensure that the member is in a position to repay the Fund during the post-program period.⁸

- In practice, the condition that the program be “fully financed” requires the following judgments to be made: (i) “firm commitments” of financing must be in place for the first 12 months of the arrangement, and (ii) there must be “good prospects” that there will be adequate financing for the remaining program period beyond the first 12 months. During program reviews, assurances on full financing of successive 12-month periods beyond the initial 12 months (or whatever period is left under the arrangement) must be ascertained. Specifically, the “good prospects” must become “firm commitments” or actual financing.⁹
- With respect to the post-program period, staff needs to assess whether the member’s prospective policies deliver a projected post-program performance that adequately safeguard repayments to the Fund consistent with a sustainable debt path during the program period. Good prospects of regaining market access and debt sustainability are germane to the observance of the financing assurances policy. A Fund-supported program in the Fund’s General Resources Account (GRA) is designed to restore the member to medium term external viability and resolve the BOP problem within the program period.^{10, 11, 12}

9. **In programs involving debt restructuring, the financing assurances policy does not prescribe the allocation of financing (through new financing and/or debt restructuring) to be provided between official and private creditors.** In case the financing gap cannot be filled with new financing (from the official and/or private sector), the Fund’s policy on financing assurances encourages the restructuring of creditors’ claims on the country on terms compatible with balance

⁸The financing assurances policy applies to all Fund-supported programs, including those supported by Policy Coordination Instruments and Policy Support Instruments. For stand-alone emergency financing (i.e., under the Rapid Credit Facility and Rapid Financing Instrument), the requirements under (i) are set aside given that there is no underlying economic program. The financing assurances policy does not apply to support under the Flexible Credit Line and the Short-term Liquidity Line.

⁹There is no defined meaning of the term “firm commitments”. In practice, the manner in which such commitments are provided varies, and whether they are characterized as “firm” is a matter of judgement. Also, while such commitments do not have to be in writing, they must be considered credible by management; creditors providing such assurances should be willing to have their commitments reflected in program documents, which will be eventually published.

¹⁰[2018 Review of Program Design and Conditionality](#), May 2019.

¹¹Under ECF arrangements under the PRGT, the protracted BOP need does not need to be resolved within the program period. However, any financing gaps in the post program period for an ECF arrangement need to be such that, notwithstanding the gaps, the Fund is assured that the member has the capacity to repay the Fund (irrespective of a successor arrangement), and that any gaps are consistent with a sustainable debt path.

¹²Staff would need to assess that the member has good prospects for (re)gaining access to capital markets at sufficient depth, maturity, and price to ensure capacity to repay the Fund and consistent with a sustainable debt path, taking into account all sovereign maturities falling due in the post-program period during the time repayments to the Fund are outstanding. As long as obligations to the Fund are outstanding, staff needs to judge that there no financing gaps in the post-program period at arrangement approval and each respective program review.

of payments viability.¹³ Assurances about debt sustainability and financing in these cases are obtained as laid out above under the section on debt sustainability (Box AI.1).

10. **The Fund always encourages members to stay current on their obligations to the extent possible.** Sometimes, however, financing gaps are filled through the accumulation of arrears. In these instances, the arrears policies, discussed in the next section, set forth a framework under which the Fund can provide financial assistance to members despite such arrears. The ultimate goal of the Fund's arrears policies is to ensure that the member will soon regularize its relations with creditors, thereby resolving the arrears and ensuring its medium-term viability and securing the financing assurance required for the post-program period.

D. Arrears Policies

11. **Recognizing the destructive nature of arrears, since 1970, the Fund has had a policy of non-toleration of arrears (NTP), unless a specific policy applies that enables the Fund to lend into sovereign arrears.** These specific policies are those on Lending into sovereign Arrears (LIA) to private creditors—which was adopted in 1989 and last reviewed in 2002—and on Lending into Arrears to Official Bilateral Creditors (LIOA), which was adopted in 2015. As described in more detail below and in Annex III, the application of the specific arrears policies depends on (i) whether a sovereign debtor member (“member” or “debtor”) is in arrears to private sector, official bilateral, or multilateral creditors, and (ii) whether Private Sector Involvement (PSI) and/or Official Sector Involvement (OSI) is needed. The arrears policies do not apply to claims in dispute (Box AI.4, below).

¹³2013 Paper.

Box AI.4. Disputed Claims Doctrine

The Fund's arrears policies do not apply to arrears on claims in dispute. Under this practice, where the Fund accepts a member's representation that the validity or amount of a debt claim is in dispute, such disputed claim does not give rise to arrears for all Fund purposes.^{1/2/} However, such claims are taken into account (as a contingent claim) for purposes of determining whether adequate assurances exist for the financing of a Fund-supported program and the DSA. The disputed claims doctrine is grounded in the Fund's duty of neutrality. As an international organization, the Fund must maintain a neutral position with respect to claims whose underlying validity or amounts are in dispute between members.^{3/}

Although the Fund reserves the right to challenge a member's representation of a dispute, it has given the member the benefit of any reasonable doubt in this regard. In line with this practice, staff has on rare occasion queried whether there was a factual basis for a member to credibly represent a dispute to the Fund. The considerations relevant to staff's queries have included the record of the positions between the debtor and creditor, the record of statements to the Fund, the arguments made in any litigation, and the status of such litigation. The Executive Board makes the final determination of claims in dispute.

^{1/}See The Role of the Fund in the Settlement of Disputes Between Members Relating to External Financial Obligations, May 1984 (SM/84/89), p. 8.

^{2/}Where only a portion of a claim is in dispute—e.g., the amount recognized by the debtor is less than the amount claimed by the creditor—only the difference in the amount would fall under the disputed claims doctrine; the portion of the claim recognized by both parties would be treated as an undisputed claim.

^{3/}The Role of the Fund in the Settlement of Disputes Between Members Relating to External Financial Obligations, May 1984 (SM/84/89) and the related [Summing Up](#), June 1984 (BUFF/84/107); Recent Developments in Sovereign Debt Litigation and Implications for Debt Restructuring and Debt Relief Processes, March 2004 (SM/04/98).

12. For both the LIA and LIOA policy, as long as there are external arrears to creditors (either private or official bilateral), the Fund needs to conduct a financing assurances review at the approval of an arrangement or emergency financing or at each program review.¹⁴

Financing assurances reviews—which are distinct from the above-described financing assurances policy—provide the Fund with the opportunity to assess progress in restoring debt sustainability in a context where the member has incurred external arrears as well as to determine whether there are sufficient safeguards in place for the further provision of Fund financing in the member's circumstances. In particular, the Fund needs to determine whether the member's adjustment efforts are undermined by developments in debtor and creditor relationships, and whether in light of progress the existence of arrears is temporary and, therefore, does not undermine the medium-term external viability of the member's balance of payments and its capacity to repay the Fund.¹⁵ The recommendation to complete the financing assurances review requires staff's judgment that, in light of progress made in restructuring the member's debt, the Fund should continue to provide the member with access to Fund resources.

¹⁴The arrears policies apply to all Fund financing instruments. They also apply to the Policy Support Instruments and Policy Coordination Instruments by analogy. They do not apply to SMPs. As described in the main paper, the arrears policies apply with some flexibility to financing under the RCF and RFI.

¹⁵See [Summing Up](#) by the Acting Chairman—Fund Policy on Arrears to Private Creditors—Further Considerations, June 1999 (BUFF/99/71); [Aspects of the Fund's Lending Into Arrears Policy](#), April 2005 (FO/DIS/05/53); and [Reforming the Fund's Policy on Non-Tolerance of Arrears to Official Creditors](#), December 2015 (SM/15/261).

13. **The arrears policies interact in important ways with the financing assurances and debt sustainability policies.**¹⁶

- *Financing assurances.* As noted above, financing gaps may be filled through the accumulation of arrears so long as the relevant arrears policy is satisfied.
- *Debt sustainability.* Application of the arrears policies, which are underpinned by criteria designed to restore debt sustainability, may provide sufficient safeguards to negate the need for further assurances on debt sustainability. In particular, the application of the LIA or LIOA criteria will generally act as a safeguard to assure the Fund that a restructuring deal will be forthcoming that will restore debt sustainability.^{17, 18} To the extent the member makes a debt restructuring offer to creditors, such offer must be consistent with program parameters. As an additional safeguard, the financing assurances reviews required under the LIA/LIOA policies allow the Fund an opportunity at each program review to reassess the status of debtor-creditor negotiations and whether a restructuring deal is likely to be forthcoming. Thus, staff could also assess that no assurances regarding the restoration of debt sustainability beyond the application of the arrears policies are required, depending on the member's circumstances.
- However, in cases where there are significant uncertainties that the creditor(s) will restructure their claims (e.g., the debt is collateralized and/or there is a high legal risk that creditor action could severely undermine program implementation) and such restructuring is critical to achieving debt sustainability and medium-term viability, the Fund may still need to seek further assurances from the creditor(s) as laid out in Box AI.1 before approval of an arrangement or completion of a review to sufficiently establish safeguards for Fund resources.

¹⁶Where the member has defaulted on some, but not all, of its external claims, the standard for assurances laid out in the above section on debt sustainability would need to be met for all claims; the arrears policies could only be used to satisfy that standard for claims in default.

¹⁷This includes cases where, under the exceptional access policy, debt sustainability must be restored with a high probability. If the member's offer had not yet been made, the Fund could proceed if an offer consistent with debt sustainability was expected to be forthcoming.

¹⁸This was explicitly recognized in The Fund's Policy on Financing Assurances, April 1989 (EBS/89/79), which stated that: "The member would ... need to maintain a negotiating position toward its commercial bank creditors that was broadly consistent with the assumptions of the adjustment and financing program being supported by the international community."

Annex II. Creditor Dialogue in Pre- and Post- Default Debt Restructuring

Table All.1. Creditor Dialogue in Pre- and Post- Default Debt Restructurings

	Time between announcement of restructuring and start of dialogue	Did the debtor share non-confidential relevant information with creditors? 1/	Did the debtor provide creditors with early opportunity to give input on the design of the restructuring?	Type of creditor dialogue: Creditor Committee (CC), London Club (LC); Bilaterally (Bil.)	If creditor committee formed, share of claims represented	Debt treated (US\$bn)	NPV Haircut Estimate 2/	Participation rate 3/	Time from announcement to completion of restructuring
<i>Preemptive restructurings</i>									
Belize 2007 (Ext Bonds/Loans)	2m	Yes	Yes	CC	>51%	0.5	23.7%	97.0%	6m
Belize 2013 (Ext Bonds)	2m	Yes	Yes	CC	37%	0.5	31.5%	100.0%	7m
Belize 2017 (Ext Bonds)	2m	Yes	Yes, (after initial consent solicitation)]	CC	60%	0.5	19.7%	100.0%	4m
Cyprus 2013 (Dom/Ext Bonds)	<1 m	No info.	No info.	Bil.	N/A	1.2	35.8%	No info	1 m
Chad 2018 (Ext Loans)	<5m	Yes	Yes	Bil.	N/A	1.2	27.3%	100.0%	17 m
Dom. Republic 2005 (Ext Bonds)	9 m	Yes	Yes	Bil., CC	20-25%	1.1	4.7%	93.6%	13 m
Ecuador 2020 (Ext Bonds)	2m	Yes	Yes	CC (3 committees)	53%	17.4	42.4%	100.0%	5m
Greece 2012 (Dom/Ext Bonds)	<1 m	No info.	No info.	CC	30-40%	273.4	64.6%	96.9%	8 m
Grenada 2005 (Dom/ExtBonds/Loans)	2 m	No info.	Yes	CC	>70%	0.3	33.9%	93.3%	13 m
Jamaica 2010 (Dom Bonds)	<1m	Yes	No info.	CC	-	7.9	22.5%	99.2%	1 m
Jamaica 2013 (Dom Bonds)	<1 m	Yes	No info.	CC	-	9.1	24.2%	99.0%	1 m
Mongolia 2017 (Ext Bonds)	<1 m	Yes	No (but reprofiling only)	Informal Bil.	N/A	0.6	-3.0%	82.0%	<1 m
Mozambique 2016 (Ext bond)	<1m	No	No (but reprofiling only)	Bil.	N/A	0.7	-5.7%	100.0%	10 m
Ukraine 2015 (Bonds/Loans)	2 m	Yes	Yes	CC; Bil. for SOE debt	44%	18.0	23.2%	100.0%	10m
Uruguay 2003 (Ext Bonds)	<1 m	Yes.	Yes	Bil., Roadshows (2)		5.4	9.8%	91.5%	2 m
Average/Share	2m	Mostly yes	Mostly yes	10/15 had CC	48%	1.2	24%	99%	6m
<i>Post-default restructurings (LIA cases)</i>									
Argentina 2005 (Dom/Ext Bonds)	<1m	Yes	No	CC	>50%	79.7	76.8%	80.3%	42m
Argentina 2020 (Dom/Ext Bonds)	4 m	Yes	Yes	CC (3 committees)	40-45%	65.5	35.6%	99.0%	9m
Barbados 2019 (Dom/Ext Bonds/Loans)	<1m	Yes	Yes	CC	>50%	0.8	24.3%	100.0%	19m
Côte d'Ivoire 2009 (Ext. Bonds)	<1 m	Yes	No info	LC	100%	0.1	6.1%	100.0%	21m
Congo, Rep. ongoing (Ext Bonds/Loans)	>6m	Yes	Yes	Bil.	N/A		n/a	n/a	Ongoing
Dominica 2006 (Bonds/Loans)	7 m	Yes	Yes	Bil., Roadshow	N/A	0.1	54.0%	72%	36 m
Dominican Republic 2005 (Ext Loans)	4 m	?	No info	LC	No info	0.2	11.3%	No info	18 m
Grenada 2015 (Bonds/Loans)	12 m	Yes	Yes	CC	>50%	0.2	50.3%	100.0%	32 m
Iraq 2006 (Bank/Comm. Loans)	> 7 m	No info	No info	CC, Bil.	No info	17.7	89.4%	96.0%	20 m
Mozambique 2019 (Ext bond)	17m	Yes	Yes	CC	68%	0.7	11.0%	99.5%	35 m
Serbia-Montenegro 2005 (Loans)	10 m	No info	No info	LC, Bil.	No info	2.7	70.9%	No info	44 m
Seychelles 2010 (Ext Bonds/Loans)	< 1 m	Yes	No info	Bil., Roadshow	N/A	0.3	56.2%	100.0%	19 m
St. Kitts & Nevis 2012 (Bonds/Loans)	3 m	Yes	Yes	CC and Bil./Roadshow	No info	0.1	62.9%	100.0%	10 m
Average/Share	5m	Mostly yes	Mostly don't know	10/13 CCs (incl. LC)	50%	0.5	52.2%	100%	20.5m

Sources: Staff reports and media reports; Asonuma, Niepelt and Ranciere (2018), Asonuma and Trebesch (2016), Cruces and Trebesch (2013), Das, Papaioannou and Trebesch (2012), Park and Samples (2021).

1/ According to the LIA policy this would normally include information on the assessed economic situation/financial circumstances, outline of a viable program, and a comprehensive picture of the proposed treatment of claims.

2/ Anthony, Impavido and van Selm (2020) for Barbados domestic debt episode. Staff calculations for Argentina and Ecuador (both 2020), Cruces and Trebesch (2013) for cases prior to 2014, Asonuma, Niepelt and Ranciere (2018) updated dataset for all remaining episodes. Weighted average (respect to debt outstanding) of instrument-specific NPV and market haircuts. NPV and market haircuts correspond to $1 - (PV \text{ of new bonds} / PV \text{ of old bonds})$, and $1 - (PV \text{ of new bonds} / \text{Face value of old bonds})$, respectively.

3/ Based on Staff Reports, media reporting, and Park and Samples (2021). After application of CACs, where relevant

Annex III. The Evolution of the Fund's Lending into Arrears Policy

A. The Pre-1989 Policy

1. **Prior to 1989, the Fund had a non-toleration of arrears policy with respect to all creditors (private, official bilateral and multilateral) including with respect to sovereign arrears to private creditors.** To this end, the non-accumulation and elimination of arrears served as a general condition for the availability of Fund resources to members. The success of the policies was attributable, in part, to creditors' recognition that cooperation in the financing of Fund-supported programs was in their self-interest.

2. **In its original conception, however, the scope of the arrears policy was limited in two important respects.** First, the policy's coverage was limited to arrears on payments from residents to non-residents on current (and not capital) transactions;¹ and second, the policy applied to arrears arising from exchange restrictions and not to those arising from a government default on its own external obligations.² Against the background of a growing emergence of sovereign arrears, however, the policy was extended in 1980 to include such arrears, recognizing that payment arrears incurred by governments as a result of a default are as damaging to a country's credit standing and the effective functioning of the world's payments system as jurisdictional arrears. As a result, the Fund aligned its position on the elimination of sovereign and jurisdictional arrears, calling for their clearance both in the context of Fund-supported programs and the Fund's surveillance activities.³

3. **Against this background, in 1982 the Fund developed a policy on financing assurances to complement the arrears policy.**⁴ Under this policy, the Fund requires, as a prior condition to the availability of financing under Fund arrangements, that other creditors (official and private) provide assurances that they would offer the necessary support (typically by restructuring of arrears and principal maturing during the program period and new financing) to fill the estimated gaps in the

¹Current payments are defined in Article XXX(d) of the Fund's Articles of Agreement to include not only payments due in connection with foreign trade and other current business, but also, and without limitation, "payments due as interest on loans and as net income from other investments" and "payments of moderate amount for amortization of loans."

²The Fund has held the position that a government cannot justify non-performance either as a principal debtor or guarantor by pleading the exchange control that the government itself has imposed. External arrears incurred by a government on its own debt are not evidence of exchange restrictions and are, therefore, outside the Fund's jurisdiction under Article VIII, Section 2(a). Review of Fund Policies and Procedures on Payments Arrears, October 1980 (EBS/80/190).

³*Id.*

⁴See Financing Assurances in Fund-Supported Programs, December 1987 (EBS/87/266); The Fund's Policy on Financing Assurances, April 1989 (EBS/89/79 and EBM/89/61); Concluding Remarks by the Chairman on Fund Policy on Sovereign Arrears to Private Creditors, March 1998 (BUFF/98/25); and Fund Policy on Sovereign Arrears to Private Creditors, January 1998 (SM/98/8).

financing of the program on terms consistent with the member's return to external viability.^{5,6} As there were limits both to the degree of adjustment that could be undertaken by a member and the amount of financing that could be provided by the Fund, the absence of such financing assurances from other official and private creditors was considered to undermine both the viability of the program and the member's capacity to repay the Fund.

B. The 1989 modification and the introduction of the LIA Policy

4. In 1989, the Fund introduced the policy on lending into sovereign arrears to private creditors (LIA) as a limited exception to its general policy of non-toleration of arrears.

Following the debt crises, financial institutions had gradually strengthened their balance sheets by the late 1980s, and had become increasingly reluctant to provide financing assurances required by the Fund, resulting in delays in the Fund's support for members' adjustment programs.⁷ At the same time, the growing recognition that problems faced by many debtors were reflecting sustainability rather than liquidity, and that a comprehensive resolution of the debt difficulties might entail some debt reduction, reinforced the difficulty of reaching agreement on conventional financing packages. As a result of these developments, the Fund's policy of non-toleration of arrears had the unintended consequence of providing private creditors with leverage over debtors and Fund arrangements.

5. **In view of these developments, the Fund modified its financing assurances and arrears policies with respect to external commercial banks to allow the approval of a Fund arrangement before commercial banks had provided assurances as to their willingness to support a financing package consistent with the program parameters.** This modification of the policy was recognized to entail certain risks regarding the safeguard of Fund resources. To ease these concerns, the LIA policy required that approval of a Fund arrangement be granted only in cases where: (i) prompt Fund support was judged to be essential for the successful implementation of the member's adjustment program; (ii) negotiations between the member and its creditors had begun; and (iii) it could be expected that a financing package consistent with external viability would be agreed upon within a reasonable amount of time.

⁵In practice, the Fund required a formal confirmation from a critical mass of creditor banks through their advisory committee. A critical mass was considered to be the level of participation that made the implementation of financing agreement virtually certain. The share of banks that constituted a critical mass was a matter of judgment on a case-by-case basis, but generally was over 90 percent. During the 1980s debt crisis, the acceptance of a term sheet by banks holding a critical mass of principal was considered as eliminating arrears and providing adequate assurances regarding commercial bank financing.

⁶While, in principle, the application of the Fund's policies on arrears and financing assurances has required that all private creditors participate in burden sharing, small private creditors with relatively small exposure (for example, bondholders and uninsured suppliers) had generally been excluded from this requirement for practical reasons.

⁷[Summing Up by the Chairman on Fund Involvement in the Debt Strategy—Further Considerations](#), May 1998 (BUFF/89/89).

C. The 1998 and 1999 Modifications

6. **In 1998, the scope of debt to which the LIA policy could be applied was broadened to encompass international sovereign bonds and other debt to private creditors.**⁸ Until then, the policy provided for lending into arrears only on debt to external commercial banks. However, as a result of changes in the composition of capital flows to emerging market sovereigns, international bonds replaced syndicated bank loans as the primary financing vehicle for sovereigns. In 1998, the LIA policy would include cases of arrears to sovereign bonds and Fund financing be provided on a case-by-case basis and only where (i) prompt Fund support was considered essential for the successful implementation of the member's adjustment program; (ii) negotiations between the member and its private creditors had begun; and (iii) there were firm indications that the sovereign borrower and its private creditors would negotiate in good faith on a debt restructuring plan. The first two criteria replicated the first two criteria of the 1989 policy, while the third criterion was intended to address specific concerns with regard to bond restructuring.

7. **In a further discussion of the LIA policy in 1999, it was recognized that private creditors might delay negotiations with sovereign debtors following a default for a variety of reasons.**⁹ First, the heterogeneity of the creditor base could result in coordination difficulties, complicating the task of assembling a representative group. Second, the creditor base might include a large element that had no ongoing commercial interest in the sovereign debtor. As a result, the incentives to negotiate in order to return the debtor to good standing in the international financial community may be less than for commercial bank creditors of the 1980s who were generally seen as having a long-term business interest in the debtor country. Finally, given the magnitude of the financing available to emerging market borrowers, the outcome for debtors of losing market access was likely to be at least as serious as in the 1980s. There was also a concern that, if any combination of the above were to prevail, the Fund could be precluded from lending even if the member's policies were appropriate and Fund support was essential to the adjustment effort, since requirements (ii) and (iii) under the 1998 policy would not be met. In 1999, the Fund replaced these requirements with an assessment of whether the member was making good faith efforts to reach a collaborative agreement with its private creditors. The Fund retained the requirement for the criticality of prompt Fund support for the support of the authorities' adjustment program.

D. The 2002 Modification

8. **In 2002, the Board reviewed the application of the good faith criterion and provided procedural clarity in guiding the dialogue between debtors and their external private**

⁸Concluding Remarks by the Chairman on Fund Policy on Sovereign Arrears to Private Creditors, March 1998 (BUFF/98/25) and Fund Policy on Sovereign Arrears to Private Creditors, January 1998 (SM/98/8).

⁹[Summing Up by the Acting Chairman on Fund Policy on Arrears to Private Creditors—Further Considerations](#), June 1999 (BUFF/99/71) and Fund Policy on Arrears to Private Creditors—Further Considerations, April 1999 (EBS/99/67).

creditors, including in cases where representative creditor committees had been formed.¹⁰ In particular, the Fund stressed the need to strike an appropriate balance between the greater clarity about the good faith dialogue between a debtor and their private external creditors to provide better guidance about the application of the LIA policy and the flexibility in applying the good faith criterion to accommodate the characteristics of each specific case. As under previous iterations of the LIA policy, all purchases made while a member has outstanding arrears to private creditors continue to be subject to financing assurances reviews, which will provide an opportunity for the Fund to monitor relations between a debtor and its external private creditors.

9. Directors agreed that Fund lending into sovereign arrears to private creditors (including bondholders and commercial banks) should be on a case-by-case basis and only where:

- (i) prompt Fund support is considered essential for the successful implementation of the member's adjustment program; and
- (ii) the member is pursuing appropriate policies and is making a good faith effort to reach a collaborative agreement with its creditors.

10. Directors considered that the following principles would strike an appropriate balance between clarity and flexibility in guiding the dialogue between debtors and their private external creditors.

- First, when a member has reached a judgment that a restructuring of its debt is necessary, it should engage in an early dialogue with its creditors, which should continue until the restructuring is complete.
- Second, the member should share relevant, non-confidential information with all creditors on a timely basis, which would normally include:
 - an explanation of the economic problems and financial circumstances that justify a debt restructuring;
 - a briefing on the broad outlines of a viable economic program to address the underlying problems and its implications on the broad financial parameters shaping the envelope of resources available for restructured claims; and
 - the provision of a comprehensive picture of the proposed treatment of all claims on the sovereign, including those of official bilateral creditors, and the elaboration of the basis on

¹⁰Fund Policy on Lending into Arrears to Private Creditors—Further Consideration of the Good Faith Criterion, July 2002 (SM/02/248) and [The Acting Chair's Summing Up on Fund Policy on Lending into Arrears to Private Creditors—Further Consideration of the Good Faith Criterion](#), September 2002 (BUFF/02/142).

which the debt restructuring would restore medium-term sustainability, bearing in mind that not all categories of claims may need to be restructured.

- Third, the member should provide creditors with an early opportunity to give input on the design of restructuring strategies and the design of individual instruments.

11. **Although, as a general premise, the form of the dialogue would be left to the debtor and its creditors, under this approach a member in arrears would be expected to initiate a dialogue with its creditors prior to agreeing on a Fund-supported program consistent with the principles discussed above.** In cases in which an organized negotiating framework is warranted by the complexity of the case and by the fact that creditors have been able to form a representative committee on a timely basis, there would be an expectation that the member would enter into good faith negotiations with this committee, though the unique characteristics of each case would also be considered. This formal negotiating framework would include, inter alia, the sharing of confidential information needed to enable creditors to make informed decisions on the terms of a restructuring (subject to adequate safeguards), and the agreement to a standstill on litigation during the restructuring process by creditors represented in the committee. By the same token, in less complex cases, where creditors have not organized a representative committee within a reasonable period, or where for other reasons a formal negotiation framework would not be effective, the member would be expected to engage creditors through a less structured dialogue.

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