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AGENDA

EBS/85/32
Correction 1

CONFIDENTIAL

February 28, 1985

To: Members of the Executive Board

From: The Secretary

Subject: Overdue Financial Obligations to the Fund - Supplementary
Notes to EBS/84/211 and EBS/84/231

The following corrections have been made in EBS/85/32 (2/5/85):

Page 1, para. 1, line 14: for "EBS/85/12" read "SM/85/12"

Page 3, footnote 1: for "EBS/85/12" read "SM/85/12"

Page 6, last para., line 3: for "EBS/85/12" read "SM/85/12"

line 6: for "EBS/85/12" read "SM/85/12"

Page 7, 1st full para., line 1: for "EBS/85/12" read "SM/85/12"

Corrected pages are attached.

Att: (4)

CONFIDENTIAL

INTERNATIONAL MONETARY FUND

Overdue Financial Obligations to the Fund--Supplementary
Notes to EBS/84/211 and EBS/84/231

Prepared by the the Treasurer's Department and
the Bureau of Statistics

(In consultation with the External Relations
Department and the Legal Department)

Approved by W.O. Habermeler and W. Dannemann

January 31, 1985

At the Executive Board meeting on December 17, 1984 (EBM/84/185-186), Executive Directors requested additional information on the reporting by the Fund in published documents of overdue financial obligations to the Fund, with particular reference to the question of identification of members in arrears to the Fund, and on the effects of overdue payments on the Fund's income and reserves. Section I of this paper discusses reporting on members' arrears to the Fund in the Annual Report; the identification of members in arrears to the Fund in the Fund's financial statements, including a summary of the practices of other institutions; and the presentation of arrears to the Fund in other Fund statistics. Section II discusses certain questions relating to the effects of overdue payments on the Fund's income and reserves. The issue of publicity upon a declaration of ineligibility is discussed in SM/85/12, dated January 9, 1985. The question of "corrective" charges on overdue payments, designed to compensate the Fund for costs arising from overdue obligations, will be discussed in a separate paper on penalty charges presently under preparation.

I. Reporting by the Fund of Overdue Financial
Obligations to the Fund

With the increasing amount of overdue obligations to the Fund, the issuance of complaints by management, and decisions by the Executive Board in a number of cases, questions have arisen about the appropriate extent and form of reporting by the Fund on these matters in documents that are made available to the general public. In the first six-monthly report on overdue financial obligations to the Fund, 1/ it was proposed that information on decisions by the Executive Board on complaints by the Managing Director should be reported in the Fund's Annual Reports; and that information on members' arrears to the Fund should be reported in the Fund's yearbook issue of Balance of Payments Statistics, provided that the member had been overdue in payments to the Fund for six months

1/ EBS/84/211 (10/11/84).

or more, and, without identification of the members involved, reflected in monthly issues of Balance of Payments Statistics and International Financial Statistics. In a subsequent paper on the effects of overdue obligations on the Fund's income and their treatment in the financial statements, 1/ it was proposed that the notes to the Fund's financial statements should report, in aggregate and by member, all overdue obligations of members that are late by six months or more in making payments to the Fund.

In general, the suggestions relating to the reporting of information on overdue payments in published documents were based on the considerations that the Fund's position as an institution of high standards in general, and that it be so regarded, make it desirable that information provided to the public in such documents present a fair and accurate statement of the Fund's position and its financial relations with members; and that generally accepted accounting principles prescribe that the financial statements include information that is considered material to the financial position of an organization. The suggestion that information that would permit identification of individual members in arrears not be reported by the Fund in any of these publications until a member had been in arrears for six months or more was guided principally by the following considerations: that reporting of relatively short-term arrears would not appear to be required by these standards; that premature reporting of arrears could unnecessarily complicate the balance of payments problems of the members concerned; and that, within a period of six months following the emergence of arrears, the Executive Board would, as a minimum, normally have received a complaint from the Managing Director relating to the member's overdue obligations. 2/ The following sections discuss the Annual Report, the financial statements, and other Fund statistical publications in turn.

1. Annual Report

As noted, the staff has proposed that all decisions by the Executive Board on complaints by the Managing Director be reported in the Annual Report for the year concerned. Appropriate references would be made to these decisions, if still pertinent, in subsequent Annual Reports; and the termination of any decisions would also be reported. This recommendation was based on the consideration that the Annual Report is the most comprehensive publication of the Fund and the vehicle through

1/ EBS/84/231 (11/14/84).

2/ It was agreed in the discussion of EBS/84/211 that complaints would normally be circulated to the Executive Board three months after an obligation became overdue; and that, even if no individual obligation had been overdue as long as three months, a complaint would be circulated if a member were in arrears for a continuous period of six months. Therefore, six months would be the outside limit for circulation of a complaint to the Executive Board. See EBM/84/167 (11/19/84) and the Managing Director's summing up of the discussion in Buff Statement 84/188 (12/3/84).

which important decisions by the Fund are routinely communicated. The existence of a member's overdue financial obligations to the Fund, the issuance of complaints by the Managing Director on such obligations, and subsequent decisions by the Executive Board on the complaints are all matters of substantial importance not only to the bilateral relationship between the Fund and the member concerned but also to the institution itself and the membership at large. Accordingly, the emergence of such problems should be reported in the Annual Report at an appropriate point. In light of the considerations relating to short-term arrears noted above and the Fund's procedures in dealing with overdue financial obligations, it was suggested that this could be the point at which the Executive Board had formally taken decisions pursuant to complaints vis-a-vis a member. Such reporting in the Annual Report would be consistent with the practice in the past in the very few cases in which members have been subject to formal actions by the Fund on account of failures to fulfill financial or other obligations to the Fund. 1/

The staff remains of the view that appropriate references to Executive Board decisions on complaints with respect to members' overdue financial obligations to the Fund should be included in the Annual Reports. It is suggested that the precise form and content of such references could best be determined in the course of preparing the 1985 Annual Report, when the relevant facts relating to several members now subject to various decisions by the Board will be better known. The staff would plan to present drafts for consideration by the Board which would in each case describe the decisions taken and the basic facts on the amount and duration of the member's overdue obligations to the Fund.

2. Identification of members in arrears to the Fund in the Fund's financial statements

At the discussion of EBS/84/231 (EBM/84/185-186), Executive Directors were generally agreed that the notes to the Fund's published quarterly financial statements should contain information on overdue obligations to the Fund on an aggregated basis, but there was less convergence of view on whether the individual members and amounts involved should be identified in the notes. The staff was asked to report to the Board on the practices of central banks, commercial banks, and other international financial institutions in this regard as background for the Board's further consideration of the issue.

In order to obtain a reasonably wide sample yet keep the survey to manageable proportions, the assistance of Executive Directors representing the twenty member countries having the largest quotas in the Fund was requested in obtaining the relevant information with respect to the central banks and commercial banks of these countries. The staffs of the International Bank for Reconstruction and Development (IBRD), the Inter-American Development Bank (IDB), and the Bank for International

1/ See EBS/84/211, p. 14 and SM/85/12, pp. 1-2.

Settlements (BIS) were also asked to provide similar information with respect to these institutions. Information was requested on the institutions' practices with respect to the identification in financial or other published statements of individual borrowers in arrears, considerations that may have led to the adoption of the practices, and, if possible, circumstances that could lead to such identification if it were not the normal practice. In no case was it reported that such identification is a standard practice, for reasons ranging from the absence of any significant experience with arrears (and therefore any need to consider the matter) to legal and regulatory prohibitions on disclosure of customer information. The results of the survey are summarized below.

a. Central banks (and BIS)

Most explained that their operations generally did not involve assets of a kind that could give rise to significant problems of arrears (e.g., because the assets are fully secured or marketable) or that for other reasons their experience had not given rise to a need to consider reporting publicly on arrears in any way. In most cases, therefore, the questions posed had not been relevant to the institutions' operations and had not been specifically considered. Some noted that if a significant problem of overdue obligations were to arise, it might well be in circumstances requiring confidentiality and discretion with respect to the borrower concerned; others indicated that the question of any reporting would need to be considered in light of the materiality of any problem that might arise; and two reported that any bad debts would be consolidated on an aggregate basis with "miscellaneous" or "other" assets. ^{1/}

b. Commercial banks

In none of the countries surveyed do banks generally publish information that would permit identification of borrowers in arrears. Considerations of two general types appear to guide commercial practice. One is the protection of the confidentiality of customer relationships, which is a legal or regulatory requirement in some cases. The second is that in many systems there are general provisions or standards for the reporting in aggregated form of information relevant to risk evaluation and on steps taken (e.g., establishment of loan loss provisions) to cover risk of nonpayment. In general, the reporting of such information

^{1/} In addition to explaining the relevant practice of the Federal Reserve System, the response from the United States indicated that information on the debts of foreign obligors to U.S. Government agencies (not including debts to the Federal Reserve) that are due and unpaid 90 days or more is published in the Annual Reports of the National Advisory Council on International Monetary and Financial Policies. The figures do not identify individual obligors but do identify the country of the borrower; in most cases, the credits are to public borrowers in the countries shown.

in aggregated form appears to be considered sufficient for assessment of banks' financial positions, although some respondents indicated that a bank might report information on an individual borrower in an exceptional situation (e.g., a major bankruptcy) or if a borrower's overdue obligations to the bank were considered especially significant in relation to the bank's portfolio.

Reporting requirements for banks in the United States may, however, require identification of foreign debtor countries under certain circumstances. Commercial banks in the United States are required under Guide 3 of the Securities and Exchange Commission to disclose information on the amount and status of loans to individual foreign countries where such outstandings exceed one percent of total assets, and to report any material amount of such outstandings that are past due, in non-accrual status, and/or involve troubled debt restructurings. The Guide also provides that where current conditions in a foreign country (in which a bank's exposure exceeds one percent of total assets) give rise to liquidity problems which are expected to have a material impact on timely payment of interest or principal on that country's private or public sector debt, disclosure of the nature and impact of such developments should be made.

c. IBRD and IDB

Neither institution currently publishes information, in the financial statements or elsewhere, on the identity of borrowers in arrears. ^{1/} Both institutions rely for funding on borrowing in the private financial markets and, in determining the extent of their reporting on arrears, are guided generally by the importance of such information to investors in evaluating the financial positions of the institutions. The reporting of information on the identity of borrowers in arrears is not con-

^{1/} The IBRD indicated that such information was provided in one instance in a prospectus issued in 1976, but such reporting was subsequently discontinued. As explained in EBS/84/231, the IBRD publishes in notes to its financial statements the aggregate amount of interest payments that are overdue by more than 90 days, together with the aggregate principal amount outstanding on such loans. This note is accompanied by a statement that it is not anticipated that these delays will result in any loss to the Bank. In addition, the IBRD will have, for the first time, non-accruing loans in fiscal year 1985. The aggregate amount of such loans will be disclosed without reference to the member(s) involved. The IDB reported that it has experienced delays in payments exceeding 60 days only rarely; in general, these have been of relatively modest size, both in the aggregate and with respect to overdue obligations on the part of an individual member. The IDB's financial statements contain the following reference to delays in payments: "No losses on loan receivables are anticipated; accordingly, no provision for such losses has been established. Although there have been some delays in the payment of loan service, these delays are not considered significant."

sidered to be warranted in present circumstances. If, however, a situation arose in which the identification of a member were considered information that might be important to an investor in evaluating the position of the institutions, the reporting of such information would need to be considered.

It was noted in EBS/84/231 that it might be sufficient to include in the notes to the financial statements only aggregated information on overdue obligations to the Fund. In suggesting identification of members in arrears in the financial statements, the staff mentioned two main considerations. The first was that information on the category of payment and debtor might be thought relevant to readers in assessing the Fund's financial position. The second was that the provision of such information would prevent a situation in which inferences could incorrectly be drawn about members that are in fact current in their financial obligations to the Fund.

With respect to these considerations, neither would appear to be of particular relevance to central banks or the BIS. By and large, these institutions do not hold assets of a kind that give rise to problems of arrears or have not experienced significant problems in this respect, and have not needed to consider the question of identifying borrowers in their financial statements. The practices of commercial banks on the matter are generally guided by the confidentiality of customer relationships and include in many cases disclosure of aggregate information on risk and on steps (such as loss provisions) taken to cover risk. The second consideration noted above, protection of the interests of borrowers that are not in arrears, would not appear to be relevant in the case of commercial banks. The World Bank and the IDB both noted that such identification is not made as it is not in present circumstances considered to be information that would be of importance to investors in evaluating the financial positions of the banks. Neither institution appears to have considered whether the reporting of such information would be called for in order to avoid mistaken inferences about members that are not in arrears.

A further point relating to information to be reported in the notes to the financial statements was mentioned in the staff paper on publicity upon a declaration of ineligibility (SM/85/12). That is the question of including in the notes references to decisions by the Executive Board on complaints by the Managing Director. As noted in SM/85/12 and earlier papers, the Executive Board's decisions taken in late 1978 to limit Democratic Kampuchea's use of the Fund's general resources and to suspend the member's use of SDRs have been referred to regularly in the notes to the financial statements of the SDR Department beginning in 1979. At the time, the longest outstanding obligation was overdue for about four years. As explained in EBS/84/231, the unique presentation in the financial statements regarding Democratic Kampuchea, including both the non-accrual of charges from the member and the explanatory notes on the Executive Board's decisions, reflects the fact that it has not been possible to communicate with the member

for many years. It was proposed in EBS/84/131 not to change this presentation regarding Democratic Kampuchea, which has been associated in the notes to the financial statements of the General Department with the non-accrual of charges from the member.

SM/85/12 pointed out that one consideration in favor of issuing press releases upon or soon after a declaration of ineligibility is that exclusive reliance on the Annual Report for the reporting of such decisions might raise questions as to the uniformity of treatment of members, as the timing of such reporting in relation to the timing of the decisions could vary substantially. One way to ameliorate this possible timing difficulty would be to report such decisions in the notes to the quarterly financial statements. The issue of timing of reporting could, of course, arise in relation to decisions to limit members' use of the Fund's resources and to suspend members' use of SDRs. If it were desired to include references to decisions on ineligibility in the notes to the financial statements, the question would arise whether similar references should be made to these decisions as well.

3. Treatment of overdue financial obligations in Fund statistical publications

Consideration also needs to be given to the questions whether and how overdue obligations to the Fund should be reported in other relevant statistical publications of the Fund. This section discusses the recording of overdue obligations in the balance of payments statistics published in Balance of Payments Statistics and International Financial Statistics. It also discusses the question of presentation of such information in the Monetary Accounts and Fund Accounts reported in IFS.

a. Balance of payments statistics

In the detailed presentations that are published in the monthly and annual issues of Balance of Payments Statistics, a contractual obligation of any sort (for example, for the payment of interest or the repayment of principal on a loan) that is not actually settled when it falls due, i.e., an overdue obligation, is nonetheless shown in the period when it falls due. In a case of this kind, a new obligation is shown as having been created to take the place of the old obligation that was not settled. This practice is followed partly because the two obligations have different characteristics (sector of domestic creditor or original maturity, for example) that will result in their being classified in different items of that detailed presentation as well as in the aggregated presentations that are published in the monthly and annual issues of Balance of Payments Statistics. This practice, which is in line with the compilation requirements of the fourth edition of the Balance of Payments Manual, would result in the identification of arrears to the Fund for an individual country without regard to the length of time an obligation had been overdue. It would not result in such identification in the highly aggregated presentations of balance of payments data in IFS, unless it were decided to add a line for which data would be derived from Fund records.

In light of the concerns over the question of public reporting of information on arrears to the Fund, the practice described in the previous paragraph is not currently being implemented in terms of overdue obligations to the Fund (including the Trust Fund). It was suggested in EBS/84/211, in the context of the general question of reporting in published documents on arrears to the Fund, that the practice described above should be implemented, subject to the qualification that the arrears of members not having obligations outstanding for more than six months would not be reported in these documents. At EBM/84/155-156, the Executive Board asked for additional information, including illustrations of the way in which the information could be reported.

Three approaches could be considered in addressing the question of the publication of overdue obligations in balance of payments statistics by the Fund. Obligations to the Fund that have become overdue could be: (a) included in balance of payments statistics published by the Fund with such statistics for an individual country revealing any overdue obligations to the Fund, as would be consistent with the compilation requirements of the Balance of Payments Manual; (b) included in the balance of payments statistics published by the Fund, but in such a way that statistics for an individual country would not reveal any overdue obligations to the Fund; or (c) excluded altogether. In the interests of reporting comprehensive balance of payments statistics, it is assumed that alternative (c) is not a desirable approach. The aggregated and detailed presentations in Attachment I therefore reflect options (a) and (b), respectively. Specifically, that attachment shows two pairs of columns, one pair referring to the option under which the presentations would identify a country's overdue obligations to the Fund and another pair referring to the option under which the presentations would not identify the overdue obligations to the Fund. In each pair, one column indicates the recording of the transactions in the period in which payment becomes due but is not made, and another column indicates the recording of the transactions in the period in which payment is actually made. The notes to the attachment describe these recording procedures in more detail for each of four specific types of obligations, i.e., overdue repurchases obligations, overdue Trust Fund repayments, overdue charges to the Fund, and overdue interest payments to the Trust Fund.

Two considerations may be noted. First, obligations to the Fund that are settled within a period (month, quarter, half year, or year) in which they are due but not paid will not show up as having become overdue in a balance of payments statement for that period. In this connection, the Fund publishes monthly balance of payments data for only a few countries, quarterly data for slightly more than fifty countries, and semiannual or annual data for the rest of the countries for which data are available. Second, a few countries report balance of payments data approximately three months after the end of the reporting period. The bulk of the countries, however, report balance of payments data more than six months after the end of the reporting period. It has also been observed that lags in reporting data for publication tend to be longer for countries that experience balance of payments difficulties.