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Minutes of Executive Board Seminar 03/4

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Executive Board Attendance

A. Krueger, Acting Chair

Executive Directors	**Alternate Executive Directors**
	A. Alazzaz
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K. Bischofberger	
	W. Cho, Temporary
	S. Boitreaud
	I. Alowi
V. Egilsson	
N. Jacklin	M. Lundsager
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G. Le Fort	A. Zoccali
	A. Monajemi, Temporary
	L. Palei, Temporary
	L. Rutayisire
P. Padoan	
	R. Steiner
	A. Tombini, Temporary
	K. Kanagasabapathy, Temporary
	A. Stuart, Temporary
A.S. Shaalan	O. Kanaan
	P. Ngumbullu
	J. Yu, Temporary
	Y. Yakusha
	M. Abbing, Temporary
K. Yagi	
F. Zurbrügg	W. Szczuka

S.J. Anjaria, Secretary
J. Puig, Assistant

Also Present
IBRD: P. Stella, Principal Economist. Asia and Pacific Department: J. Felman. External Relations Department: P. Reynolds. Finance Department: S. Bassett. International Capital Markets Department: G. Häusler, Director; C. Medeiros, E. Psalida, L. Zanforlin. Legal Department: D. Eastman, T. Laryea, Y. Liu, N. Rendak, G. Rosenberg. Monetary and Financial Systems Department: E. Frydl. Policy Development and Review Department: M. Allen, Deputy Director; A. Arvanitis, M. de Bolle, H. Finger, K. Hur, K. Hviding, R. Kincaid, J. Kozack, M. Mecagni, H. Shah, K. Srinivasan. Statistics Department: J.R. Rosales. Western Hemisphere Department: R. Teja, E. Vesperoni. Advisors to Executive Directors: A. Baukol, J. Costa, D. Farelius, P. Gitton, A. Ismael, F. Manno, M. Melhem, J. Milton, T. Moser, G. Shbikat, C. Sia, F. Vermaeten. Assistants to Executive Directors: A. Al Nassar, O. Cuny, A. Dupont, P. Inderbinen, M. Jamaluddin, B. Mamba, B. Reichenstein, T. Segara, A. Segura, T. Sekine, O. Steudler, T. Stucka, S. Vtyurina.

1. THE RESTRUCTURING OF SOVEREIGN DEBT—ASSESSING THE BENEFITS, RISKS, AND FEASIBILITY OF AGGREGATING CLAIMS

Documents: The Restructuring of Sovereign Debt—Assessing the Benefits, Risks, and Feasibility of Aggregating Claims (SM/03/308, 9/4/03)

Staff: Hagan, LEG; Fisher, PDR

Length: 2 hours, 55 minutes

Mr. Bennett submitted the following statement:

Key Points

A common definition of inter-creditor equity could enhance the predictability of the restructuring process.

The large number of bond issues, the successful litigation and the size of the haircut, all potentially exacerbate the collective action problem in Argentina.

The benefits of stronger majority action clauses that increase creditor participation have to be balanced against the potential loss of creditor rights. There seem to be significant benefits to the type of trust indenture used by Uruguay in affecting aggregations as well as in preventing disruptive litigation.

We would like to thank the staff for the innovative format of this seminar. Not only did they produce an interesting paper for discussion, but their invitation of two experts will go a long way to improving the Board's understanding of the complexities of debt restructuring.

A common definition of inter-creditor equity would be beneficial: The staff notes that one of the risks involved with aggregation is the potential for a majority of creditors, holding a particular type of claim, to impose an agreement on a minority that hold a very different sort of claim. The two types of potential inter-creditor equity problems raised by the staff are the treatment of preferential (secured) claims and of claims of different maturities.

As Annex I points out, in the case of corporate restructurings, the "absolute priority rule" protects dissenting creditors by ensuring that they receive no less than they would under liquidation. However, there is no such protection for minority creditors in the sovereign context.

We believe that a common definition of inter-creditor equity could go a long way to redressing this defect. In addition, it could provide predictability to restructurings, which could enhance the operation of capital markets and ultimately lead to a higher volume of capital flows.

Our proposed definition of inter-creditor equity is a simple one. First, the ex-ante seniority of claims would be preserved in a restructuring. The imposition of seniority ex-post would impair the operation of capital markets, which depend on predictable and even-handed treatment.

Second, all non-secured creditors should take the same net present value (NPV) reduction in exposure. We believe that NPV is the appropriate metric for valuing claims and calculating the haircut because it better represents the relative weight of claims of different maturity on the sovereign's liquidity position and its solvency. While claims are often restructured in a way that addresses NPVs, this is typically done in an ad hoc manner.[1] Notwithstanding some difficulty in determining NPVs, agreement on this metric by market participants could go a long way to improving the predictability of restructurings. The staff's comments would be welcome.

Is the collective action problem in Argentina likely to be especially acute? The staff asserts that making debt restructuring more orderly, predictable, and rapid requires addressing weaknesses in the existing system, including collective action problems and creditor coordination issues.

However, there is a view in the private sector that the system already works quite well.[2] It is argued that private creditors are able to deal with debt restructuring quickly and have shown considerable flexibility in their response. Moreover, the absence of "innovative mechanisms" have not impeded debt workouts for Ecuador, Pakistan, Russia, Uruguay, and the Ukraine, where debt relief was obtained through the use of exchanges. In addition, according to this view, litigation has not inhibited debt restructuring.

Our experience with debt restructuring is evolving. It is difficult to extrapolate general conclusions from the limited number of cases we have to date. However, it does appear that the efforts of Argentina to restructure its debts will be precedent-setting in many respects. Restructuring the Argentine debt could be complicated by the very large number of outstanding bond issues. Moreover, successful litigation by some creditors could persuade

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[1] In a restructuring, both bonds maturing this year and twenty years from now are often exchanged for new twenty-year instruments.

[2] For a good exposition of this view, see Arturo C. Porzecanski, "The Constructive Role of Private Creditors," Ethics and International Affairs 2003, Volume 17, Number 2, (www.carnegiecouncil.org/viewMedia.php/prmID/1002).

others that holding out is worthwhile strategy. Finally, the large haircut asked of creditors could dissuade them from participating in the restructuring.

Stronger majority action clauses have costs and benefits: We appreciated the analysis in Box 2, which showed, on a pro-forma basis, how changing the type of majority action clause would have resulted in different uptakes by creditors in Uruguay's recent debt exchange.

The actual result, with no majority provisions in any of the bonds, resulted in an acceptance rate of 89 percent. A more complex structure, with an overall threshold of 85 percent and a per bond threshold of 50 percent would have resulted in an acceptance rate in excess of 99 percent.
Before concluding that the more complex structure would have been preferable, it is important to consider the costs and benefits closely. What is the cost of being unable to convince 11 percent of Uruguay's creditors (by value) not to participate? Are they litigating and preventing payments on the restructured debt? Are they being paid in full and perhaps setting a precedent for the next restructuring that it is more worthwhile to hold out than to participate? On the other hand, what would have been the cost of engineering the acceptance rate of 99+ percent? This only would have been possible by reducing the per bond voting threshold to 50 percent—i.e., in some bond issues, there was a sizable minority of creditors who were affected by the cramdown. From their perspective, being forced to restructure by a slim majority would likely have been seen as an abrogation of bondholder rights. What would have been the implications of uncertainty in a bondholder's ability to enforce his rights for the asset class?

Trust indenture: We found the discussion of the trust indenture used in the Uruguay restructuring quite intriguing. Uruguay's ability to issue an unlimited amount of bonds in different series under the same "master agreement" ensures that they will all be subject to the same aggregation provision.

In the case of a single bond issue, a trust deed, which vests the power of litigation in a trustee and requires that the proceeds of litigation be shared pro-rata can effectively minimize the prospect of disruptive litigation. However, this does not seem to present a clear advantage over the fiscal agent arrangement, where acceleration/deacceleration provisions play a similar role.

However, in the case of multiple issues, the trust indenture provides the additional ability to aggregate across issues. Therefore, it seems to us that it should be the preferred arrangement. We recognize that moving to a situation where the trust indenture covers all relevant bonds for a particular sovereign is some way off because of the existing outstanding stock that would not be covered. However, the outstanding stock problem has not prevented us from endorsing collective action clauses. Can the staff give a similar endorsement to the trust indenture?

Ms. Jacklin submitted the following statement:

The staff paper presents a range of issues, theoretical and practical, surrounding whether the aggregation of creditor claims for voting purposes could be of benefit to the sovereign debt restructuring process. The paper highlights the limited goals of aggregating claims both across similar types of instruments and across different instruments, namely to force holdout creditors to accept the terms of a restructuring (the so called 'cram-down') and in so doing, make the process more efficient. However, the paper seems to downplay clear risks and fails to demonstrate that the present lack of aggregation has resulted in failed restructurings or significant numbers of holdouts such that potential debtor/creditor agreements have been derailed. Are proposals on aggregation a solution in search of a demonstrated problem? And, has the market place moved fairly cautiously on making changes because of the potential risk that aggregation in some cases may impede a prompt restructuring rather than facilitate the process?

We are interested in hearing about market participants' views on a number of key points. First, we would appreciate a market assessment of the extent to which aggregation concerns have in the past contributed to preventing or delaying a restructuring. Second, we would benefit from an update on the ideas being developed by the private sector to consider how creditors might contractually, that is to say, voluntarily, agree that their claims should be part of an aggregation process for voting purposes in the event of a subsequent restructuring. Also, we would welcome them sharing with us any reactions on the part of actual or potential investors to these issues.

Touching on some of the specific matters included in the staff paper, we were a little puzzled by the emphasis on commercial bank credits. We understand that in at least one instance, the Indonesian restructuring, syndicated loans contained majority action clauses, although there was no aggregation across instruments. But more broadly, the specific nature of commercial bank loan documents (with detailed covenants) would seem to make such loans ill-suited for aggregation. And there would seem to be easier and better ways to address the possible problem of a vulture fund acquiring a blocking position on bank loans. For example, if there are concerns that a commercial bank might sell the loan to a vulture fund, debtors could seek to include limits on transferability in the loan documentation (potential limits on a loan's liquidity and higher costs should be acknowledged, but borrowers could make this choice). We would, however, welcome our guests' comment on how much of a problem the commercial loan market is to securing restructuring agreements and whether the private markets see this as an issue.

Turning to aggregation across bond issues, we find that the recent Uruguay restructuring offers several original concepts, and we would be interested in hearing how the market is assessing this approach. Is the investment community responding well, and if so, could Uruguay's documentation become a model in this area? The use of the trust indenture seems an efficient approach, and the thresholds chosen by the Uruguayan authorities—requiring approval of 85 percent of the aggregated principal, but only 662/3 percent for each individual series to amend key terms of multiple issues—seem to have been accepted at least in this transaction as a good balance between facilitating a restructuring and setting a high bar for acquiring a blocking share. We would also be interested in thoughts on the potential for utilizing some of these concepts in original issues, not just a bond issued in a debt exchange?

While not seeking to endorse the specifics of the instructive Uruguay example, we are encouraged by the innovative approaches developed by the market in this case. Market innovation to address documentation improvements which issuers and investors accept as useful should be applauded. We took that view on CACs, and believe the same principles apply here—that is, some variety and experimentation by those in the market will contribute to the development of the most effective tools. It is premature to endorse a single approach. It is worth commenting that despite the very positive developments regarding the adoption of CACs, this is still a work in progress. Efforts by other issuers to incorporate aggregation provisions similar to Uruguay's may highlight new considerations in this area, and eventually, restructurings involving CACs will add to our understanding of how clauses will work in practice.

In Box 3, the staff paper describes a proposal for achieving aggregation through class action procedures. We would be interested in a clearer assessment of risks presented by this approach, as well as the experts' view of its future evolution. Also, the JP Morgan two-step approach with its 'interim debt claim' is an alternative being developed by market participants themselves. To what extent are these ideas being considered by investors, and what are initial reactions? Have any sovereign borrowers commented on these proposals?

The fact that the market is generating new ideas and trying to find innovative approaches to resolving sovereign debt difficulties more efficiently is very much to be welcomed. With CACs becoming more widely accepted, it will take some time to see how this major accomplishment translates into future handling of sovereign debt servicing difficulties. In line with the staff's conclusion, we do not believe the Fund should take a stand on aggregation at this time, but should instead encourage continued constructive consideration by market participants.

Mr. Padoan submitted the following statement:

We welcome the opportunity to discuss the issue of aggregation in the context of sovereign debt restructuring. While there is currently not enough support for the establishment of an SDRM we continue to believe that, while contractual provisions would introduce a clear improvement in sovereign debt management , they might be fruitfully complemented by a statutory approach to sovereign debt restructuring. The careful examination of costs and benefits of procedures to aggregate claims discussed in the paper reinforces our conviction.

Collective action problems will always arise as long as market participants hold the view that the costs of non participating to restructuring agreements will be lower than the benefits of individual action. Aggregation is a problems exactly because of this perception. On the other hand a decision to participate into an agreement is strongly influenced by inter creditor equity concerns. Possibly such a concern weighs even more heavily than litigation concerns. Seminar participants' views on this matter would be welcome.

Different "real life" cases always abound, yet basic incentives should be set as clearly as possible. But even if aggregation is desirable there are different ways through which it can be obtained. The paper offers a very detailed analysis of the different possible cases, and when one has finished reading it one is left with the impression that there will always be yet an additional case for which new considerations will have to be made and lessons drawn.

As a simple minded economist I feel disappointed by the fact that no simple model of collective action resolution can be identified through which to reach "optimal" solutions. But I admit that lawyers have a comparative advantage in dealing with practical issues. Nonetheless, some basic principles can be useful to organize discussion.

An effective framework for sovereign debt restructuring must be based on strong and clear incentives. As we have reiterated in other occasions incentives would be best set out if two conditions are in place: the perception of increasing costs of debt restructuring if an agreement is not reached on a voluntary basis; a credible expectation by market participants of what the role of the Fund would be in crisis prevention and resolution.

Can solutions to aggregation be ranked? In this perspective I continue to believe that it is possible, and useful, to rank debt restructuring mechanisms according to their cost and complexity, moving from a fully voluntary approach (possibly to be organized within a Code of Conduct), through a contractual approach, to a statutory approach. Costs are increasing because, after a crisis breaks out or a deterioration of debt relations starts developing the window of opportunity of dealing with debt problems becomes smaller, available resources become more scarce, and risks of litigation increase.

If such a ranking can be identified incentives for market participants should be clearly determined and aggregation could be achieved more efficiently. If the tool box includes a statutory approach market participants will act "in the shadow of the SDRM" (even in its "light" version) knowing that if aggregation issues are not resolved through voluntary or contractual solutions the statutory procedures will lead to similar results at possibly higher individual costs.

It would be useful to hear from staff and from seminar participants whether they agree about the usefulness of ranking approaches to aggregation according to increasing costs and, if so, how proposals such as the two step approach proposed by JP Morgan would be placed in such a ranking.

A key factor in setting the right incentives will be the perception by market participants that the Fund will be applying consistently its access policy and, especially, in exceptional access cases. After all, countries, do need to remain in business retaining market access after a crisis. Rigorous implementation of access policy should guarantee that return to markets is based on sound fundamentals and that the sources of the crisis have been appropriately dealt with.

While we appreciate efforts by staff in preparing the paper we regret the lack of conclusions and suggestions for a way forward.

Other issues in addition to aggregation deserve further attention. We mention the following: further investigation of alternative ways to deal with statutory approaches such as "class action" approaches; strategies to deal with the 2/3 of outstanding debt that does not include CAC, including proposals such as the "two step" approach; the usefulness and possibility of establishing a Dispute Resolution Forum without necessarily moving towards the full implementation of a statutory approach.

Finally, we agree that it is too early, to say the least, to draw any firm conclusion on how to deal with aggregation issues. Experience drawn form the evolution of market assessment and pricing of CAC issuances will provide opportunities for further discussion and so will debt restructuring cases. In paragraph 82 (page 70) of the staff paper on Argentina the Board will be discussing in November (SM/03/345) we read: " The [Argentine] experience suggests that it would be desirable, if it is possible, to find a more orderly approach to debt restructuring. This was an important initial motivation for the Fund's work on the Sovereign Debt Restructuring Mechanism (SDRM). The underlying problem remains: the Argentine experience highlights the need to find better ways of anticipating and resolving debt crises"

Mr. Yagi and Mr. Miyoshi submitted the following statement:

We welcome today's seminar. Since the IMFC directed the Fund to continue work on issues of general relevance to the orderly resolution of financial crises, it is appropriate for the Executive Board to discuss this issue prior to publication. That said, we would like to thank staff for preparing another paper of high quality, and we support its publication after the seminar. In particular, we appreciate the follow-up of recent developments in the private sector on the issue of aggregation, which has been recognized at Board discussions on the SDRM and CACs as one of the major issues to be addressed.

We broadly agree with the paper's conclusion that it would not be appropriate for the Fund to endorse a particular set of aggregation provisions at this time, in view of the uncertainty about the degree of acceptance by the market of those provisions and a number of challenges they face. As the staff points out, while aggregation would potentially contribute to the orderly restructuring of debt by preventing holdout creditors from disrupting the whole restructuring process, it risks being exploited to discriminate against certain creditors and to manipulate the restructuring process. Indeed, the implications of aggregation for the principle of inter-creditor equity are not clear-cut; although aggregation would promote inter-creditor equity by ensuring that some creditors are not given favorable treatment through holdout strategies, it could, without adequate safeguards, be exploited by a majority of creditors to impose unfair burden on the minority, who may well have legitimately differing interests.

In any case, inter-creditor equity is not a straightforward concept. It is easy to say that the same type of debt should be treated in the same way and different types of debt should be treated differently, but careful judgment is needed to determine whether a particular differentiation in treatment is justified. Moreover, different treatment may sometimes be warranted even within the same type of debt, depending on the different interests of various creditors and the economic implications of debt restructuring. These considerations call for flexibility in the treatment of claims in the context of debt restructuring; flexibility, however, could create more room for manipulation.

As we mentioned above and as the staff indicates, there is clearly a trade-off between the need for resolving collective action problems and ensuring equity, or preserving creditor rights. In view of such difficult challenges, and since consideration of aggregation issues is still at an early stage, it is appropriate for the Fund and the markets not to rush to a hasty conclusion on this issue but to continue to explore ways to capture the benefits of aggregation while minimizing its potential risks. Since support for establishing the statutory framework is insufficient, priority should be given to considering the aggregation of claims under a contractual framework. At the same time, we agree with the staff that the idea of a statutory framework can provide a point of reference. We encourage the staff to monitor market developments and continue its work on this issue.

With regard to contractual solutions, we agree with the staff that the bonds issued by Uruguay earlier this year are a helpful development. The issuance of different series of bonds under the same "master agreement" under the trust indenture is appealing because these bonds will automatically be subject to aggregation. We wonder, however, whether such a structure would be practically feasible or congenial to other jurisdictions, and therefore still hesitate to suggest that the Fund endorse the trust indenture. On private sector proposals to facilitate the restructuring of the existing stock of debt, our views are broadly similar to those of the staff. J.P. Morgan's proposal is interesting, but we think that creditors are likely to be unwilling to enter into the first step under uncertain circumstances without substantially strong incentives. The ABRA is essentially a voluntary framework, and it remains to be seen whether it will be effective in the face of critical situations. Finally, we have the impression that, under a contractual framework, the objective of ensuring inter-creditor equity becomes too complicated in pre-default restructuring because differing interests among creditors caused by differences in maturities would be difficult to resolve. As the staff suggests, it might be realistic to design a CAC that provides for aggregation only in circumstances where all bond issuances have been accelerated, despite the potential benefits from pre-default restructuring.

With regard to the statutory approach, we agree with the staff's views that it would have advantages over the contractual approach in that the framework would apply to the existing stock of debt and a single process for dispute resolution would be established. We think, however, that the paper might be a little too favorable towards the statutory framework. On the issue of discrimination, the staff assumes a high possibility of "pre-packaged" arrangements in the sovereign context, arguing that creditors could be willing to have their claims aggregated even if their claims have different maturities because the SDRM would only be activated when debt is unsustainable; however, it would be difficult for all the creditors to conclude that debt is unsustainable in every case, given country-specific differences with respect to the strength of reforms and adjustment. On flexibility, the staff states that the concept of "optional classes" could accommodate the preferences of different creditors; however, if claims are to be classified with a view to protecting particular creditor groups, such as banks, from debt restructuring, it is not sure whether other creditors would really be willing to accept being treated as inferior to some banks because, under uncertain circumstances, one would not be assured that such a short-term sacrifice would turn in to a long-term gain. Finally with regard to manipulation, while domestic courts are usually given strong authority and play an active role in corporate restructuring, we are skeptical about whether, in the sovereign context, the proposed DRF would have sufficient authority to effectively prevent abuse and ensure equity.

Mr. Usman submitted the following statement:

The Fund' efforts to the designing of a sovereign debt restructuring mechanism (SDRM) has substantially increased the awareness of potential problems and risks that may arise when a sovereign debtor country needs to restructure its foreign debt or actually go into default. To address these potential problems, sovereign debtors have increasingly included collective action clauses (CACs) in their bond contracts, as a mechanism to address potential problems related to debt restructuring or default.

In this very interesting paper, staff provides an update on the progress made regarding the aggregation problems of creditors that could arise during a sovereign debt restructuring or default. The paper traces the possible advantages and risks in solving these problems, as well as proposals on how to deal with the issue by Fund staff, and other role players outside the Fund. The proposals by staff have previously been considered in the context of the SDRM framework. We will focus our comments on the developments outside the Fund, namely by Uruguay, the J.P Morgan proposals and the Argentine Bond Restructuring Agency.

We concur with staff that the major benefit to be achieved from successfully dealing with issues pertaining to collective actions and creditor coordination in the context of debt restructuring would make the restructuring of unsustainable debt more orderly, predictable and rapid. In this regard the issue of the size of the qualified majority of creditors to bind in all creditors and that of claims across different debt instruments was considered during previous Board discussions. The Uruguayan authorities attempted to address both of these issues in a recently issued bond contract, which included CACs. The features of the CAC as highlighted in Box 1 of the staff report covers, inter alia, aggregation of voters across debt instruments and majorities needed to bind in all creditors. The significance of the Uruguayan bond issue is that it also contains provisions to limit Uruguay's ability to use coercive exit strategies from bond restructurings, safeguarding the integrity of the voting process, and providing assurances to creditors concerning information before modifying bonds. We commend the Uruguayan authorities for their groundbreaking efforts to find solutions to potential problems during a debt restructuring. This clearly illustrates the ability of a sovereign debtor and its creditors to contribute to a framework for an orderly resolution of problems that could arise from a restructuring process.

The J.P. Morgan two-staged approach is another attempt by an outside institution to deal with the issue of debt restructuring. Again, we welcome the initiative taken by market participants to develop ideas on how to deal with issues concerning those bond contracts that do not include collective action clauses. We would like to know how well the J.P. Morgan proposals have been received by other private sector financial institutions.

The newly formed Argentine Bond Restructuring Agency (ABRA), which has been formed under Irish law attempts to congregate bondholders to deal with the issue of restructuring negotiations. In our view, possibility of investors to withdraw from the arrangement could make the restructuring process uncertain and unstable. Staff's views will be welcome.

Finally, we welcome the active contributions by institutions outside the Fund to address the difficulties that may emanate from the resolution of crises. We support staff's view that the Fund should not at this stage endorse any particular initiative, but should encourage and support the process of generating new innovative ideas.

Mr. Portugal and Mr. Tombini submitted the following statement:

The staff report provides an assessment of the use of aggregation clauses in international claims. In our view, it unequivocally demonstrates how complex this issue is and persuasively presents the various risks that the introduction of aggregation clauses might generate to the functioning of international sovereign debt markets. The staff fails to demonstrate, however, that the introduction of aggregation clauses will solve the two issues that it intends to solve; namely, the collective action problem across debt instruments and creditor coordination issues.

We were puzzled by the fact that the staff paper devotes almost five pages to discussing aggregation under the SDRM when (i) it is clear that SDRM does not enjoy the necessary support, and (ii) the full implications of aggregation under the SDRM were never fully developed and resolved at the Executive Board level. We find this insistence by the staff counterproductive at this stage.

The idea that the introduction of aggregation clauses would facilitate collective action in case of multiplicity of instruments is simply not consistent with the existing experience with sovereign debt restructuring. A central problem with the paper is the stated unproven assumption that collective action difficulties are exacerbated by the multiplicity of instruments and growing diversity of creditor interests. The same point arises where it is stated, with respect to the so-called "multiple issuance holdout strategy" that it is still too early to determine whether the "gap" (between issues with collective action clauses and issues with both CACs and aggregation clauses) will have a significant impact on the speed and order of the debt restructuring process. The key point on the collective action problem's discussions (CAC, SDRM) that has been overlooked is that the impact of holdouts is directly related to the amount of money they can succeed in collecting, as opposed to the amount of the judgments they may threaten to, or actually, obtain.

As the staff clearly points out, issues of intercreditor-equity may even be exacerbated by an instrument that pulls together the different claims in the pre-default phase. Accordingly, aggregation clauses may not be a determining factor in facilitating early creditors' organization and in speeding up the restructuring process. As pointed out by the staff, under some circumstances, for instance, when there is great uncertainty concerning economic prospects and debtor's payment capacity, the debtor and its creditors may favor a delay in the restructuring process. In this case, which seems to be a plausible and frequent scenario in debt restructuring, the introduction of aggregation clauses would do little if anything to improve creditor coordination issues.

The staff admittedly offers a rather speculative justification for introducing aggregation clauses in bond contracts; namely, that it would be easier for a qualified majority of creditors to represent to the debtor that it can enforce an agreement on the entire universe of bondholders and prevent litigation before reaching the agreement. While this is said to be one of the justifications behind recent private sector proposals, we fail to see debtor's fear of non-enforceability as a major stumbling block to a rapid sovereign debt restructuring process. First because if a majority is formed across debt instruments, the sovereign will be in a position to confirm whether this group is indeed representative of the universe of bondholders –i.e. the aggregation clause would have done little else in persuading the debtor. Second, as the staff mentions in many passages of the report, it is relatively limited what an aggregation clause can do in preventing litigation in the pre-default scenario.

One of the most relevant risks that aggregation clauses bring about is to reduce flexibility in dealing with debt restructuring events. As mentioned by the staff, for the aggregation to achieve better results regarding voting across different instruments, it should be accompanied by a rule that requires all aggregated claims to receive the same terms or the same menu of terms. Here there are two problems: first, in a pre-default scenario, when claims are still being serviced, the aggregation clause will treat different claims, in terms of maturities and coupons, in the same way, therefore disregarding inter-creditor equity; second, even after a default occurs, the different relations that bond holders sustain with the sovereign debtor could reasonably entail different solutions for the distressed debts. We entirely agree with staff's assertion that "Being able to take advantage of these different preferences will be critical for a sovereign that is seeking to secure a restructuring on terms that provide it with maximum economic latitude." By treating all creditors the same after default, the aggregation clause may detract from the principle of inter-creditor equity, while stifling innovation in debt restructuring deals.

The other very important risk from the sovereign's perspective has to do with potential costs and flows reductions in international sovereign debt markets. The staff suggests, and we concur, that securing a debt restructuring agreement previous to a default is preferable since it is less disruptive to the sovereign debtor and, in general, to its creditors. However, it is reasonable to assume that by treating the same way different claims, in terms of maturities and coupons, aggregation will run the risk of discriminating amongst creditors. Accordingly, the problems faced by aggregation clauses in the pre-default phase may represent an implicit incentive for the occurrence of an event of default as a required step to make the restructuring process work smoothly. This clear risk associated to aggregation clauses has the potential to raise the costs and reduce the flows to sovereign issuers. This is certainly a major difficulty that sovereign issuers will consider before embarking in aggregation clauses.

As an alternative to solve the inter-creditor discrimination on the pre-default phase, the staff suggest that an aggregation clause could be designed to be applicable only in circumstances where all bonds have been accelerated. In addition to being silent on the issue of secured versus unsecured instruments, this proposition confirms the implicit incentive for the occurrence of a default event, an issue that will certainly make this proposed bond covenant a costly alternative to facilitate sovereign debt restructurings.

We are not attracted by the private sector proposals to deal with the stock of bonds that do not contain collective action clauses in the event of a crisis. The first private sector proposal presented by the staff –J.P. Morgan "Two-Step" Proposal– has the desirable feature of being one notch more flexible than the staff's proposed aggregation clause (along the lines of the Uruguayan clause). By allowing a reversal to the original claim prior to the restructuring agreement, the proposal is an improvement in terms of flexibility for the bondholder; however, this comes at the expenses of less predictability in the restructuring process. The basic flaw, however, as stated by the staff, is the lack of assurances that investors would be willing to exchange into the "Interim Debt Claim". To address this issue, it is proposed that positive and negative incentives are offered such as up-front cash and aggressive use of exit consents to erode contractual rights of non-participating investors.

The proposal of achieving limited aggregation of different sovereign claims through "Class Action" under existing statutory rules of civil procedure of the U.S. law seems farfetched. First of all, the aggregation of sovereign claims would certainly involve more than one national jurisdiction and in this respect it is unlikely that a U.S. court would be in a position to have jurisdiction over a claim that is governed by a foreign law, or is subjected to a foreign jurisdiction. It is also doubtful that a U.S. domestic court would be willing to rule on sovereign debtor and its creditors' issues, as the recent rulings in the New York district court that turned down class certification to two cases filed against Argentina may suggest.

Finally, we agree with the staff that the design and implementation of aggregation clauses face several challenges and the Fund should not endorse any particular set of aggregation provisions. Our view is that no matter how much the Fund prescribes, through the "endorsement" of contractual clauses or otherwise, the market will always look for a way to work around the clauses or the rules. Decisions about what should and should not be aggregated are particular to each country and may change over time. We would go one step further and urge the staff not to push for the inclusion of aggregation clauses of any sort. We are dealing with much more complex issues than the collective action clauses applied to single instruments. Here we are in a broadly untested territory and any initiative that the Fund tries to push forward will most likely have an impact on the size, composition and costs of flows to sovereigns. The Fund has to maintain a hands off approach and leave this issue for debtors and creditors to deal with.

Mr. Wang submitted the following statement:

We thank staff for the well-written paper and welcome this opportunity to discuss the aggregation issue in relation to sovereign debt restructuring. While it was deemed unfeasible to move forward with the establishment of an SDRM under a statutory approach at this time, the issues raised during our discussions provided important insights into reforming the approaches to sovereign debt restructuring, with particular focus on the inclusion of collective action clauses in sovereign debt documentation. Aggregation—claimed to be one of the major advantages of the statutory over the contractual approach—is being tried out in the proposed reform of the contractual approach. We welcome the progress made by Uruguay and the private sector in this direction. Nevertheless, it is not clear whether the Uruguay model is fit for other countries. The approaches proposed by the private sector have yet to be tested in the market. Hence, it is too early to determine whether the aggregation problem can be completely resolved, even without the presence of a statutory mechanism. Meanwhile, we also appreciate staff's view that the Fund is not in a position to endorse a particular set of aggregation provisions at this time, given the uncertainties and potential risks.

As staff points out, aggregation provisions could probably enhance the efficiency of sovereign debt restructuring by reducing the collective action difficulties related to the multiplicity of instruments and the growing diversity of creditor interests. However, they could also bring about risks—discrimination against certain creditors and manipulation of the restructuring process. Without careful design, this mechanism could impede market acceptance of the reformed CACs. To dispel creditors' doubts, creditor coordination and measures to ensure inter-creditor equity are essential.

However, it is usually difficult to define and judge inter-creditor equity given the complex terms of different issuance, and there is probably a trade-off relation between efficiency and equity. We wonder whether the proposed code of conduct will provide some guidance on how to capture the benefits of aggregation while minimizing its risks, most notably the issue of inter-creditor equity.

The approach proposed by J.P Morgan envisages a way creditors could be treated equally after exchanging their debt instrument holdings for IDC. However, as noted by staff, the first stage could be difficult with investors unwilling to give up their contractual rights since there is no leeway for them to escape once they have participated in the first stage. We are also doubtful of the proposed incentives for creditors to participate in the IDC exchange. The aggressive use of exit consents seems to be too strong and could possibly undermine market acceptance. Therefore, although this approach has a number of merits, we are not convinced about its feasibility.

With respect to the different types of debt, we do not see the need to bring commercial bank debt under the aggregation of claims. So far, commercial bank debt has not been confronted with significant collective action problems. We do not know whether the case of Peru represents a perverse phenomenon. However, so far the litigation cases arising from syndicated loans seem to have been tenuous. Therefore, at the current stage, it is our understanding that the inclusion of commercial bank debt could result in more costs than benefits.

Finally, we have a brief comment on SDRM. The statutory approach has certain advantages in terms of coverage of the entire debt stock and debts across different jurisdictions. Meanwhile, staff has indicated the envisaged operation of SDRM to avoid discrimination with flexibility arising from "optional classes". However, we share the view that some advantages advocated by staff still face certain technical difficulties. For example, the operation of DRF in avoiding manipulation involves the verification of valid claims. When we discussed the design of SDRM, the Board still had differences on this issue.

In conclusion, we appreciate staff's work on the research of aggregation issues under both the contractual and statutory frameworks. So far, there is no optimal mode. However, innovative ideas are being born and will provide important guidance for the concerned reforms. We encourage staff to continue monitoring market development and further their study.

Mr. Kanagasabapathy made the following statement:

My brief statement is essentially to welcome the staff paper and this discussion as a follow-up of the indication provided by the International

Monetary and Financial Committee last April. The paper, high in quality and well-balanced in its approach has brought out clearly the potential benefits, the risks and the feasibility of achieving the goal of the aggregation of claims as part of the sovereign debt restructuring process in the present juncture. The paper has identified and well documented the various possible options and the developments taking place already in the bond market in that regard.

In achieving the objective of restructuring debt in a less costly, more timely and in a predictable manner, there could be potential advantages in the aggregation of claims. We however recognize that in achieving the inter creditor equity in a predictable manner, there could be potential problems and it may also limit the flexibility available to the sovereign debtor. In this background, we appreciate the details provided by the staff on the efforts in private and official sectors to arrive at a framework that can achieve a reasonable balance between minimizing the potential risks and maximizing the possible benefits. It is encouraging to note that innovative features are being experimented by the market in this regard. We agree with the view that some variety and experimentation will contribute to further development in this regard, as expressed in the U.S. preliminary statement.

While the paper brings out various methodologies and approaches followed and being suggested, in the present stage, we agree with the staff conclusion that it is very difficult to firm up a view, one way or the other. We also agree that it would not be appropriate for the Fund to favor or disfavor any particular set of aggregations provisions or for that matter even inclusion or exclusion of such provisions at this time. Given the importance of this subject, we would also join some of the other Directors in strongly encouraging the staff to continue to monitor the use and evolution of aggregation provisions in particular in the use of CACs and report to the Board on any significant developments as proposed by them.

Mr. Beauregard made the following statement:

The staff paper presents a key picture of how important aggregation issues are for debt restructurings, but it also serves to reflect the complexities of the issue, whether under a contractual or a statutory approach. The staff indicates that a statutory framework would be more ambitious than the contractual approach, but given that there is no support to move forward with such a framework, work should continue on issues faced in its development that are of general relevance to the orderly resolution of crises. We agree with this assessment and will limit our comments to aggregation issues in the context of the contractual framework.

To start with, we would appreciate it if the staff could provide us with evidence of how bad the problem of aggregation is to solve restructuring problems. Thus far there has not been any case where a restructuring process has not been finalized due to an aggregation problem.

Second, can we develop a framework to deal with all aggregation possibilities in all cases and at all times? This is probably what the staff paper tries to address, and perhaps that is why there are no specific proposals or conclusions, other than that the staff will continue to monitor the use of aggregation provisions, which are being developed by creditors and debtors. This is the right approach and, as we have said regarding CACs, the Fund should not endorse any set of aggregation rules, as flexibility is of utmost importance. This being said, it is important to learn from experience in order to deal with future restructuring cases more efficiently.

Like Ms. Jacklin, we are not convinced that commercial bank credit might represent a problem. We believe the solutions that she proposes are sensible and should merit careful consideration. The Uruguayan case offers the best example of how it is possible to react swiftly to solve restructuring problems. Without a specific set of rules on aggregation, they were able to confront a problem along with their creditors and set their own rules, which enabled them to reach over 90 percent acceptance to their exchange offer. In this regard, we found Box 2 very illustrative. This is the type of analysis that will help us better understand how different rules on aggregation might affect a restructuring process.

We believe that the use of a master agreement like the one used in Uruguay has its benefits. However, as the staff notes, this approach might have its own limitations, given that investors could in the future react negatively if the sovereign decides to use a different indenture. This would have an excessively restrictive effect on the sovereign. Sovereigns will have to weigh thoroughly the pros and cons of adopting an avenue like that of Uruguay. We would appreciate it if the staff could provide us with more evidence that this is the case and what the implications could be.

Mr. Bischofberger made the following statement:

At the outset, let me thank staff for providing us with a high quality paper, and let me also say that I find the format of today’s seminar with the participation of two external experts very helpful. I really learnt a lot this afternoon.

We welcome today’s discussion on the aggregation of claims which is in our view a key feature for involving the private sector into an orderly restructuring of sovereign debt. Although approximately one third of the existing stock of international sovereign bonds now includes CACs, issuances and other debt instruments without CACs still pose a substantial risk for an orderly debt restructuring. Therefore, more work needs to be done on exploring possible ways for an orderly and predictable restructuring process in the absence of a statutory approach.

However, let me add like Mr. Padoan, that we continue to believe that, while contractual provisions are a clear improvement, they could be effectively complemented by a statutory approach to sovereign debt restructuring. In our view, the Fund has an important role to play in this discussion, and here, I agree with Mr. Padoan's regret on the lack of conclusions of the paper and I support his proposals for possible issues that deserve further attention and the possible way forward.

Regarding potential risks and problems of aggregation which are extensively discussed in the paper, we think they are manageable. Let me just briefly comment on some issues that are raised by staff.

First, with respect to inter-creditor discrimination, we concur with the view that only where creditors are holding the same type of claims, they should receive the same terms under a restructuring agreement. That implies that inter-creditor equity requires different treatment for creditors with different types of claims. Secured claims, for example, should not be treated in the same way as unsecured claims. This problem has also been taken into consideration in last year's staff report on "The Design of the SDRM—Further Considerations", where secured claims are excluded from a restructuring mechanism. Furthermore, we feel that there is no need to include CACs into secured claims, because this would be in a sense a contradiction in itself. Including CACs into secured claims would only make sense if they refer to the case that the security itself would no longer be available.

Second, while we share the view that a pre-default restructuring would be desirable, we continue to believe that in the case of an insolvency or near-insolvency, a restructuring prior to default is a rather unlikely. In particular, claims that would become due during the negotiation period would be fully served. However, creditors whose claims have longer maturities are unlikely to accept this and would therefore have an incentive to prolong the negotiation process. Therefore, a cut-off needs to go hand in hand with the debtor's announcement to restructure its debt. And in this case, we believe that only a broad-based standstill would prevent creditors from "running for the exit", thereby endangering an orderly and predictable restructuring process. As a consequence of such a standstill, all claims would be accelerated, and the problem of discrimination between creditors holding claims with different maturities would disappear.

However, in a liquidity crisis, it seems likely that the problem can be solved by extending the maturities without a net present value reduction. And this can be achieved through a voluntary restructuring agreement where, instead of a formal voting, only a sufficient acceptance from creditors is needed. Here, the problem of aggregation would not exist and the danger of discrimination would not evolve.

Third, staff rightly points to the problem of potential manipulation by the sovereign, and this is the next serious risk in the view of a market participant at the informal seminar held before our current Board discussion. We, therefore, support measures that prevent the sovereign from distorting the voting process. We would like to emphasize that the so called disenfranchisement provisions, as mentioned in the Quarles Report from September 2002, would exclude creditors from the voting process if they are under the influence of the sovereign.

Fourth, in cases where CACs are not included in bond contracts, as in Argentina, we welcome pragmatic solutions like creating an Interim Debt Claim or the ABRA-Initiative. However, both proposals depend on the voluntary participation of creditors in the restructuring process. This implies that the restructuring process can only be successful if it receives broad acceptance among market participants.

Looking ahead, it would be desirable to see solutions emerging that aggregate creditor claims for voting purposes, such as CACs with the refinement—as it was called earlier today—of an aggregate voting clause. In our view, the voting threshold should not be set too high. An overall threshold of say, 75 percent and a threshold of 50 percent for individual bond series seems to be appropriate.

Finally, with a grain of salt, a remark on procedures: Unfortunately, my authorities received the paper rather late because it was posted on the extranet only a month or so after it was issued. This made it somewhat difficult to pay due attention to this important issue.

Mr. Cho made the following statement:

The staff paper is comprehensive and it once again confirms the importance of addressing the aggregation issue if the recent surge of interest in CACs is to achieve its intended objective.

I understand the concerns about the potential risks of aggregation noted in the paper, but like Mr. Bischofberger I would like to underline that this should not be overdramatized. In my view, intercreditor discrimination is a real outcome of striving for intercreditor equity. The matter in question should be how to strike a balance rather than eliminate any room for intercreditor discrimination. The loss of flexibility is an inevitable outcome in the introduction of any new institution, whether it is based on contracts or regulation. The same is true of use by sovereign debtors. The potential use of insolvency by a debtor is a problem in any corporate case as well, and there is no system that successfully cures the risk of this type of abuse of power. In this regard, I welcome the clever approach adopted in the Uruguayan case, and I hope this will provide a benchmark for other cases.

There seems to be few credible solutions emerging for aggregation problems despite the extensive search by staff within the existing legislative framework. Collective action clauses under the contractual framework, including those used in the recent bond exchange in Uruguay, are a novelty, but a number of unanswered issues remain, including those regarding aggregation across different issues. J.P. Morgan's two-step proposal is interesting, but it has not yet been tested. Given the lukewarm creditors' response to date to the ABRA, it is difficult to say whether it has a promising future. Besides, the proposal is designed for post-default cases only. The suggestion of using U.S. class action procedures under the existing legislation is also stimulating, but in my view it overstretches the mark. Class action laws are designed for plaintiffs who would have a similar interest, but the aggregation issue is for those who have very diverse, often conflicting interests. It would be difficult to conceive of a case where a court would impose its own decision in the absence of clear rules regarding the acceptability of the terms of a restructuring. One may conceive a case where a significantly large flow of creditors goes to the court with the acquiescence of the sovereign debtor only to seek the auspices of the court, just like a pre-packaged corporate bankruptcy case, but one should note that the key contributing factor to the success of a prepackaged bankruptcy deal is a clear and strong insolvency system, like in the United States.

This leads me to my final point on the validity of the SDRM, as the third chapter of the paper clearly demonstrates. Our chair certainly appreciates the Board's previous finding that there is currently insufficient support for the SDRM. Nevertheless, I hope that the need for a statutory approach will be reconfirmed as the private sector's own efforts to address aggregation continue. On that basis, I support the staff's conclusion that it is not appropriate for the Fund to endorse a particular set of aggregation provisions at this time, but that there is a continuous need for extensive monitoring.

Mr. Alowi made the following statement:

I welcome today's discussion on the aggregation issue in the context of sovereign debt restructuring. While the staff has provided a useful update and analysis, more analysis and further work and research would be needed to address the issues raised by Directors and to provide useful guidance for a way forward.

The staff has correctly pointed out that the key challenge in designing a legal framework that can achieve some degree of aggregation is to find a way to capture the maximum benefit of aggregation while minimizing its risks. While progress has been made in achieving some degree of aggregation under the contractual framework, uncertainties remain regarding the extent to which such approaches reach all sovereign debtors and are acceptable to all investors. Given these uncertainties, risks and challenges, I support the staff's view that it is premature for the Fund to endorse a particular set of aggregation provisions at this time. Nevertheless, the staff should continue to monitor the use and evolution of aggregation provisions and report to the Board on any significant developments.

Mr. Kiekens made the following statement:

I would like to make eight observations. The first is that in order to advance the idea of orderly restructurings further, it will indeed be particularly useful to discuss, in detail, the aggregation of claims.

My second preliminary observation is that publishing today's paper will make a real contribution to the ongoing debate among issuers of debt and their creditors. Good as it is, however, it may be useful to streamline it somewhat, since private market participants cannot always take the time to read 36 pages of carefully drafted phraseology.

The increasing use of the CAC represents a major step forward, and since the aggregation under discussion is a refinement of the aggregation already achieved by the use of CACs, we should view in its proper perspective.

Fourth, it seems to me that, under a contractual approach, aggregation will be promising and feasible only among similar kinds of claims, and not for different kinds of claims. It does not seem realistic to believe that we will see a market-based approach to aggregation of claims that will include bondholders, bilateral public creditors, trade credits, and bank credits.

Fifth, it seems to me that the most promising approach is that used by Uruguay, which has established a trust indenture that in principle will govern all future bonds, at least when confirmed in the subsequent individual bond issues. I think that is a most promising avenue, provided it includes adequate clauses to protect creditors against fraud and other maneuvers inimical to their legitimate interests.

Sixth, the outcome of Argentina's restructuring is certain to be highly relevant to how market practice will evolve in this connection.

Seventh, the two private market participants who spoke at the beginning of our seminar confirmed that the markets have little confidence that the good faith criterion of the Fund for lending into arrears provides real protection against "bad faith" behavior on the part of debtors who accumulate arrears to their private creditors. The perception expressed by market participants at the informal seminar held before the current Board discussion, that the good faith criterion is too vague, and that the Fund is seen as an institution that includes geopolitical considerations in its decision making should seriously concern us. It should not become an excuse for a failure to adhere strictly to the Fund's rules. The Fund's policy of lending into arrears requires that the staff closely monitors the behavior of debtors towards their creditors, and to express reservations whenever they conclude that a debtor's behavior is contrary to best practices and good faith.

As my eighth and last conclusion, let me say that the staff should continue to monitor the evolution of market practices and to promote all those which will improve and facilitate orderly debt restructurings. In my opinion this includes achieving a greater degree of aggregation, probably, as I have said, through the approach used in Uruguay's case.

Mr. Abbing made the following statement:

I welcome the Board's discussion and the comprehensive staff paper, although I was somewhat disappointed that while the paper is rich in information and detail, it does not draw conclusions or proposals, perhaps because it was not originally intended for Board discussion. The current discussion reflects the IMFC mandate as confirmed at the recent annual meetings to follow up on relevant elements of the SDRM. Given this mandate, going forward we should try to be even more ambitious and not just discuss existing suggestions for the contractual approach in technical and legal terms, but also try to generate our own ideas and initiatives to meet the challenges of aggregation and intercreditor equity, instead of just monitoring these developments.

One example is that the paper could have discussed in more detail whether ongoing efforts to promote collective action clauses should also include promotion of Uruguay-style aggregation and nonabuse clauses. Perhaps this runs in all kinds of legal problems, but the possibility could at least have been discussed in the staff paper.

The scope of the paper could have been extended with regard to the debt covered. The analysis focuses primarily on bonds, with or without CACs. Other sorts of debt like syndicated bank loans, but not individual bank loans, and trade credit are briefly referred to, but the staff seems to take the position that it is not necessary to include these in the aggregation discussion. I would be interested to learn whether market participants agree with this assessment and on a more technical level how should debtors deal with claims that are the result of legal rulings in favor of a vulture creditor. The case of a creditor recently acquiring large claims against Argentina seems to be a case in point. Can such judgment claims be included in aggregation?

It seems that in order to have a proper discussion on orderly and timely crisis resolution, the Fund cannot look at the contractual approach in isolation, and analysis of the development of the code of conduct, currently in the realm of the G-20, would also be appropriate. I would be interested to learn if this is forthcoming. On several occasions the staff paper rightly points out that the success of the contractual approach in aggregation, especially in pre-default cases, crucially depends on transparency on the macroeconomic and structural policy intentions of the debtor country and on the existence of an effective and transparent mechanism for resolving disputes. Both these issues are potentially addressed in the code of conduct and monitoring by the Fund of discussions in this area should not interfere with the direct ownership of the code by debtor countries and private creditors.

From the paper, it seems that elements of the statutory approach remain relevant. I would like to reiterate our support for such an approach. While at this stage it does not seem feasible, it would be useful to consider the possibility of introducing a Dispute Resolution Forum in the absence of a general framework. Perhaps rulings by the forum would not themselves be legally binding, but when challenged could be accepted by national courts if such rulings are generally seen as objective and authoritative.

Finally, on the role of the Fund itself, I would also welcome some further reflection, not only regarding the access policy in crisis resolution. This is already in the work program presented by the Managing Director, but further discussion of lending into arrears is also needed given the views expressed by market participants at the informal seminar held prior to our current Board discussion. The potential role of the Fund is highly relevant for debtors and creditors if they are to take decisions whether or not to cooperate.

Mr. Kiekens observed that skepticism from private creditors about the Fund’s lending into arrears policy should be no excuse for the Fund not to take its own decisions seriously. The current policy called on the Fund to follow closely the restructuring negotiations with creditors and to give an opinion about the debtor country’s good faith approach to the negotiations.

Mr. Kanaan made the following statement:

The thorough paper produced by the staff, irrespective of its policy implications or its ultimate policy impact, is of important analytical value in its own right, as it puts into perspective the potential benefits and risks of aggregating creditor claims across different instruments for voting purposes.

We would like to associate ourselves with the points made by Messrs. Portugal and Tombini in their preliminary statement. In light of the potential risks of aggregation, and the fact that we still have very limited knowledge about how markets will react to the introduction of aggregation provisions, it is important for the staff not to push for the inclusion of aggregation provisions of any sort, and for the Fund to maintain a hands-off approach and allow debtors and creditors to agree on contractual clauses without endorsement from the Fund of any particular type of provisions.

It is important to bear in mind that in the case of Uruguay, a limited form of aggregation was introduced into the recent bond issuance as an outcome of unfettered negotiations between the country and creditors, without any influence from the Fund and its staff (Mr. Hagan may wish to confirm this). We also share Ms. Jacklin's view that market innovation and experimentation to resolve sovereign debt difficulties more efficiently should be welcomed, as in the case of Uruguay, but that an assessment of the merits of incorporating aggregation provisions will need to be based on the experience of other countries in experimenting with such provisions under a wide variety of circumstances. As noted by several Directors, the merits of aggregation depend on several key factors, including the weight of the shares of retail investors as opposed to institutional investors, the rules applied for the homogenization of claims, and whether the aggregation occurs in a pre-crisis or post-crisis context. The case of Uruguay is too recent to allow us to assess the merits of introducing aggregation clauses, notwithstanding the update received earlier from staff that additional bonds were issued using the same limited aggregation clauses as those used in earlier bonds.

Ms. Jacklin made an important point that even the adoption of CACs in general should still be viewed as a work in progress or as a learning-by-doing process. As mentioned by Mr. Kiekens, aggregation of claims could be viewed as a refinement of CACs. In that sense, it is important for staff, in its monitoring of CACs, not to place undue weight on cases where aggregation provisions are used, but to monitor more broadly the use of CACs, including those that do not necessarily include aggregation provisions but which nevertheless could help in pointing to other potentially useful refinements.

Ms. Stuart made the following statement:

I just have six points to make. First, this was a thorough paper and we continue to see aggregation as an important issue for reducing intercreditor coordination problems and holdouts, achieving a more orderly and predictable process that minimizes costs for debtors and creditors and, where restructuring is unavoidable, helping to achieve a sufficiently comprehensive treatment to achieve a sustainable debt position.

Second, we agree with Mr. Padoan that it would be helpful to set out areas that are going to be most fruitful for further investigation.

Third, continuing to press the use of CACs is important. We also think that trust deeds help address holdout problems.

Fourth, the Uruguay example does show that potential problems of discrimination and abuse by the debtor can be addressed in a contractual approach.

Fifth, an important aspect of the SDRM was the Dispute Resolution Forum, which could help with debtor/creditor problems, as well as helping with intercreditor problems. It could be useful to consider ways of further promoting a Dispute Resolution Forum, not necessarily with the Fund at its center, and to think about ways that would fall short of the statutory approach.

Finally, I would appreciate staff's comments on the risk that the dynamics of holdouts could be shifting. There could be a problem of people going for earlier litigation, and we have a concern that we could end up with two classes of creditors, one class of judgment creditors and the rest, with judgment creditors treated as senior. This is something that needs to be seriously considered and monitored.

Mr. Boitreaud made the following statement:

Like other Directors, I have found the seminar to be very instructive. It was an excellent idea to invite private sector experts to speak at out informal seminar held prior to our formal Board discussion. Regarding the staff's paper, it is comprehensive and fully in line with the recommendation of the IMFC to continue analyzing issues raised in the context of the SDRM discussion.

As I very much share the ideas expressed by Mr. Padoan in his preliminary statement, I will only make two comments. First, we appreciate that the staff paper embraces aggregation under both contractual and statutory frameworks, as we continue to believe, like Mr. Bischofberger and other Directors, that both approaches can contribute to improve sovereign debt management.

Second, the ongoing progress in achieving some aggregation certainly has to be monitored by the Fund, and the present staff paper is useful in this regard. We expect that the staff will report on developments in the Uruguayan recent issuance, the Argentine Bond Restructuring Agency, and other possible initiatives like the J.P. Morgan two-step approach. But beyond monitoring, the Fund should also provide some encouragement. While we agree with the staff that the Fund is not in a position to endorse a particular set of aggregation provisions at this time, we believe that it has a general guidance role to play on these issues, and a clear positive stance of the Fund can indeed contribute to create incentives for collective action. More generally, we concur with Mr. Padoan and others that a clear perception of the role of the Fund in crisis prevention and resolution, including of course the application of its access policy, is a condition to enhance the framework of sovereign debt restructuring.

Finally, like many other Directors, and in particular Mr. Abbing, we regret the lack of strong conclusions in the paper. At the same time, we understand the reasons why there is not a strong conclusion. Other relevant issues are also worth putting on the work table. Therefore, we really encourage the staff to forge and share their own opinion on these issues with the Board.

Mr. Padoan made the following additional statement:

I found the seminar to be very useful, and I regret that the format of this seminar, combining an informal seminar with the participation of market representatives with our formal Board discussion, was not used earlier on in our discussion on crisis resolution issues. We could have had useful inputs if this format had been adopted earlier.

On publication, as already indicated by Mr. Kiekens, this would be very helpful in keeping the discussion going in the months ahead. In that respect, I wonder whether some effort could be done in streamlining the paper which is very rich. I trust that the drafting and editing abilities of the staff will result in a good product, but I wonder about the extent to which some inputs from the current seminar could be taken on board. The views of market participants expressed at the informal seminar held prior to our current Board discussion were very interesting, especially as we are all in uncharted territory on aggregation issues, and the perception of market participants on the relevance of possible issues for discussion at the Board would be very helpful in guiding our future discussions.

On the lending into arrears policy, the skepticism expressed by market participants on the Fund's good faith criterion is a cause for serious concern for two reasons. First, this might be a failure in the external communication of the Fund's policies. Second, if it is true that markets perceive that policy as ineffective or irrelevant, whenever the Fund goes on forward with that principle as part of our crisis resolution policies, that might be diminishing or even damaging the effectiveness of those policies. The Board and management should consider, as experience develops with its implementation, how that criterion could be strengthened.

Mr. Costa made the following statement:

We thank the staff for a thorough analysis of the many factors impinging on the aggregation of claims in the restructuring of sovereign debt and the market participants that took part in the informal seminar held before our current Board discussion. Perhaps this format could also be used in the assessment of other areas of critical importance for the institution such as the world economic outlook and the global financial developments. From the outset, it is our view, that the benefits of aggregation of different creditor claims, particularly in overcoming collective action problems far outweigh its potential risks, such as inter-creditor discrimination and the possibility of manipulation by the sovereign debtor. While sharing the overall conclusion that it is not appropriate for the Fund to endorse a particular set of aggregation provisions at this time, we encourage the staff to continue closely monitoring the use and evolution of aggregation provisions in the realization that it will contribute to make the restructuring of unsustainable sovereign debt more orderly, predictable and rapid.

Given the insufficient support for the establishment of a SDRM framework there is, in fact, no other way at present to approach the claims aggregation issue, except through a voluntary or contractual approach. We are pleased to note that this latter approach has proven so far to be quite effective. Despite initial skepticism about the acceptability of CACs, the staff paper highlights that already one third of the existing stock of international sovereign bonds has collective action clauses, including in most of the new issues of emerging market sovereigns. It is also remarkable that no significant premium for the inclusion of such clauses has been found. All of this augurs well for a sustained progress of the contractual approach. It is also important to note that the potential risks associated with aggregation provisions such as inter-creditor discrimination and debtors' manipulation are not specific to the contractual approach but they are also present in the SDRM framework. Perhaps the document could have benefited from a more explicit discussion of this point.

The staff points out that, even a widespread use of CACs—in their conventional types of majority restructuring provisions and majority enforcement provisions—would fall short of what is needed to reach an orderly restructuring since it would still be possible for a creditor or a group of creditors to obtain a "blocking position" in one or more issuances which can undermine the likelihood of a successful restructuring. An obvious avenue to overcome this problem is to expand the scope of CACs through the introduction of an aggregation provision that extends the effects of the restructuring and enforcement provisions to the whole of the sovereign bonds as it was done under the "trust indenture" restructuring, which was concluded very successfully by Uruguay recently.

The staff document also provides a useful analysis of the several initiatives in place to address the need for aggregation provisions. Two of them, such as J.P. Morgan two-steps and the class action procedures are at the stage of only proposals, although it is interesting to note that there was an attempt at implementing the latter in a New York court for the Argentine debt but was dismissed by the sheer size of the undertaking. We were left wondering, however, if this can be considered a sufficient reason. As to the J.P. Morgan proposal, it is not clear what are the incentives, or where the funding for the incentives could come from, for creditors to enter into step one and exchange their bonds for a paper whose value is totally uncertain.

Two others initiatives analyzed by the paper, the ABRA in the case of the Argentine restructuring, and the trust indenture governed by New York law in the case of Uruguay have already being implemented, although in fact only the Uruguayan experience is the relevant one, since ABRA is in the formation stage and remains to be seen how effective or successful it will become. The fact that the Argentine authorities have already committed to afford equal treatment to all creditors empties the ABRA initiative of some of its benefits. Other factors, as the costs involved for creditors and the penalties for early withdrawal may also have an impact, as highlighted by the staff.

The Uruguayan experience, on the other hand, can be considered as the most promising development in this area of claims aggregation. The fact that it has been implemented under a fully contractual framework adds hope to the expectation that this approach can bring about an effective and substantial progress in facilitating more orderly and predictable debt restructuring procedures when needed. In addition, the Uruguayan experience has specifically addressed some of the potential risks of the aggregation process, including those related to debtor manipulation, such as the need for Uruguay to affirmatively certify in future restructuring the amount of bonds owned or controlled by the government and the commitment to avoid resorting to coercive exit consent clauses that could make the current bonds less attractive than the bonds to be offered in an eventual future exchange. The Uruguayan case serves to prove therefore that, at least some of the risks of aggregation mentioned in the paper can be readily addressed under the appropriate framework. In any event, we wonder how significant the manipulation risk alluded to in the staff document may actually be in practice. It is difficult to imagine governments going to that length, or even being legally able to manipulate debt issuance to influence the results of a debt restructuring. Staff comments would be welcome.

As to the other important risk highlighted by the staff document, the one related to inter-creditor discrimination focused on the different maturities of bonds held by different creditors and the potential for unequal treatment to those holding shorter maturities, we believe that this risk has been somewhat overstated in the document, since it only applies to a pre-default scenario. This fact is not always made explicit in the document thus creating the possibility for some confusion. Moreover, as the document itself acknowledges in the discussion of the SDRM framework, even under a pre-default scenario is quite likely that creditors in general, including those holding short-term debt can come to the conclusion that agreeing on uniform terms or a menu of options for a restructuring is the safest way to protect their interests, since for all practical purposes the circumstances are such as if all claims would have been already accelerated. The fact that activation of the SDRM framework would require a formal declaration of unsustainability does not make much of a difference vis-à-vis a contractual framework since a debtor country will most likely not enter into a restructuring exercise unless it feels impelled to do so, given its costs, as was repeatedly proven in recent experiences. Moreover, the aggregation provisions of the Uruguayan case were implemented in a scenario that might not fit the strict characterization of a pre-default, given the assertions of debt sustainability. Thus, the risk of inter-creditor discrimination did not appear to represent any significant difficulty. Staff comments would be welcome.

Mr. Zurbrügg made the following statement:

Just a few brief comments. First, I very much appreciated the presence of two external experts for today's discussion. Creating something similar to congressional hearings is very appropriate on issues, such as the one before us today. I hope we will use such opportunities more frequently in the future.

Second, it was quite striking to see the two experts stress two different issues of the complex problem of sovereign debt restructuring. The banker participating at the informal seminar held before the current Board discussion strongly stressed the risk of abuse by debtors of a framework which would include aggregation clauses. On the other hand, the lawyer participating in the discussion stressed the problem of holdouts. I tend to side with the lawyer's view, but this shows once more how different the concerns are of the various participants in this process. A successful framework will need to adequately address these issues, particularly in light of the comments of market participants at the informal seminar on the limited role of the Fund's "good-faith criterion". Markets appear to see the Fund as driven by geopolitical concerns and, thereby, deemed unable to be unbiased.

Third, is aggregation a problem? While there seems to be different views on this fundamental question, the fact stressed by the experts and Ms. Jacklin that the market is generating new ideas and trying to find innovative approaches to resolving sovereign debt difficulties more efficiently, would indicate a yes. Is aggregation only a refinement of CACs, as stated by some speakers? I do not think so. The increasing number and variety of outstanding bond instruments will make future debt restructurings more complex. The positive historical experience will be of the limited value and CACs might not suffice. Aggregation is an important issue, and work in this area should thus continue, both on the contractual as well as the statutory approach. If we assume that the unexpected recent progress in the use of CACs in sovereign bond issues is mainly due to the Fund's development of an SDRM, may I suggest that you warm up the issue once again to get similar results in the area of aggregation clauses.

More seriously, the different proposals for aggregation under the contractual approach all have severe weaknesses. I agree that it is too early to endorse a particular set of aggregation provisions at this time. As to the statutory approach, I agree with Mr. Padoan that it would be useful to refine the proposal in such areas as aggregation, particularly the creation of creditor classes and their aggregation. It might also be necessary to revisit to problem of different maturities. On the one hand, there is a good chance that sooner or later—maybe under the experience of the forthcoming Argentina restructuring—the SDRM will be back on the table. On the other hand, as noted by staff, work on the statutory approach has helped identify a number of problems and the features of a statutory framework provide a useful reference for the range of issues to be addressed.

Ms. Jacklin considered that the different views expressed by market participants taking part in the informal seminar held prior to the current Board discussion regarding the key risks facing sovereign debt restructurings reflected the different groups that they were representing. The banker representing the creditor community had stressed the risk of abuse of aggregation clauses by debtors, whereas the lawyer representing issuers had stressed the holdout problem.

More generally, Ms. Jacklin joined other Directors in welcoming the innovative format of the current Board discussion including the prior informal seminar, which allowed for a more candid and open discussion with outside experts on aggregation.

Mr. Tombini made the following additional statement:

I have a couple of requests for modifications in light of the intention to publish the staff paper following this Board discussion. Box 2 on page 20 is very illustrative, but I would prefer not to have countries mentioned, other than Uruguay and perhaps Mexico if the relevant chairs have no objections about that. I would not like to see Brazil mentioned in the second row of the table.

Still on Box 2, it is interesting to note that the impact of lowering the threshold from 85 to 75 percent in simulations was to add only 0.3 percent to the coverage of the restructuring, that is $11 million out of $3.5 billion. That reminds me of the agreement reached at the Board when discussing CACs, that the Fund should not be seen as endorsing any specific type of majority restructuring clauses. However, the paper gives the impression that a 75 percent threshold is in some way the typical or traditional threshold. In this regard, I would suggest that the language be adjusted, specifically in paragraphs 11 and 53, to avoid giving the impression that the Fund is endorsing a specific majority restructuring clause.

Mr. Kiekens recalled that he had urged the Fund at the last Board discussion on CACs to voice concerns about the use of majority threshold levels that may impede the effectiveness of CACs. If Mr. Tombini's suggestion to strike out the reference to Brazil as the leading country using 85 percent majority voting thresholds was an indication that Brazil intended to start using the 75 percent threshold, that would indeed be a welcome development.

Mr. Palei made the following statement:

> I would like to thank the staff for a carefully crafted paper, Ms. Jacklin for proposing to discuss it on the Board, and management for adapting the format of the seminar by inviting the two distinguished guests. Like several other speakers, I found this format to be very useful and hope that it will become a standard tool in the Fund's arsenal, especially when the Fund is handling challenging issues that cannot be effectively addressed without meaningful input from outside experts.
>
> We are generally satisfied with the pace of the CACs' introduction and note the creative solutions proposed and implemented by the sovereign debtors and their creditors in specific country circumstances. Given this progress, we find the absence of the "firm" conclusions and the "soft" approach in the paper quite appropriate. I hope that the publication of the staff paper will further stimulate broader discussion on the CACs, aggregation and other issues central for the sovereign debt restructuring.

Mr. Kruger noted that some Directors had stressed their disappointment at the lack of stronger conclusions or policy recommendations in the staff paper, while other Directors had strongly welcomed the conclusion that the staff should not endorse a particular set of aggregation provisions. In terms of redrafting the paper, an adequate balance would probably be to outline the general principles of aggregation without endorsing any specific provisions, in line with the approach taken in the discussion on CACs.

The Deputy General Counsel (Mr. Hagan), made the following statement:

> I learned a lot from the comments given by private sector participants at the informal seminar held prior to the current Board discussion, and I am glad that the Board enjoyed this combined format for the discussion on aggregation.
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> Regarding the concerns that the conclusion could have been more muscular and prescriptive, this should not be misinterpreted as staff ambivalence on what is perceived as the costs and benefits of aggregation. It is our continued belief that the SDRM provides an effective framework for capturing the benefits while minimizing the risks of aggregation. I agree with Mr. Cho that the risks can never be eliminated. The question is whether or not they can be effectively minimized, and the SDRM continues to be the optimal mechanism in this regard.

In terms of the question raised by Mr. Kruger on the costs of CACs and their absence in Uruguay, this reflects a more general philosophical issue. The cost of having CACs is not an abrogation of rights because creditors purchase that limitation of rights, as these are known to them when they decide to purchase the bond. Presumably they decide to buy the bond despite the fact that it constrains them individually because on balance the value of their rights increases if there is a restructuring as the restructuring becomes more orderly. Mr. Buchheit wrote an interesting article called "Sovereign Bonds and the Collective Will", where he demonstrates the origins of CACs in the U.K. in the 19th century, when creditors got together and came up with an alternative to liquidations, which were not giving them efficient recovery values.

The issue of the cost of not having CACs or a collective action framework is interesting. The worst case scenario is likely not litigation, but the possibility that the holdout problem becomes so severe that a deal is not reached, as creditors perceive that the value of holding out is increasing to such an extent that they opt not go into the deal. This is not just a question of creditors' own judgment, as those that manage other people's funds will be concerned about their own legal liability if they accept a deal while others get preferential treatment.

This brings us to the question of judgment creditors, which is important because if creditors are obtaining favorable judgments, they are signaling pretty strongly that they are not going to be participating in the deal. To the extent to which they are getting significant judgments—as unfortunately is the case with Mr. Dart whose judgment is $700 million—that attracts considerable attention in the market. Building on Mr. Padoan's concept of a ranking of frameworks, the question is what framework will be better able to stop that from happening. CACs will typically not work in that case because it is our understanding that Mr. Dart was able to get a controlling interest in the bond issuance, and that would neutralize any majority enforcement provisions that would have stopped him from getting a judgment. Aggregation in a contractual context could potentially minimize that problem, but a majority restructuring provision is not effective after a judgment has been obtained, as contractual terms cannot modify a judgment creditor's claim. The judgment creditor's claim is reduced to the judgment, it is moved outside the contract framework. The SDRM is more effective because it would bind judgment creditors along with contractual creditors. Directors may remember that in the discussion about the possibility of an automatic stay under the SDRM the staff sustained that one of the most powerful tools of the SDRM in terms of addressing litigation was its ability to bind judgment creditors.

Several questions arose on the issue of trust deeds, which is an important question. In response to Mr. Kruger's question, we believe in trust deeds as one of the most important limitations on vulture enforcement in the context of CACs because of the de facto sharing provision. We are more ambivalent on the extent to which the Uruguay approach of having a master agreement should be the model. While the staff has expressed a preference for the approach of having CACs in a master agreement, it is still premature to bless trust indentures as the way forward because markets are still evolving. A fiscal agency agreement might work just as well. This would address the concern raised by Mr. Yagi as to whether a master agreement framework could be used in countries with civil law jurisdictions that do not necessarily give effect to the divided ownership concepts that underline trust structures. The answer is that they could also be used in those countries.

Just one final response to Mr. Kanaan. We can confirm that in the case of Uruguay the aggregation feature was spontaneously generated by the debtor and its underwriters, and not specifically advised by the Fund. We were consulted and we were interested to see how it would be designed and whether it would be successful, and we are very pleased that it has been as successful as it has been.

The staff representative from the Policy Development and Review Department (Mr. Fisher), made the following statement:

Ms. Stuart asked whether the dynamics of litigation have changed. There was one big change in the world a few years ago when Ecuador used exit consents for the first time in the sovereign context. That did slightly alter the incentives, because it may have encouraged creditors holding distress claims to obtain judgment, and thereby protect themselves from the use of exit consents.

In the case of Argentina there are perhaps two other factors that may to some extent have altered the incentives, but it is difficult to quantify this. One is a significant proportion of debt governed by German law, as those bonds do not allow for exit consents. Creditors holding other bonds who obtain judgments, would rank pari passu with German bonds. The other, which is based on market commentaries, is the authorities' announcement that they do not plan to make any payments in respect of past due interest. This, it has been argued in the market, increased the incentives for litigation because the judgment freezes and recognizes past due interest.

On the code of conduct, aggregation has not been a feature in the discussions to date. These have tended to revolve more around transparency, nature of dialogue, negotiation, provision of confidential information, and other things of that nature. We will be reporting to the Board on developments in discussions on the code in the progress report, and in the event that a consensus emerges in the G-20, we will report on that separately to the Board.

> There has been a long discussion about whether we have overstated the questions of the risk of holdouts. We will learn a lot from what happens in the next few months with Argentina, but even if that goes well, as we hope it will, we should not draw the conclusion that there is no problem. There would be no problem had Argentina been able to get a preemptive restructuring and preserved its banking system in the fall of 2001. It was the fear of holdouts based on advice given to the authorities by their legal and financial private sector advisors that led the authorities to be concerned about that.
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> Finally, Mr. Costa asked about the counterparts to institutional investors that have offloaded their bonds. Inevitably, given the nature of the market, it is difficult to be sure about that, but it seems like the dedicated investors that got out, and there are a number of them publicly saying that they got out, sold to investors with appetite for high risk, high yield, distressed debt. Some of these are funds that pride themselves on being very savvy and able to do deals which they see as profitable, and there is a spectrum going through to those who specialize in litigation as a way of extracting salvage value. We simply do not know where the balance is.

The Acting Chair (Ms. Krueger) thanked Directors and the staff for a broad ranging discussion and informed that no concluding remarks would be prepared for the current Board discussion, given the still early stages of thinking in the market and the Fund about the feasibility and desirability of various aggregation provisions. The paper to be published would be an important contribution to the discussion on aggregation issues, and its executive summary would be expanded in an effort to take into account some of the concerns raised by Directors about the length of an otherwise excellent paper. The Fund would continue to monitor closely the evolving practice and thinking in the marketplace on the subject of aggregation and the Board would have an opportunity to discuss this topic in the future in light of further work and experience on this subject. Directors would have an opportunity to reiterate their suggestions on ways to move forward in the area in the context of the upcoming Board discussion on the work program.

SHAILENDRA J. ANJARIA
Secretary