June 24, 2004
Approval: 7/1/04

INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 04/37-2

11:46 a.m., April 16, 2004

2. Crisis Resolution—Progress Report

Documents: Progress Report on Crisis Resolution (SM/04/108, 3/31/04)

Staff: Kincaid, PDR; Hagan, LEG; Blitzer, ICM

Length: 1 hour, 10 minutes

Executive Board Attendance

A. Carstens, Acting Chair

Executive Directors	Alternate Executive Directors
	A. Alazzaz (SA)
	M. Kruger (CO), Temporary
	S. Wolff-Hamacher (GR), Temporary
M. Callaghan (AU)	
	S. Boitreaud (FF)
S. Indrawati (ST)	
	B. Andersen (NO)
	M. Lundsager (UA)
W. Kiekens (BE)	
	J. Costa (AG), Temporary
	S. Rouai (MD), Temporary
	L. Palei (RU), Temporary
	S. Bah (AF), Temporary
L. Martí (CE)	
	H. Vittas (IT)
M. Portugal (BR)	
	K. Kanagasabapathy (IN), Temporary
	M. Brooke (UK)
	K. Nauphal (MI), Temporary
	J. Milton (AE), Temporary
	D. Wang (CC), Temporary
	M. Roovers (NE), Temporary
	T. Miyoshi (JA), Temporary
F. Zurbrügg (SZ)	W. Szczuka (SZ)

S. Leite, Acting Secretary
M. Pedroni, Assistant

Also Present

IBRD: M. Baroudi, Director and Chief Credit Officer. Asia and Pacific Department: A. Senhadji. European Department: N. Mates. External Relations Department: P. Reynolds. International Capital Markets Department: C. Blitzer, C. Medeiros, L. Zanforlin. Independent Evaluation Office: I. Mateos y Lago. Legal Department: S. Hagan, Deputy General Counsel; D. Eastman, N. Rendak. Policy Development and Review Department: R. Kincaid, Deputy Director; M. Fisher, J. Gold, A. Kapteyn, J. Kozack, M. Mecagni, K. Srinivasan. Secretary's Department: L. Hubloue, M. Yslas. Western Hemisphere Department: A. Aisen. Senior Advisors to Executive Directors: C. Duriyaprapan (ST), D. Farelius (NO), P. Gitton (FF), C. Sia (ST), A. Tombini (BR). Advisors to Executive Directors: O. Cuny (FF), C. De Silva (BR), A. Dupont (BE), M. Jamaluddin (ST), M. Mirabal (CE), T. Nguema-Affane (AF), A. Stuart (UK).

2. CRISIS RESOLUTION—PROGRESS REPORT

Mr. Boitreaud made the following statement:

I would like to thank the staff for a well written report which details the progress made on the issue of crisis resolution. I have a general comment and several more detailed remarks.

My general comment is the following. The progress described in the report, i.e., increased dissemination of the Collective Action Clauses (CACs), discussions on a code of conduct, development of the Evian approach, are indeed very positive. Nevertheless, they provide only a partial answer to the challenges of resolving crises in an orderly and non-disruptive way. The dissemination of CACs does not address the question of the current stock of so to speak "CACless" bonds. Neither CACs nor the code seem able to provide a definitive answer to the problem of aggregation of claims. Positive developments like the code and the Evian approach could even increase the pressure on the Fund since a growing number of private creditors are criticizing the Fund's role in determining the balance between domestic adjustment and external debt reduction, as well as its preferred creditor status. Such criticism calls for strengthening our support to the IMF and its status but also underlines the need for maintaining our impetus towards reinforcing transparency in the work of the Fund. They also point to the need to explore other aspects of crisis resolution in an innovative manner, as was the case with the Sovereign Debt Restructuring Mechanism (SDRM). From this perspective, we believe that the report could have been expanded to include, for example, our recent discussions on lending into arrears (LIA), debt litigation, and exceptional access.

Now, I will turn to my more technical remarks.

First, we welcome the progress made on the elaboration of a code of conduct. We share the staff's remark that it should offer a menu of options, focus on the crisis resolution and avoid duplicating the Fund's work on crisis prevention. The objective now is to engage in the operational phase of writing the code. Numerous problems remain of course but we think that they could be overcome only through an operational and very concrete process. My authorities will of course continue to support the work on the code.

Second, the staff's detailed description of the Evian approach is very useful. This new approach essentially defines a sequenced process which could lead to a comprehensive debt treatment in favor of non-HIPC countries with an unsustainable debt. This debt treatment would be delivered on a case-by-case basis according to specific conditions designed to ensure a strong link with economic performance and policy implementation under several Fund-supported programs. The debt treatment could take various forms depending on the result of the debt sustainability analysis (DSA): flow treatment, stock reprofiling, or debt

reduction. The latter—debt reduction—will however continue to be considered only in exceptional cases. In this regard, I think that the wording of paragraphs 22 and 23 should be nuanced so as to convey more precisely these key principles and ensure full consistency with the communication of the Paris Club.

I have two additional comments on the Evian approach.

The first is that this approach's increased focus on a given country's DSA reinforces the role of the Fund in the process. It therefore calls for regular interactions between Paris Club (PC) creditors and the Secretariat and Fund staff and a communication of the DSA, even in a preliminary form, as early as possible, to the PC creditors, that is during the elaboration and negotiation of the Fund-supported program, so as to ensure the consistency of the whole approach.

Finally, like the work on the code of conduct, the Evian approach also aims at improving coordination between creditors, official as well as private. Like the Fund, the Paris Club has taken a number of steps to increase its transparency over the past years. Paris Club creditors are now reflecting on organizing, in certain circumstances, early discussions with the private sector on specific country cases, under a clear process designed to ensure efficiency and minimize risks. Such a development would be a welcome complement to the elaboration of a code of conduct and to the IMF's increased transparency.

Mr. Roovers made the following statement:

I thank the staff for providing this short, comprehensive overview on current initiatives in crisis resolution and welcome the positive observations regarding the good practice of incorporating collective action clauses in new, international bond issuance. It is good to see that the Fund has also been playing a catalytic role in this development. However, the shortness of the paper may also reflect a possible lack of general progress in enhancing an orderly and timely resolution of crises. At least, one could say that more progress would be desirable, but that, on the other hand, the time may not be ripe. As such, the report is useful to keep the topic alive, and perhaps it could add to that function by paying some more attention to the Fund's own role in the process, as also suggested by Mr. Boitreaud, building on the recent discussions we had on for example exceptional access, Fund exposure, and the lending into arrears policy. In the same vein, some more qualitative judgment could be included on the progress achieved so far. Indeed, the success of the collective action clauses gives no reason for complacency, in particular as progress in the fields of aggregation and inter-creditor equity has been limited. Some feedback on current practices as well as forward-looking analysis would be welcome, if only to give a reflection of the Fund's active role and continuous commitment to enhancing crisis resolution initiatives. This would also do justice to the work and research that has been done by staff over the last year. Indeed, the progress report could, for example, more explicitly refer to the recent, interesting staff paper on sovereign debt litigation

and implications for debt restructuring, and the specific concerns raised in that paper.

To conclude, I suggest that some references to these issues are added to the paper, so as to highlight that the Fund is, and remains, active and alert in this field.

Mr. Portugal made the following statement:

This is a good progress report, and I thank the staff for it. We are pleased that the report appropriately reflects the major progress that has been achieved in CACs, which clearly seems to become an important instrument for crisis resolution. As the report mentions, at the margin now 75 percent of the total volume of sovereign bonds issued late last year and this year contained CACs and 39 percent of total outstanding stock also contained CACs. More important is that this has been done following a voluntary and collaborative approach with private creditors and did not lead to an increase in prices. These are major achievements in a short period of time.

We have some suggestions to the report. The first is that this month Brazil announced that it is going to lower the threshold for majority restructuring provisions of CACs from 85 percent to 75 percent. To date, no bond has yet been issued with this threshold, but perhaps the report could be updated before publication to incorporate this information.

On the issue of aggregation clauses, I think that perhaps we need to modify paragraph 13, where in the second phrase it said that, during the seminar we had, it was generally recognized that aggregation can contribute to the resolution of collective action problems. Of course, there were only a few preliminary statements and no summing up from that seminar, but I looked into the minutes and both on the basis of the presentation of the guest speakers from the private sector, and also the few preliminary statements and the discussion itself, my impression is that there were more questions than answers with respect to aggregation and that we did not yet recognize that it can contribute to the resolution of problems. There are a number of risks related to aggregation, which are appropriately reflected in the report.

My suggestion is that, instead of saying that it was generally recognized, we should say it was argued that aggregation can, in theory, contribute to resolution of collective actions. Also in this paragraph, the last phrase, which says that the main challenge is to find a formula that best balances the benefits of aggregation against potential risks, should be deleted, because this seems to assume that we have already decided that the Fund is going to work on aggregation and what is needed is just to find a formula, which I think is not yet the case.

On the Code of Conduct, I agree with Mr. Boitreaud that progress has been made in the discussions. This is adequately reflected in the paragraphs, although in both paragraphs 19 and 20, crisis prevention and the promotion of corrective policies prior to crises are mentioned as one objective of the Code. Of course, although all of us agree that crisis prevention is important, and support and value crisis prevention, the idea of the Code is mainly to concentrate on crisis resolution, and not to duplicate the work that the Fund is already doing in terms of crisis prevention and not to have the private sector directly involve in this type of Fund decisions. So, we suggest that these two mentions to crisis prevention are deleted from paragraphs 19 and 20.

Mr. Kruger made the following statement:

I would like to thank the staff for its concise and informative progress report. The international community's efforts to promote collective action clauses have been successful. The staff demonstrates that collective action clauses are quickly becoming the market standard for emerging market countries, even those who issued debt under New York law. It is noteworthy that already close to 40 percent of the outstanding stock of emerging market sovereign bonds contain collective action clauses.

We take comfort from the fact that the market did not penalize Turkey or Peru for issuing bonds that were consistent with the G-10 recommendations and included a 75 percent voting threshold. I am also happy to hear that Brazil is moving to a 75 percent threshold. While a 75 percent threshold has traditionally applied in the United Kingdom and is increasingly applied in New York, there is an important difference. In the United Kingdom, the threshold applies to the quorum of bondholders meeting, while in New York it applies to the entire outstanding principal. While market participants have suggested that New York is characterized by a preponderance of institutional investors, nevertheless applying the voting threshold to the outstanding principal is innovative and risks impeding a restructuring because of bondholder inertia. Does the staff see a risk with the evolving practice in New York, and would it be desirable that practices on both sides of the Atlantic converge?

Progress in elaborating a Code of Conduct has been limited. This is unfortunate, as developing a code could bolster the Fund's ability to assess the good faith criterion. We would have thought that there would have been a number of principles upon which there would be general agreement. Does the lack of progress indicate that the official sector is pushing for a code while the private sector does not see the need for one, or is there general disagreement about what the appropriate principles should be?

The Evian Approach could benefit from greater creditor coordination. We agree with the staff that, in cases where debt sustainability is in doubt, and where the comparability of treatment will require that private creditors take significant

write-offs, early discussions between the Paris Club and private creditors would facilitate the restructuring process. We support Mr. Boitreaud's comments in this regard. What role could the staff play in these discussions, and how would it deal with concerns over private sector representation and confidentiality?

Mr. Andersen made the following statement:

I would also like to thank the staff for this *Progress Report on Crisis Resolution*. I am encouraged by the successful increasing use of collective action clauses (CACs) and the process that is taking place in the private sector. This is, as we all know, a long process, given the existing stock of bonds that do not contain CACs. Apart from the CAC front, the progress in other areas of our crisis resolution framework appears very modest, making the report more of a stock-taking exercise. I find it important that work on improving crisis resolution needs to be continued and strengthened, including on issues related to the lending into arrears policy and the statutory approach, such as the aggregation of claims, the treatment of debt stock, and the incompleteness and asymmetry of information. Hopefully, our next report will be more of a progress report than a stock-taking report.

On the report itself, I have some comments and suggestions. In particular, I think that our report to the IMFC should cover more elements of our crisis resolution framework than suggested, more in line with the crisis resolution section in the *Managing Director's Report to the IMFC* at the Annual Meetings in 2002, where sections on improving sustainability analysis, the access policy, and lending into arrears were included as well. The IMFC in Dubai looked forward to the ongoing work on issues of general relevance to the orderly resolution of financial crisis, and the issues I just referred to certainly belong to this category and deserve some paragraphs in the report.

First of all, the most solid pillar in our crisis resolution framework today seems to be our exceptional access policy. Given that this issue is central to the topic of the report, like Mr. Boitreaud, I would suggest that we include a paragraph building on our recent discussion on our exceptional access policy. The requested and ongoing efforts aimed at improving debt sustainability and vulnerability assessments, coupled with a balance sheet approach analysis, would seem to fit well into such a description as well.

Second, the IMFC communiqué from Dubai encouraged the Fund to contribute to the work on a voluntary code of conduct. The report presents a short overview of events that have and are planned to take place in the G-20. While my impression is that there is a need for faster progress on a code that could underpin the Fund's assessment, it is somewhat unclear to what extent the Fund staff is actively involved in this process. In Dubai, the Fund was encouraged to contribute to this work, which seems to suggest more than just observing deliberations. I would appreciate the staff's comment. Furthermore, when the G-20 was

established in 1999, it was promised that the Board would be fully informed by the staff or management on the discussions. I, therefore, encourage full and transparent information on G-20 discussions.

My third point relates to the seminar we had yesterday on litigation. It would be useful to add something from this discussion to the report, including that the Board will continue to monitor the process of litigation. A paragraph like the one on aggregation features seems justified.

Finally, on the Evian Approach, I rely fully on the comments by Mr. Boitreaud who has a comparative advantage in this area for obvious reasons.

Mr. Vittas made the following statement:

The progress report possesses some qualities, which are usually highly appreciated and therefore worthy of praise. It is clear, well-written, and concise. However, I feel that on this occasion the report is a bit too concise. For this reason, my praise to the staff is also somewhat less enthusiastic than would otherwise be the case.

To be more specific, my main concern is that the report does not cover adequately two issues of the Board's recent work on crisis resolution, which are very important: lending into arrears (LIA) policy and exceptional access policy. I realize that, on the latter issue, the discussion we have had is as yet inconclusive and will be resumed soon after the Spring Meetings when we begin considering the issue of high access under precautionary arrangements. Nevertheless, it is desirable to add a brief section in the progress report to indicate that the issue continues to be pursued and retains a prominent position on the Board's agenda. Similarly, the report should indicate that the Board has had a discussion to try to clarify the application of the "good faith" criterion in the context of our LIA policy and, more generally, that our LIA policy will continue to attract attention in the future.

Let me now make a couple of brief comments on what is already in the report.

First, like Mr. Boitreaud, I believe that the discussion of the Evian Approach in the report may be open to misinterpretation. I support the modifications he has proposed.

Second, I share the concern already expressed by Messrs. Boitreaud, Andersen, and Kruger that the discussion of collective action clauses (CACs), the Code of Conduct, and aggregation issues may leave the reader with the erroneous impression that these initiatives may suffice to put in place an adequate framework for crisis resolution. It would be useful to have at least a passing but more explicit reference to the need to continue to work on less contractual

approaches to crisis resolution. The interesting seminar we held yesterday on litigation issues makes this point even stronger.

Ms. Wolff-Hamacher made the following statement:

We welcome the *Progress Report on Crisis Resolution*. On collective action clauses (CACs), we like the clear presentation of recent developments, including the use of tables. We find it encouraging that there is a trend toward the features of CACs that are in line with recommendations of the G-10 Working Group regarding majority restructuring provisions and majority enforcement provisions. This is a welcome message from the report. We also appreciate the clarification regarding CACs under German law in paragraph 7, including Footnote 9.

On aggregation, while the report is correct about the aggregation of creditor claims, we regret that there is not more progress to report on, as mentioned by Mr. Roovers. We would encourage the staff to continue to work on Sovereign Debt Restructuring Mechanism-related issues, including aggregation, as mentioned by Mr. Andersen and Mr. Vittas. I also associate myself with the remarks by Messrs. Boitreaud, Roovers, Andersen, and Vittas regarding additions to the lending into arrears policy, litigation, and exceptional access. We welcome initiatives by the Legal and International Capital Markets Departments to develop a comprehensive international sovereign bond database.

On the Code of Conduct, my authorities felt that the wording of paragraph 20 of the report should be adapted. While it is true that the G-20 has regularly discussed the Code, the G-20 has not decided to take a lead role on this issue. It is our understanding that the work on the Code is still mainly in the hands of issuers and private-sector groups. This should also be reflected in the text dealing with the technical group at the end of paragraph 20. This technical group is chaired by Brazil, but is not a G-20 group. We will provide a proposal for wording on a bilateral basis.

Finally, on the Evian Approach, I fully associate myself with Mr. Boitreaud's remarks.

Ms. Lundsager made the following statement:

We felt this was a very good progress report, and appreciated that it was concise. We read it as a complement to the Acting Managing Director's Report to the IMFC, so our sense was that we did not need to repeat many of the items that are already in that report. It would be useful to keep that in mind and to look at both reports together in terms of what might get added to this one.

Like other Directors, we welcome the progress that has been made on collective action clauses. We agree that it has been important that the emphasis

has been on borrowers (issuers) and creditors working out the modalities, and devising something that has worked well in the markets. This has been a very important result, and we welcome that the report emphasizes it. It has also been good that the Fund staff has been helpful in this matter, and has looked at it in a similar fashion to public debt guidelines and the other activities that are useful for the membership. We appreciate that many members have been contacting the staff, and getting help.

We do not have many specific comments on the progress report. We have not looked at the minutes of the discussion on aggregation, as Mr. Portugal did, but we had the same recollection that he did about the sense of the discussion. We would agree with the points that he made. Some of the other items, such as lending into arrears and exceptional access, were covered and are being revised in the Acting Managing Director's Report to the IMFC, based on our previous discussions. We do not necessarily need to repeat all of that in the context of this progress report, but we leave it in the staff's hands to put together an overall presentation of what the Fund does.

In the discussion on litigation yesterday, which was very useful, Mr. Hagan updated us on recent developments. All of this is changing rapidly, and thus it is quite helpful to provide an update periodically for the information of Executive Directors. However, we are not sure that this needs to be added to the progress report, especially as our two guests concluded that this was, in many respects, still wide open, and issues will be evolving in the coming period.

Finally, on the Evian Approach, we can support the useful suggestions of Mr. Boitreaud.

Mr. Zurbrügg made the following statement:

On debt litigation—the point raised by Ms. Lundsager—I would have appreciated a small paragraph in the progress report. This is not because we have taken any policy decisions; I fully agree that we have not, and that came out yesterday in the seminar. However, at the outset of our discussion on crisis resolution, the prospect of increased or decreased sovereign debt litigation as a relevant factor was crucial to our whole policy. Thus, we should at least include a couple of sentences, saying that the staff is following closely the developments on this matter, and it remains a part of the discussion. I would strongly suggest capturing this point.

On the Evian Approach, like Mr. Boitreaud, I found that the description could be somewhat misleading, and I look forward to seeing his editorial suggestions. The two main points were: (i) that it is not as set in stone as the text suggests, in terms of the three-phase approach; and (ii) that debt reduction is not a foregone conclusion in the second phase. I would be grateful if the text could reflect the status of this.

The text on the Code of Conduct reflects the limited progress that has been made. If I were nasty, I would say that it does not come as a surprise, as the pressure from the Sovereign Debt Restructuring Mechanism (SDRM) is gone, and issues on that front are slowly collapsing. But, I would strongly agree with Mr. Andersen's comment about the fuzzy nature of our information. Not being member of the G-20, we do not know exactly what is happening there. I picked up a report that suggested that the Code of Conduct is now being called something like "principles for emerging market finance," in order to underscore the voluntary nature of these principles. I do not know where we stand on this matter, and I do not have enough information to judge the paragraph in the progress report.

Finally, I saw that topics on exceptional access and lending into arrears were included in the umbrella report, and thus it is not necessary to repeat them in the context of this progress report. One could argue that it is part of crisis resolution, and thus it should be included, but I saw that it is under the access and use of Fund resources sections in the umbrella paper. The important point is that it is mentioned somewhere.

Mr. Portugal supported Ms. Lundsager and Mr. Zurbrügg on their points that a number of items had already been included in the umbrella paper, whereas the progress report under consideration at the current meeting was intended to be specifically on crisis resolution, as was requested by the IMFC. There were certain items that Directors had suggested including that were not exclusive of crisis resolution, such as debt sustainability and the balance sheet approach. These also played important roles in crisis prevention. It would be better, however, to mention such issues in the umbrella report rather than in the *Progress Report on Crisis Resolution*.

Mr. Andersen commented that he was among the group of Directors who had thought that the progress report should be somewhat more comprehensive. The umbrella report was of a somewhat different nature than the more topical reports for the IMFC meeting. It was also the Acting Managing Director's report, which provided room to give the report management's perspective on some of the issues. It was not the Board's report. That was also the reason why there was not an extensive drafting session to examine every sentence of the umbrella report (which was not something to be recommended). Moreover, when the IMFC communiqué was being discussed, the umbrella report did not have the same status as the Board's summings up, which conveyed the views of the Board. Topical progress reports should also be sufficiently comprehensive. When outside observers wanted to see what progress the Fund had made on crisis resolution issues, they should be able to gain a sufficiently comprehensive picture by entering the Fund's website, finding the specific section on the IMFC, and viewing the *Progress Report on Crisis Resolution*. Perhaps about one more page of coverage in the report would be sufficient, but it was important that the report was self-contained.

Mr. Brooke made the following statement:

The progress report provides a fair reflection of the work and progress that has been achieved. With regard to the section on collective action clauses, we welcome the developments over the past six months, and hope that the trends continue. Some Directors have mentioned that we could include some references to the paper on debt restructuring and legal issues that we considered yesterday. Perhaps there would be some benefit in cross-referencing the collective action clause aspect of that paper, particularly on the issue of whether we should be pushing more for the trustee structure. There was some useful information in that paper suggesting that, while collective action clauses are going to improve the situation, they may not resolve the difficulties in all scenarios, and that the trustee structure would help to move forward. We would continue to advocate, as we have done in the past, for greater use of the trustee structure. We would be happy if the progress report could be somewhat more forward-leaning in that direction.

On the Evian Approach, I agree that the text of the progress report should be revised to say that the approaches outlined in paragraph 23 are just one way that this could be addressed, and that we need a case-by-case approach, largely driven by information in the debt sustainability analysis. It could be the case that debt reduction will come quicker and be larger; equally, it may be that a flow rescheduling would be necessary. We need to make sure that the text is not saying that the three-stage approach described in paragraph 23 is the only way that this may be achieved. There will be various options that the Paris Club will consider on a case-by-case approach.

Finally, on the references to the exceptional assess paper that we discussed, my understanding is that we had agreed to publish that paper. If there is any text to be included in the progress report, it should just be a cross-reference to the paper and the summing up on exceptional assess, and the link to the location on the web should be provided.

Mr. Miyoshi made the following statement:

Like other Directors, I consider this a very balanced report, and I will make only a few short comments. First, I welcome the positive developments related to the introduction of collective action clauses (CACs) in the sovereign bond issues, and I also welcome the Fund's catalytic role in introducing them. I am open to including in this progress report the paper that we discussed yesterday, but there is no broad agreement yet on whether the trustee structure should be encouraged or promoted. Second, on the Code of Conduct, I share the view of Mr. Kruger that it is somewhat unfortunate that progress has been limited, but I am heartened by the comments made by Mr. Boitreaud and Mr. Portugal. The Fund should not be in the driver's seat in drafting the Code of Conduct, but it should be involved in this issue. Finally, on the Evian Approach, I fully support the suggestion made by Mr. Boitreaud. The current text could be misleading,

implying that only a certain type of debt treatment will be envisaged in the Evian Approach. The case-by-case approach should be emphasized.

Mr. Martí made the following statement:

We are satisfied with the progress report. Regarding the contents of the report, we are also among those Directors who believe that the framework for access to IMF resources, both normal and exceptional, should be included in a progress report such as this, without prejudice to the report's conciseness, which is necessary in any case.

Concerning the Code of Conduct, in general, the tone used in the report conveys a sense of skepticism, pessimism, or a lack of great interest. However, in the letter from Mr. Dallara, which has been sent to all of us, the private sector seems to be rather positive about developments in the Code of Conduct, and is very precise on developments. Progress has apparently been made in some of the areas. Thus, I would like the staff to comment on where we stand on this issue. The tone of our report is entirely different from the tone in communications from the private sector. However, I would also stress, as Mr. Portugal did, that the question of crisis prevention should be omitted from this progress report.

On the Evian Approach, the text in paragraph 23 might give the impression that there is automaticity in this process, which there is not. Accordingly, the text should be slightly redrafted to make sure that this impression is corrected. At the same time, it is important to stress that this process may be complicated; it will require coordination between official creditors, private creditors, and the country concerned. The Fund is also going to play a major role. This could get very complicated, and so far the Evian Approach is untested. We have a lot to learn from how this will evolve in practice. For the moment, what we have is only a theoretical approach. We should describe it properly, by not giving the impression that this is a prearranged system; rather it is an approach, and we will have to see how it actually works in practice.

Ms. Indrawati made the following statement:

We welcome the discussion on the *Progress Report on Crisis Resolution*. I have some questions to the staff. First, as stated in the staff report, sovereign issues containing collective action clauses (CACs) represent more than 75 percent of total issuance in 2003/04, but we also note that there are still some sovereign borrowers and creditors who are resisting, or are indifferent to, the use of CACs. Why are a significant number of issuers resisting CACs?

In paragraph 18 of the progress report, the staff states that the International Primary Market Association (IPMA) and other trade associations are initiating an effort to design a market standard for CACs. Yesterday, we discussed the design of CACs, which are not standardized. How will this affect the choice of the

country that is issuing bonds with CACs? Will a market standard loosen the flexibility of the country to design its own bonds, including the specification of CACs? Will a market standard be seen as effective in solving a potential crisis, especially on debt resolution? Yesterday, two lawyers mentioned that we have CACs, that they are useful, but should not be considered a panacea. Perhaps we should not expect too much from CACs. It is also encouraging to see the involvement of the Fund in this area, but apart from focusing and monitoring the development of CACs, is there any possibility of Fund involvement in assessing the institutional capacity of the country issuing CACs? We do not know whether the obstacles to solving the crisis are owing to capacity constraints. What is the role of the Fund in the future to strengthen the institutional capacity of countries? This must be related to crisis prevention, and may also be related to debt management and the possibility of debt resolution. It could be helpful to note country cases in the past that dealt with such crisis resolution: what was the institutional set-up when these countries dealt with the debt crisis, and what types of institutions would be able to provide effective solutions and avoid creating severe handicaps.

Mr. Kiekens suggested that the footnote on page 2 of the progress report be deleted from the published version of the report, as it referred to a paper that the Board had decided not to publish. Otherwise, the report was excellent.

The Deputy Director of the Policy Development and Review Department (Mr. Kincaid) made the following statement in response to questions and comments from Executive Directors:

The staff intends to update the progress report, based on developments in the market, to respond to inquiries from Directors, and to reflect more recent information, including, for example, the fact that the Institute of International Finance (IIF) circulated a letter a few days ago reflecting its views. There was also the recent informal Board seminar on the implications of litigation for sovereign debt restructuring, and further developments relevant to collective action clauses (CACs). We will take on board the various specific suggestions that Directors have proposed with respect to the Evian Approach.

On the content of the progress report, and the omissions (in the views of some Directors) of certain topics, it should be noted that this report was drafted with the umbrella paper in mind as a companion document, as several Directors mentioned. The staff made the decision to put certain material in the umbrella report and certain material in this progress report. The discussion on exceptional access is a specific example. It is possible to include a paragraph in this report based on the summing up of the exceptional access discussion, but then there would be the question of duplication between the two reports. I do not have a strong view about this issue.

On the litigation seminar that took place yesterday, it was an informal discussion by the Board, and I see scope for including a sentence that indicates

that this is an area where the Board has had a discussion, and encouraged the staff to continue to monitor developments in this area in the future. But, given the informal nature of the seminar, it would be difficult to say much more.

On the Code of Conduct, to be effective, this code needs to be driven by market forces and owned by those market actors, both on the creditor side and on the debtor side. We see this effort which, if it is going to be successful, needs to be owned by market participants, while being encouraged by the public sector. A useful example is CACs, which were encouraged by the public sector, but have been embraced by the market—both issuers and investors. We will take another look at the description of the Code of Conduct, updating it for recent information and making some adjustments as suggested by various Directors.

On the Evian Approach, we did not try to describe the views of the staff on the relationship between the Paris Club and the private sector. We were trying to describe a view that the Paris Club expressed about its role and interactions with the private sector, and Mr. Boitreaud has made those points. We will amend the report, both to clarify that the views expressed are those of the Paris Club and not of the staff, and to include the proper nuances.

The Deputy General Counsel (Mr. Hagan) made the following statement in response to questions and comments from Executive Directors:

On the point made by Mr. Portugal and Ms. Lundsager, it is correct that there was no summing up for the seminar on aggregation. What we tried to do in the progress report was to summarize the sense of the discussion. We will look at the language to make sure that the staff's own enthusiasm did not color the text too much.

On Brazil, Mr. Portugal's suggestion—to update the report to reflect the fact that Brazil will now be relying on a 75 percent threshold in its CACs—is an excellent idea.

On the issue of litigation, the paper was discussed only yesterday. The speakers confirmed, and the Acting Chair concluded, that it is too early to draw any conclusions on a policy level, both in terms of the significance of the litigation and the implications for the debt restructuring process. Nevertheless, as suggested by Mr. Kincaid, the progress report could note that there has been an increase in litigation, that the litigation issue was discussed, and that the Fund would continue to monitor this situation closely to determine the degree of increase and its possible implications on the debt restructuring process. The statement could be descriptive, while steering away from making any judgments at this stage on a policy level.

Mr. Kruger asked a substantive question on the design of collective action clauses (CACs), pointing out that, while much of the attention focuses on what

the appropriate threshold is—75 percent or 85 percent—perhaps a more technical, but very sensitive, issue is how one calculates that threshold. More specifically, the question is: how do you calculate the denominator? The approach that has traditionally been followed in bonds governed by English law has been that the voting threshold is calculated on the basis of a "duly convened meeting," where a meeting is duly convened if the specified quorum requirements are met. The CACs that have been included in bonds issued under New York law, however, calculate the threshold on the basis of total outstanding principal. There are strengths and weaknesses to both approaches, and this was an issue that attracted considerable discussion during the G-10 Working Group discussions. The concern with the outstanding principal approach is what we could describe as the "unconscious holdout," which may become more significant in a retail issuance, where essentially a non-vote becomes a vote against the proposal. A non-vote could arise because the investor is on vacation or has not opened his mail. The concern with the duly convened meeting approach raised by a number of institutional investors, particularly in the United States, however, was that it could result in a restructuring being engineered by a small group. This is because many bond prospectuses stipulate that the quorum is set at 75 percent of outstanding principal for the first bondholder meeting, but if that quorum is not met, the quorum requirement is reduced to 25 percent of outstanding principal at an adjourned meeting. There was a concern that, for sophisticated investors, there might be manipulation. The G-10 report handled this issue extremely well in its recommendation, which provides that, given the sensitivities in the New York market on these issues, it may indeed be appropriate to go with an outstanding principal approach. But the G-10 report did not recommend that the duly convened meeting approach followed in English law governed bonds be changed. It did point out, however, that if one uses the outstanding principal approach, it is risky to go above a 75 percent threshold. Whether this is going to mean that the approach followed in bonds governed by English law needs to change is an open question. The U.K. government, when it issued its own bonds recently, actually used an outstanding principal approach.

The staff representative from the International Capital Markets Department (Mr. Blitzer) made the following statement in response to questions and comments from Executive Directors:

On the point that Mr. Hagan was making about the denominator, and whether the threshold is based on outstanding principal or principal represented at meetings, it is correct that this has been an important conceptual issue and an issue of principle for many in the institutional investor community. The private-sector effort to define market standards for CACs, which is referenced in the progress report, will likely continue to recommend standardization based on outstanding amounts rather than on meeting attendance and encourage this for new bonds issued under English law. People involved in this effort believe that standardization based on outstanding principal will eventually occur for English law bonds. They believe that it is, in part, an educational issue among the legal and investment banking community in the United Kingdom. Heretofore, the

private sector groups working on CACs have focused their education efforts on the legal and investment banking communities in New York, because getting collective action clauses (CACs) introduced in New York was the higher priority until now. In this regard, the recent issue of Hungary included outstanding principal as the denominator in their English law bond, and incidentally, it also included engagement clauses. As for the markets, pricing does not seem to reflect much concern about differences in voting thresholds across bonds with CACs any more than market prices at this point reflect differences between bonds with and without CACs.

Ms. Indrawati asked us why, during the past six months, about 30 percent of sovereign bonds were still issued without CACs. There were various considerations among the five emerging market countries that issued bonds without CACs. Several of the bonds were re-openings of previously issued series of non-CAC bonds, which for debt management reasons were considered more advantageous than issuing a new series of bonds. In those cases, the countries have subsequently included CACs in their new issues. In two cases, there were bonds that were sold primarily to retail investors in Germany with the payments terms governed under German law. Because of remaining concerns about the legal status of CACs in Germany, the issuers decided to exclude them even though they have included CACs in bonds issued under New York or English law. We expect there to be a clearly rising trend in the percentage of bonds issued with CACs, particularly as the frequency of re-opening bonds without CACs declines. As the paper notes, the current state of developments in Germany looks quite encouraging.

On the Code of Conduct, in response to the questions of Mr. Kruger and Mr. Martí, Mr. Dallara's letter can be interpreted as encouraging the official sector to support the development of a Code of Conduct regardless of its periodic change in labels. More generally, however, there is some skepticism in the private sector, as there is a feeling that this process should not be led by the official sector, but rather it should be led primarily by issuers and creditors. While there are a number of representative groups that are actively engaged in and supporting development of a Code of Conduct, the institutional investor community more broadly seems somewhat disengaged on this issue, perhaps due to doubts about whether the process of developing a voluntary Code of Conduct will, in the end, bear fruit. At the same time, we have not sensed any outright opposition to this process going forward. In other words, there is encouragement, but with skepticism, by a large group of investors who are engaged in their regular businesses without being particularly focused on the Code of Conduct.

Mr. Andersen asked for a clarification on the extent of the Fund staff's involvement in the various G-20 discussions on the Code of Conduct.

The Deputy Director of the Policy Development and Review Department (Mr. Kincaid) responded that the staff had engaged in discussions with G-20 deputies and others, and the staff

was following developments, which provided the basis for the material in the report. The staff also had contacts with market groups, including the Institute of International Finance (IIF) and other investor communities. The staff also listened to the opinions of country authorities on such issues, and was trying to listen to all elements of the international community that were engaged in the discussion. At some future stage, there would be an expectation for a Board discussion of the Code of Conduct, or "principles," depending upon what terminology that was agreed.

Mr. Kiekens remarked that Mr. Kincaid had said that he had no strong feelings about whether to include in the progress report information on developments related to exceptional access and lending into arrears policies. In an effort to tilt the balance of views in the Board on this matter, it was suggested that this should not be included. The progress report was mainly about developments outside the Fund, such as collective action clauses and the Code of Conduct. Mr. Brooke had made a good suggestion to mention, in the second introductory paragraph, that the report did not address either ongoing debt restructuring negotiations or the Fund's lending policy in such cases. It could also mention that the report did not discuss exceptional access policy, but a reference to the umbrella paper could be provided. That would be a good solution.

The Acting Chair (Mr. Carstens) agreed that cross-referencing these topics would be appropriate. Directors were thanked for their valuable comments and suggestions. It was agreed that the paper would be published after taking into account any revisions in light of the current discussion, and following circulation to the members of the IMFC.

APPROVAL: July 1, 2004

SHAILENDRA J. ANJARIA
Secretary