

**EXECUTIVE
BOARD
MEETING**

SM/22/47
Supplement 1

April 26, 2022

To: Members of the Executive Board

From: The Secretary

Subject: **Reviews of the Fund's Sovereign Arrears Policies and Perimeter—
Supplementary Information**

Board Action: Executive Directors' **consideration** (Formal)

Tentative Board Date: **Wednesday, May 4, 2022**

Publication: Proposed, together with main paper

Questions: Ms. Ams, LEG (ext. 38053)
Mr. Bergthaler, LEG (ext. 34287)
Mr. Breuer, MCM (ext. 36364)
Mr. Chamon, SPR (ext. 35867)



April 25, 2022

REVIEWS OF THE FUND'S SOVEREIGN ARREARS POLICIES AND PERIMETER—SUPPLEMENTARY INFORMATION

Approved By
**Yan Liu, Jeromin
Zettelmeyer, and
Miguel Savastano**

Prepared by an inter-departmental team led by Wolfgang Bergthaler (LEG). The team comprised of Julianne Ams (LEG lead); Peter Breuer (MCM lead), Thordur Jonasson (all MCM); and Marcos Chamon (SPR lead), Tom Best (SPR coordinator), Atif Saeed Chaudry (all SPR). Sebastian Grund and Clara Thiemann (all LEG), and Maximilien Kaffo, Geoffrey Keim, and Vivian Malta (all SPR) contributed to the paper. The team worked under the overall guidance provided by Tobias Adrian, Ceyla Pazarbasioglu, and Rhoda Weeks-Brown.

CONTENTS

| | |
|-----------------------------------------------------------------------------------------------------------------|----|
| INTRODUCTION _____ | 2 |
| ANNEXES | |
| I. Consolidated Draft Executive Board Understanding of the Fund's Arrears Policies and Perimeter_____ | 3 |
| II. Consolidated Redlined Draft Executive Board Understanding of the Fund's Arrears Policies and Perimeter_____ | 10 |

INTRODUCTION

1. For illustrative purposes, if all of staff's proposals contained in the main paper (SM/22/47) are endorsed by the Executive Board, staff attaches to this supplement a clean (Annex 1) and redlined (Annex 2) version of the consolidated draft Executive Board understandings of the Fund's arrears policies and perimeter. The redlined version shows the differences of the proposals versus current Fund policies (see Box 1 of the main paper SM/22/47).¹ The benefit for Executive Directors of this approach is that the Annexes 1 and 2 consolidate current Fund policies with proposed revisions to enable a comprehensive view of the amended Fund's sovereign arrears policies. After the Executive Board meeting and dependent on the outcome of the Executive Board considerations of staff's proposals, staff will revise Annexes 1 and 2 and reissue them to the Executive Board prior to publication.

2. In addition to the proposals made in the main staff paper, the Annexes specify an alternative criterion for determining whether an International Financial Institution (IFI) should benefit from the Fund's non-toleration policy of arrears to IFIs (NTP) in official sector involvement (OSI) cases. While staff continues to believe that the proposal set forth in paragraph 61 of the main paper represents the best solution, this alternative (see italicized language in paragraph 18 of Annex I) is presented as a fallback position in case staff's proposal does not command consensus at the Executive Board.

3. Under the alternative, the question of whether an IFI should benefit from the NTP in OSI cases would remain a judgment call informed by several factors. In particular, the three factors considered under the current approach—global membership, treatment by the Paris Club, and participation in the HIPC initiative (see paragraph 16 in the main paper)—would be expanded by two additional factors, for the reasons described in the staff paper (see paragraph 58 in particular), namely:

- Whether the institution is a Regional Financing Arrangement (RFA) or a reserve currency union central bank (RCUCB) whose operations have the effect of strengthening the GFSN; and
- Whether the institution is being excluded from the scope of debt restructuring by official bilateral creditors through a creditor committee based on a representative standing forum recognized under the LIOA policy in the case at hand.

4. The alternative would leave all other proposed changes to the NTP unaffected. Specifically, the alternative refers only to Proposed Amendment 1 (paragraph 61 in the main paper). Proposed Amendment 2 (paragraphs 62-63) and Proposed Simplification (paragraphs 64) would remain unaffected.

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

Annex I. Consolidated Draft Executive Board Understanding of the Fund's Arrears Policies and Perimeter

Introduction

1. [Directors] welcomed the comprehensive review of the Fund's policy on lending into arrears to private creditors, the Fund's policy on lending into sovereign arrears to official bilateral creditors, and the Fund's non-toleration of sovereign arrears policy to official bilateral and multilateral creditors.

2. [Directors] agreed that overall, the Fund's arrears policies have worked well in enabling the Fund to proceed with providing financing in cases of arrears. At the same time, [Directors] noted that practice in sovereign debt restructuring and the creditor landscape have evolved over the last 20 years and certain amendments, refinements, and updates are in order.

Lending Into Arrears (LIA) Policy

3. [Directors] concurred that the Fund's policy on lending into arrears to private creditors continues to provide a useful tool enabling the Fund to support a member's adjustment efforts before the member has reached agreement with its private creditors on a debt restructuring. Specifically, [Directors] agreed that Fund lending into sovereign arrears to private creditors should continue to 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.

4. [Directors] also agreed that Fund lending into non-sovereign arrears stemming from the imposition of exchange controls should continue to 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, the member 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.

5. With respect to lending into sovereign arrears to private creditors, [Directors] agreed that greater clarity about the good faith dialogue between a debtor and its creditors during the restructuring process and enhanced debt transparency could help provide better guidance about

the application of the Fund's LIA policy and, more generally, promote a better framework for the engagement of debtors and creditors in the restructuring of sovereign debt. Greater clarity concerning the framework for possible debt restructuring would strengthen the capacity of investors to assess recovery values under alternative scenarios, thereby facilitating the pricing of risk and improving the functioning of the capital markets. At the same time, however, [Directors] stressed the need for continued flexibility in applying the "good faith" criterion to accommodate the characteristics of each specific case to avoid putting debtors at a disadvantage in the negotiations with creditors; and to avoid prolonged negotiations that could hamper the ability of the Fund to provide timely assistance. Indeed, any clarification of the "good faith" criterion should serve primarily to support the difficult judgments that will continue to have to be made in each case, and should be made operational in a manner that does not impair market discipline.

6. [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 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 outstanding debt stock and its terms, and the proposed treatment of all claims on the sovereign, including those of official bilateral creditors; the perimeter of claims subject to the envisaged debt restructuring; and the elaboration of the basis on which the debt restructuring would restore medium-term debt 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.

Fourth, any terms offered to the creditors by the member should be consistent with the parameters of the Fund-supported program.

7. Although, as a general premise, the form of the dialogue would continue to 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 consistent with the principles discussed above. In cases in which 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.

8. [Directors] stressed that, in going forward with the suggested approach, it would be crucial to strike the appropriate balance between the need to promote effective communication between a debtor and its creditors, and the need to retain flexibility to address the diversity of individual member circumstances.

9. [Directors] emphasized that in assessing whether the member is making good faith efforts to negotiate, judgments would continue to be required in a number of important areas. These include a consideration of the extent to which creditor committees are sufficiently representative, and whether a reasonable period has elapsed to allow for the formation of representative committees. In the absence of such creditor committees, the member would be expected to engage creditors through a less structured dialogue.

10. [Directors] viewed the considerations laid out in the staff paper as useful inputs for helping to make such judgments, which would need to be made flexibly. They also noted that to the extent that negotiations become stalled because creditors are requesting terms that are inconsistent with the adjustment and financing parameters that have been established under a Fund-supported program, the Fund should retain the flexibility to continue to support members notwithstanding the lack of progress in negotiations with creditors.

11. [Directors] recognized that there may be circumstances where, following a default, the debtor enters into good faith discussions with creditors prior to the approval of a Fund arrangement. In these circumstances, creditors are likely to express views as to the appropriate dimensions of the program's adjustment and financing parameters. While such input would be welcome, [Directors] emphasized that decisions on an adequate macroeconomic framework and the design of the financing plan or the adjustment program that could form the basis for the Fund's lending into arrears will remain in the sole purview of the Fund.

12. [Directors] recognized that there may be 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 good faith efforts to reach agreement with its creditors. When a judgment has been made that such exceptional circumstances exist, the Fund may provide financing under the Rapid Credit Facility (RCF) or the Rapid Financing Instrument (RFI) despite arrears owed to private creditors. However, 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 on lending into sovereign arrears to private creditors.

13. All purchases/disbursements made while a member has outstanding arrears to private creditors will continue to be subject to financing reviews, which will provide an opportunity for the Fund to monitor relations between a debtor and its creditors, and for the Board to be kept informed about developments in this area at an early stage.

14. [Directors] noted that the policy outlined above supersedes all previous policies regarding lending into arrears to private creditors.

Codifying Existing Practice into a Policy in Preemptive Restructuring Cases

15. [Directors] agreed that the current practice in preemptive restructuring cases remains appropriate. To the extent that the Fund determines that a contribution from external private creditors in the form of a debt restructuring will be needed to restore debt sustainability, the restructuring should ideally be undertaken before the approval of the Fund arrangement. However, there may be circumstances under which more flexibility is warranted, so that the conclusion of the debt operation is contemplated at a later date, normally, by the first review under the arrangement. In such cases, the Fund may provide financing only if it has adequate assurances that such a restructuring will be successful. Such assurances are obtained by a judgment that a credible process for restructuring is underway and will result in sufficient creditor participation to restore debt sustainability and close financing gaps within the macroeconomic parameters of the program, taking into account official sector commitments. This judgment will depend on member-specific circumstances, but relevant considerations to inform such judgment may 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. [Directors] emphasized that the member would be expected to share relevant information as defined under the LIA policy with all private creditors on a timely basis.

Lending Into Arrears to Official Bilateral Creditors (LIOA) Policy

16. [Directors] agreed that the Fund's non-toleration of arrears policy in non-(Official Sector Involvement) OSI cases and the policy on lending into sovereign arrears to official bilateral creditors in OSI cases continues to be appropriate and no amendments are needed.

17. [Directors] concurred that new Fund-supported programs should continue to incorporate the assumption that old OSI-related claims would be restructured in line with the terms stipulated in the original Fund-supported program.

International Financial Institutions

18. [Directors] agreed that application of the non-toleration of arrears policy with respect to multilaterals has worked well, but the policy needs to be updated to clarify how the policy applies to new International Financial Institutions (IFIs) and to ensure that the special treatment multilateral creditors receive under the Fund's arrears policy is not diluted. IFIs are defined as international

financial institutions with at least two sovereign members (and no non-sovereign member). Therefore, [Directors] endorsed staff's proposal in the paper along three main lines:

- First, Fund financing in the face of arrears to the World Bank Group should continue to require an Agreed Plan between the debtor and the World Bank to clear the arrears over a defined period. Fund financing in the face of arrears to any other IFI should continue to require that a Credible Plan be in place in cases where a contribution from the official sector is not required in order to restore debt sustainability (non-OSI cases). In this context, a Credible Plan is a plan that is credible to the Fund, and the creditor's concurrence is not required.
- Second, in cases where a contribution from the official sector is required in order to restore debt sustainability (OSI cases):
 - The Fund should only provide financing when a Credible Plan is in place in cases in which arrears are owed to (i) regional financing arrangements and reserve currency union central banks that form part of the global financial safety net or IFIs with global membership as defined in the staff paper, or (ii) IFIs being excluded from the scope of debt restructuring by official bilateral creditors through a creditor committee based on a representative standing forum recognized under the LIOA policy—either in the case at hand or as expected based on previous cases if no decision has been made in the current case.

[OR (alternative formulation, see introduction)

Where the member is in arrears to an IFI, the Fund should judge whether a Credible Plan to resolve such arrears is required as a condition for lending. Factors informing the Fund's judgment in this regard will include: (i) global, rather than regional, membership of the institution; (ii) whether the institution is a regional financing arrangement or a reserve currency union central bank that forms part of the global financial safety net; (iii) the Paris Club's treatment of the institution, (iv) participation of the institution in the Heavily Indebted Poor Countries (HIPC) Initiative, and (v) whether the institution is being excluded from the scope of debt restructuring by official bilateral creditors through a creditor committee based on a representative standing forum recognized under the LIOA policy in the case at hand.]

- When arrears are owed to an IFI that does not fall under the previous bullet above, [Directors] agreed that the Fund's policy on lending into official bilateral arrears should be expanded to apply to these cases mutatis mutandis. In these cases, the Fund policy will also provide for the flexibility in extraordinary circumstances for emergency financing cases consistent with the Fund's policy on lending into official bilateral creditors arrears.

[Directors] agreed that in the latter cases, the Fund would consider lending into arrears owed to an IFI creditor only in circumscribed circumstances where all the following criteria are satisfied:

- Prompt financial support from the Fund is considered essential, and the member is pursuing appropriate policies;

- The debtor is making good faith efforts to reach agreement with the IFI 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
- 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.

19. In assessing whether a debtor is acting in good faith, the Fund will consider, *inter alia*, whether the debtor has approached the IFI creditor to which it owes arrears bilaterally; has offered to engage in substantive dialogue with the IFI creditor and has sought a collaborative process with the creditor to reach agreement; has provided the creditor relevant information on a timely basis consistent with the Fund's policy on confidentiality of information; and has offered the creditor terms that are consistent with the parameters of the Fund-supported program. If the debtor requested terms from an IFI creditor that would result in financing contributions that exceeded the requirements of the program it would generally not indicate good faith.

20. In assessing whether the Fund's decision to lend into arrears owed to an IFI creditor would have an undue negative effect on the Fund's ability to mobilize official financing packages in future cases, the Fund will consider the signal that such a decision would send to IFI creditors, or to official creditors more generally, as a group, given the specific circumstances of the case.

21. An IFI creditor may choose to consent to Fund financing notwithstanding arrears owed to it. Such consent could be conveyed to the Fund either through an Executive Director designated by the IFI or an authorized executive of the IFI to the Managing Director. In such cases, the Executive Board would not need to make a judgment as to whether the three criteria above are satisfied. The Fund would nevertheless continue to encourage the parties to come to an agreement during the program, since the regularization of arrears is an objective of any Fund-supported program and important for the functioning of the international financial system at large.

22. So long as arrears to IFI creditors remain outstanding, purchases or disbursements will be subject to a financing assurances review where the Executive Board will verify that all three criteria are satisfied and the policy continues to be met for the further use of the Fund's resources in the member's circumstances.

Perimeter

23. For the purpose of determining the application of the Fund's arrears, financing assurances and debt sustainability policies, [Directors] endorsed the approach proposed by staff.

24. Specifically, Direct Bilateral Claims will continue to be defined as 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 debtor member.

25. In operationalizing this definition, [Directors] supported using the creditor member's budgetary process to determine which entities form part of the creditor government. For entities that fall outside the government, a case-by-case analysis, taking into account the totality of the circumstances, would continue to be required to determine whether the entity is "acting on behalf of the government." [Directors] recognized that secondary market purchases of claims by official bilateral creditors would not qualify as Direct Bilateral Claims, as they would not directly extend financing to the debtor member.

26. [Directors] endorsed two amendments to the classification of official claims: First, to the extent that the IFI purchases securities in the secondary market as part of the global financial safety net, such claims can be treated as claims subject to the Fund's arrears policies as applicable to IFIs; however, the Fund would rely on the IFI's own representation in this regard. Second, any Direct Bilateral Claims or claims held by IFIs that are contractually part of a pooled voting mechanism with private creditors shall be subject to the LIA policy.

Effectiveness

27. The above amendments and new policies will enter into effect immediately and will apply to all future purchases and disbursements (including under existing arrangements), with respect to existing and future arrears.

Reviews of the Arrears Policies

28. Finally, [Directors] agreed that the Fund's arrears policies should be reviewed on an as needed basis.

Annex II. Consolidated Redlined Draft Executive Board Understanding of the Fund's Arrears Policies and Perimeter

Introduction

1. [Directors] welcomed the comprehensive review of the Fund's policy on lending into arrears to private creditors, the Fund's policy on lending into sovereign arrears to official bilateral creditors, and the Fund's non-toleration of sovereign arrears policy to official bilateral and multilateral creditors.
2. [Directors] agreed that overall, the Fund's arrears policies have worked well in enabling the Fund to proceed with providing financing in cases of arrears. At the same time, [Directors] noted that practice in sovereign debt restructuring and the creditor landscape have evolved over the last 20 years and certain amendments, refinements, and updates are in order.

Lending Into Arrears (LIA) Policy

Directors welcomed the opportunity to reexamine the criteria set out earlier for Fund lending into arrears to private creditors stemming from sovereign defaults and from the imposition of exchange controls that lead to an interruption in debt service payments by nonsovereign borrowers.

Directors emphasized that the modification of the financing assurances and arrears policies to permit lending into arrears is an adaptation of existing policies to changing circumstances, and is intended to reinforce the Fund's ability to promote effective balance of payments adjustment while providing adequate safeguards for the use of the Fund's resources.

Directors agreed that the Fund's policy on lending into sovereign arrears to private creditors continues to provide a useful tool enabling the Fund to support a member's adjustment efforts before it has reached agreement with its private creditors on a debt restructuring. The pillars of this policy are first, that the timely support of the member's adjustment program is considered essential to help limit the scale of economic dislocation and preserve the economic value of investors' claims; and second, that the debtor engages its creditors in an early and constructive dialogue to help secure a reasonably timely and orderly agreement that would help the country regain external viability.

Directors welcomed the opportunity to review the application of the criterion requiring a member to make good faith efforts to reach a collaborative agreement with its creditors, in light of the experience with bond restructurings since the introduction of the "good faith" criterion in 1999. They observed that this experience, although limited, suggests that notwithstanding the ability of debtors to reach restructuring agreements with their creditors, the restructuring processes have in some

~~cases been protracted, reflecting the complexity of each individual case, as well as different perspectives and concerns among debtors and creditors.~~

~~Directors concurred that the criteria set out earlier for the case of sovereign arrears may be too restrictive and could lead to instances in which creditors particularly bondholders could exercise a de facto veto over Fund lending. They also considered that the criteria set out earlier for the case of nonsovereign arrears are too restrictive, as they may not take adequate account of the possibility that, even when both creditors and debtors are willing to participate in collaborative negotiations, the process of debt renegotiation may be protracted. Directors noted that in the case of nonsovereign arrears to private creditors, it would be important to ensure that appropriate steps are taken to protect creditors' interests. One suggestion to staff in this regard was to consider the establishment of an escrow account into which debt service payments in local currency to nonresident creditors would be made. Against the background of variations in institutional arrangements and members' capacity, however, Directors considered that it would be difficult to specify as a criterion for lending into nonsovereign arrears the implementation of specific mechanisms to protect creditors' interests; instead, this judgment would need to be made on a case-by-case basis.~~

3. [Directors] ~~agreed~~ **concur**red that the Fund's policy on lending into arrears to private creditors continues to provide a useful tool enabling the Fund to support a member's adjustment efforts before the member has reached agreement with its private creditors on a debt restructuring. **Specifically**, [Directors] agreed that Fund lending into sovereign arrears to private creditors ~~(including bondholders and commercial banks)~~ should **continue to** 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.

4. [Directors] also agreed that Fund lending into non-sovereign arrears stemming from the imposition of exchange controls should **continue to** 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, **the member** 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.

5. ~~Against this backdrop,~~ **With respect to lending into sovereign arrears to private creditors,** [Directors] agreed that greater clarity about the good faith dialogue between a debtor and its creditors during the restructuring process **and enhanced debt transparency** could help provide better guidance about the application of the ~~lending into sovereign arrears policy~~ LIA policy and, more generally, promote a better framework for the engagement of debtors and creditors in the restructuring of sovereign debt. Greater clarity concerning the framework for possible debt restructuring would strengthen the capacity of investors to assess recovery values under alternative scenarios, thereby facilitating the pricing of risk and improving the functioning of the capital markets. At the same time, however, [Directors] stressed the need for continued flexibility in applying the “good faith” criterion to accommodate the characteristics of each specific case; to avoid putting debtors at a disadvantage in the negotiations with creditors; and to avoid prolonged negotiations that could hamper the ability of the Fund to provide timely assistance. Indeed, any clarification of the “good faith” criterion should serve primarily to support the difficult judgments that will continue to have to be made in each case, and should be made operational in a manner that does not impair market discipline.

6. [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 outstanding debt stock and its terms,** **and** the proposed treatment of all claims on the sovereign, including those of official bilateral creditors; **the perimeter of claims subject to the envisaged debt restructuring;** and the elaboration of the basis on which the debt restructuring would restore medium-

term **debt** 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.

Fourth, any terms offered to the creditors by the member should be consistent with the parameters of the Fund-supported program.

~~In discussing the various approaches that would best clarify the content of a member's good faith efforts in the context of the lending into arrears policy, Directors emphasized that the modalities guiding the debtor's dialogue with its creditors will need to be tailored to the specific features of each individual case. Most Directors considered that the third approach suggested in the staff paper for refining the good faith criterion provides an appropriate basis for the implementation of the Fund's policy, while retaining sufficient flexibility to address the diversity of individual situations.~~

7. Although, as a general premise, the form of the dialogue would **continue** to 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 consistent with the principles discussed above. In cases in which 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.~~

8. [Directors] stressed that, in going forward with the suggested approach, it would be crucial to strike the appropriate balance between the need to promote effective communication between a debtor and its creditors, and the need to retain flexibility to address the diversity of individual **country member** circumstances.

9. [Directors] emphasized that in assessing whether the member is making good faith efforts to negotiate, judgments would continue to be required in a number of important areas. These include a consideration ~~of the complexity of the restructuring case~~, the extent to which creditor committees **are** sufficiently representative, and whether a reasonable period has elapsed to allow for the formation of ~~a~~ representative committees. ~~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. In the absence of such creditor committees, the member would be expected to engage creditors through a less structured dialogue.~~

~~Directors discussed a variety of factors that would need to be considered in making the proposed framework operational. They emphasized that in assessing whether the member is making good faith efforts to negotiate, judgments would continue to be required in a number of important areas. These include a consideration of the complexity of the restructuring case, the extent to which a creditor committee is sufficiently representative, and whether a reasonable period has elapsed to allow for the formation of a representative committee.~~

10. [Directors] viewed the considerations laid out in the staff paper as useful inputs for helping to make such judgments, which would need to be made flexibly. They also noted that to the extent that negotiations become stalled because creditors are requesting terms that are inconsistent with the adjustment and financing parameters that have been established under a Fund-supported program, the Fund should retain the flexibility to continue to support members notwithstanding the lack of progress in negotiations with creditors.

11. [Directors] recognized that there may be circumstances where, following a default, the debtor enters into good faith discussions with creditors prior to the approval of a Fund arrangement. In these circumstances, creditors are likely to express views as to the appropriate dimensions of the program's adjustment and financing parameters. While such input would be welcome, [Directors] emphasized that ~~it would be inappropriate for private creditors to be given a veto over the design of the financing plan or the design of the adjustment program~~ decisions on an adequate macroeconomic framework and the design of the financing plan or the adjustment program that could form the basis for the Fund's lending into arrears will remain in the sole purview of the Fund.

12. [Directors] recognized that there may be 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 good faith efforts to reach agreement with its creditors. When a judgment has been made that such exceptional circumstances exist, the Fund may provide financing under the Rapid Credit Facility (RCF) or the Rapid Financing Instrument (RFI) despite arrears owed to private creditors. However, 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 on lending into sovereign arrears to private creditors.

~~In both cases, all purchases by the member would be subject, as provided at present, to financing reviews to bring developments at an early stage to the attention of the Executive Board, and to provide an opportunity for the Board to consider whether adequate safeguards remain in place for further use of the Fund's resources in the member's circumstances. Specifically, such reviews would~~

~~provide a basis to assess whether the member's adjustment efforts are considered to be undermined by developments in creditor-debtor relations.~~

13. All purchases/~~disbursements~~ made while a member has outstanding arrears to private creditors will continue to be subject to financing reviews, which will provide an opportunity for the Fund to monitor relations between a debtor and its creditors, and for the Board to be kept informed about developments in this area at an early stage. ~~Going forward, a number of Directors also underscored the importance of strengthening debtor-creditor dialogue in good times, as this will provide a good base for advancing the required negotiation framework in times of stress.~~

14. [Directors] noted that the policy outlined above supersedes all previous policies regarding lending into arrears to private creditors.

~~Finally, Directors noted that it would be important to monitor experience with lending into arrears and to keep the policy outlined above under review, so as to ensure that it achieves its objectives.~~

Codifying Existing Practice into a Policy in Preemptive Restructuring Cases

15. [Directors] agreed that the current practice in preemptive restructuring cases remains appropriate. To the extent that the Fund determines that a contribution from external private creditors in the form of a debt restructuring will be needed to restore debt sustainability, the restructuring should ideally be undertaken before the approval of the Fund arrangement. However, there may be circumstances under which more flexibility is warranted, so that the conclusion of the debt operation is contemplated at a later date, normally, by the first review under the arrangement. In such cases, the Fund may provide financing only if it has adequate assurances that such a restructuring will be successful. Such assurances are obtained by a judgment that a credible process for restructuring is underway and will result in sufficient creditor participation to restore debt sustainability and close financing gaps within the macroeconomic parameters of the program, taking into account official sector commitments. This judgment will depend on member-specific circumstances, but relevant considerations to inform such judgment may 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. [Directors] emphasized that the member would be expected to share relevant information as defined under the LIA policy with all private creditors on a timely basis.

Lending Into Arrears to Official Bilateral Creditors (LIOA) Policy

16. [Directors] agreed that the Fund's non-toleration of arrears policy in non-Official Sector Involvement (OSI) cases and the policy on lending into sovereign arrears to official bilateral creditors in OSI cases continues to be appropriate and no amendments are needed.

17. [Directors] concurred that new Fund-supported programs should continue to incorporate the assumption that old OSI-related claims would be restructured in line with the terms stipulated in the original Fund-supported program.

International Financial Institutions

18. [Directors] agreed that application of the non-toleration of arrears policy with respect to multilaterals has worked well, but the policy needs to be updated to clarify how the policy applies to new International Financial Institutions (IFIs) and to ensure that the special treatment multilateral creditors receive under the Fund's arrears policy is not diluted. IFIs are defined as international financial institutions with at least two sovereign members (and no non-sovereign member). Therefore, [Directors] endorsed staff's proposal in the paper along three main lines:

- First, Fund financing in the face of arrears to the World Bank Group should continue to require an Agreed Plan between the debtor and the World Bank to clear the arrears over a defined period. Fund financing in the face of arrears to any other IFI should continue to require that a Credible Plan be in place in cases where a contribution from the official sector is not required in order to restore debt sustainability (non-OSI cases). In this context, a Credible Plan is a plan that is credible to the Fund, and the creditor's concurrence is not required.
- Second, in cases where a contribution from the official sector is required in order to restore debt sustainability (OSI cases):
 - The Fund should only provide financing when a Credible Plan is in place in cases in which arrears are owed to (i) regional financing arrangements and reserve currency union central banks that form part of the global financial safety net or IFIs with global membership as defined in the staff paper, or (ii) IFIs being excluded from the scope of debt restructuring by official bilateral creditors through a creditor committee based on a representative standing forum recognized under the LIOA policy—either in the case at hand or as expected based on previous cases if no decision has been made in the current case.

[OR (alternative formulation, see introduction)]

Where the member is in arrears to an IFI, the Fund should judge whether a Credible Plan to resolve such arrears is required as a condition for lending. Factors informing the Fund's judgment in this regard will include: (i) global, rather than regional, membership of the institution; (ii) whether the institution is a regional financing arrangement or a reserve currency union central bank that forms part of the global financial safety net; (iii) the Paris Club's treatment of the institution, (iv) participation of the institution in the Heavily Indebted Poor Countries (HIPC) Initiative, and (v) whether the institution is being excluded from the scope of debt restructuring by

official bilateral creditors through a creditor committee based on a representative standing forum recognized under the LIOA policy in the case at hand.]

- When arrears are owed to an IFI that does not fall under the previous bullet above, [Directors] agreed that the Fund's policy on lending into official bilateral arrears should be expanded to apply to these cases *mutatis mutandis*. In these cases, the Fund policy will also provide for the flexibility in extraordinary circumstances for emergency financing cases consistent with the Fund's policy on lending into official bilateral creditors arrears.

[Directors] agreed that in the latter cases, the Fund would consider lending into arrears owed to an IFI creditor only in circumscribed circumstances where all the following criteria are satisfied:

- Prompt financial support from the Fund is considered essential, and the member is pursuing appropriate policies;
- The debtor is making good faith efforts to reach agreement with the IFI 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
- 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.

19. In assessing whether a debtor is acting in good faith, the Fund will consider, *inter alia*, whether the debtor has approached the IFI creditor to which it owes arrears bilaterally; has offered to engage in substantive dialogue with the IFI creditor and has sought a collaborative process with the creditor to reach agreement; has provided the creditor relevant information on a timely basis consistent with the Fund's policy on confidentiality of information; and has offered the creditor terms that are consistent with the parameters of the Fund-supported program. If the debtor requested terms from an IFI creditor that would result in financing contributions that exceeded the requirements of the program it would generally not indicate good faith.

20. In assessing whether the Fund's decision to lend into arrears owed to an IFI creditor would have an undue negative effect on the Fund's ability to mobilize official financing packages in future cases, the Fund will consider the signal that such a decision would send to IFI creditors, or to official creditors more generally, as a group, given the specific circumstances of the case.

21. An IFI creditor may choose to consent to Fund financing notwithstanding arrears owed to it. Such consent could be conveyed to the Fund either through an Executive Director designated by the IFI or an authorized executive of the IFI to the Managing Director. In such cases, the Executive Board would not need to make a judgment as to whether the three criteria above are satisfied. The Fund

would nevertheless continue to encourage the parties to come to an agreement during the program, since the regularization of arrears is an objective of any Fund-supported program and important for the functioning of the international financial system at large.

22. So long as arrears to IFI creditors remain outstanding, purchases or disbursements will be subject to a financing assurances review where the Executive Board will verify that all three criteria are satisfied and the policy continues to be met for the further use of the Fund's resources in the member's circumstances.

Perimeter

23. For the purpose of determining the application of the Fund's arrears, financing assurances and debt sustainability policies, [Directors] endorsed the approach proposed by staff.

24. Specifically, Direct Bilateral Claims will continue to be defined as 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 debtor member.

25. In operationalizing this definition, [Directors] supported using the creditor member's budgetary process to determine which entities form part of the creditor government. For entities that fall outside the government, a case-by-case analysis, taking into account the totality of the circumstances, would continue to be required to determine whether the entity is "acting on behalf of the government." [Directors] recognized that secondary market purchases of claims by official bilateral creditors would not qualify as Direct Bilateral Claims, as they would not directly extend financing to the debtor member.

26. [Directors] endorsed two amendments to the classification of official claims: First, to the extent that the IFI purchases securities in the secondary market as part of the global financial safety net, such claims can be treated as claims subject to the Fund's arrears policies as applicable to IFIs; however, the Fund would rely on the IFI's own representation in this regard. Second, any Direct Bilateral Claims or claims held by IFIs that are contractually part of a pooled voting mechanism with private creditors shall be subject to the LIA policy.

Effectiveness

27. The above amendments and new policies will enter into effect immediately and will apply to all future purchases and disbursements (including under existing arrangements), with respect to existing and future arrears.

Reviews of the Arrears Policies

28. Finally, [Directors] agreed that the Fund's arrears policies should be reviewed on an as needed basis.