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September 20, 2005

To: Members of the Executive Board

From: The Secretary

Subject: **Progress Report on Crisis Resolution**

Attached for the **information** of Executive Directors is a revised version of the Progress Report on Crisis Resolution (SM/05/342, 9/2/05), which takes into account comments made by Executive Directors at EBM/05/80 (9/16/05). A redlined version of the revised document is also attached for the convenience of Executive Directors.

Following circulation of the report to the IMFC, the summary of the Concluding Remarks from the recent Board discussions on managing systemic banking crises in the context of sovereign debt restructuring (Section VII) will be deleted from the published version of the progress report, and paragraphs 3 and 4 modified accordingly.

Questions may be referred to Mr. Mecagni, PDR (ext. 38202), Mr. Laryea, LEG (ext. 37794), and Mr. Medeiros, ICM (ext. 36348).

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INTERNATIONAL MONETARY FUND

Progress Report on Crisis Resolution

Prepared by Policy Development and Review, International Capital Markets, and Legal Departments
In consultation with other Departments

Approved by Gerd Häusler, Mark Allen, and Sean Hagan

September 20, 2005

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I. Introduction

1. **In its recent Communiqué, the International Monetary and Financial Committee (IMFC) considered progress on crisis resolution initiatives**.[1] It welcomed the increased inclusion of collective action clauses (CACs) in international sovereign bonds, and called on the Fund to continue to promote progress in this area. It also noted the "Principles for Stable Capital Flows and Fair Debt Restructuring in Emerging Markets" (henceforth, the “Principles”) developed by a number of sovereign issuers and the investor community, and encouraged further efforts to improve the Principles aimed at achieving a broad consensus. The IMFC looked forward to further work on the orderly resolution of financial crises, including the implementation of the Fund’s lending into arrears (LIA) policy.

2. **A number of countries have continued the process of restructuring their sovereign debt and several have secured agreements with their private creditors**. This has occurred, in some cases, as part of a comprehensive debt restructuring strategy following earlier agreements with the Paris Club to reschedule official debt. In a separate development, a number of countries have prepaid portions of their Paris Club debt under the Club’s new framework for early repayments.

3. **The Executive Board considered two staff papers on issues related to the orderly resolution of financial crises**. The first paper assessed the determinants and prospects for the pace of market access by countries emerging from crisis. A second staff paper provided a preliminary discussion of the difficult policy challenges members face when banking system distress is associated with a sovereign debt crisis.[2]

4. **This report focuses on these crisis resolution issues**. Section II describes progress in the inclusion of CACs in international sovereign bonds. Section III provides an update of efforts to broaden the consensus on the Principles. Section IV reports on developments in recent sovereign debt restructuring cases. Section V discusses progress in the Evian Approach and other Paris Club issues. Sections VI and VII provide summaries of the aforementioned papers on the determinants and prospects for regaining market access and managing systemic banking crises in the context of sovereign debt restructuring.

II. Collective Action Clauses

5. **Since the last progress report in March 2005, with one exception, all newly issued international sovereign bonds have included CACs that are broadly in line with**

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[1] *Communiqué of the International Monetary and Financial Committee of the Board of Governors of the International Monetary Fund*, Washington, April 16, 2005.

[2] See *Assessing the Determinants and Prospects for the Pace of Market Access by Countries Emerging from Crisis—Further Considerations* (SM/05/76, 3/2/05) and *Managing Systemic Banking Crises in the Context of Sovereign Debt Restructurings* (SM/05/249, 7/1/05).

the G-10 recommendations.[3] As to New York law-governed issues, this reflects the newly established market practice of including CACs in bonds in that jurisdiction.[4] The only country that did not include CACs in its New York law-governed bond was Jamaica. International sovereign bonds governed by English and Japanese laws have continued the existing practice of including such provisions (Appendix, Table 1).[5] There were no issues under German law.[6] To date, the inclusion of CACs has not had any observable impact on bond pricing (Appendix, Figure 1).

6. **As a result, the outstanding stock of emerging market sovereign bonds that include CACs has increased** from approximately 31 percent at end-2002, in value terms, to approximately 53 percent as of end-June 2005(Appendix, Table 2 and Figure 2). Importantly, recent sovereign debt exchanges have replaced a large volume of bonds that did not include CACs with bonds that included these clauses. Correspondingly, this increase reflected a rather even pattern of growth of bonds with CACs across regions (Appendix, Table 3).

7. **Staff has continued to take a proactive role in promoting the inclusion of CACs in international sovereign bonds**. In particular, staff continues to maintain an active dialogue with private market participants and debt managers from a number of emerging market countries, including through the Forum for Public Debt Managers, and to encourage the use of CACs both in the context of the use of Fund resources and the Fund's surveillance activities.

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[3] See *Review of G-10 Working Group on Contractual Clauses,* 9/26/02, www.bis.org/publ/gten08.htm, and *Acting Chair's Summing Up: Collective Action Clauses—Recent Developments and Issues* (BUFF/03/52, 4/10/03).

[4] Fourteen countries issued bonds under New York law including CACs: Argentina, Brazil, Colombia, the Dominican Republic, El Salvador, Indonesia, Italy, Lebanon, Mexico, Peru, the Philippines, Turkey, Uruguay, and Venezuela. The Lebanon bonds include only majority restructuring provisions. See Appendix Table 4 for a detailed description of CACs contained in New York law-governed bonds issued since March 2005, and a comparison of these provisions with the G-10 recommendations.

[5] Seven countries issued bonds under English law: Austria, the Czech Republic, Hungary, Poland, Spain, Sweden, and Tunisia; and three countries issued under Japanese law: Hungary, Poland, and Thailand. Hungary continued to include an engagement clause in its English law governed bonds which allows bondholders with at least 50 percent of outstanding principal to appoint "any persons as a committee to represent the interests" of bondholders in the event of a default or acceleration or following any public announcement by the issuer of a restructuring.

[6] Bonds governed by German law have not included CACs. Legal questions have been raised as to whether the inclusion of CACs in international sovereign bonds governed by German law could be voided by individual bondholders based on consumer protection law. Notably, on June 28, 2005, the German Supreme Court substantially resolved this question in holding that commercial bonds are not subject to certain consumer protection provisions in the German Civil Code. Following the general elections scheduled for September 2005, legislation is expected to be adopted, which will, inter alia, codify the legality of the inclusion of CACs in bonds and set out the limitations for their application (e.g. in terms of required minimum majorities).

III. Principles for Stable Capital Flows and Fair Debt Restructuring in Emerging Markets[7]

8. **Efforts have been made by the Institute of International Finance (IIF) to broaden the consensus on the Principles among emerging market issuers and private sector creditors**. Staff from the IIF has conducted briefings in major financial centers aimed at advancing awareness and developing a better understanding of the Principles. The IIF reports that about 30 countries have expressed support for the Principles. In addition, senior private sector leaders are exchanging views on how best to effectively integrate the Principles within firms' day-to-day practices.

9. **Discussions among emerging market issuers and private sector creditors on a process for implementing the Principles are unfolding**. The IIF has proposed a three-tier process for monitoring implementation of the Principles, which remains the subject of discussion among stakeholders, including emerging marker issuers and private sector participants. Fund staff has not been involved in these discussions.

- The implementation process envisaged by the IIF would have four main functions: (i) to identify circumstances where early course correction in specific cases could prevent crises from unfolding; (ii) to offer guidance for the restructuring process in cases where debt restructuring is needed; (iii) to evaluate the overall effectiveness of the Principles, including whether the right balance has been achieved between providing sufficient guidance and allowing flexibility; and (iv) to ensure the continued relevance of the Principles in light of changing characteristics of international capital and credit markets.

- The three tiers suggested by the IIF include:

    - *Technical Work (Tier One)*. An analysis of the Principles' implementation by key emerging market issuers and creditors would be undertaken, based on the IIF's ongoing work on emerging market countries. This is envisaged to involve close consultation with the marketplace and, in selected circumstances, country authorities. Trends in international capital markets as they pertain to the Principles will also be examined.

    - *Principles Consultative Group (PCG) (Tier Two)*. Based on the technical work undertaken in Tier 1, the PCG—comprised of emerging market officials and market participants—would consider specific country circumstances with a view to providing suggestions to authorities and creditors on how better to align their policies and/or actions with the expectations set out in the Principles. The PCG would also review general market trends to help advise the Trustees (see below) whether the Principles remain relevant or require amendment. All parties involved in the discussions would adhere to a code of conduct to ensure confidentiality.

[7] The section is based on information provided by the Institute for International Finance. The Principles can be found at http://www.iif.com/data/public/principles-final_0305.pdf.

- *Group of Trustees (Tier Three)*. The Group of Trustees—comprising senior officials and senior representatives of the financial industry—would provide overall guidance on the implementation of the Principles, with the aim of ensuring the legitimacy and objectivity of the review process. The Trustee Group's role would include reviewing development of the Principles*,* including their implementation, and modifying the Principles*,* if needed. It is anticipated that the Trustees would not be involved in specific cases except in exceptional circumstances. Individual countries or market participants could consider seeking the guidance of the Trustees individually or as a group on a confidential basis.

10. **Staff will continue to monitor developments in broadening the consensus on the Principles and in their implementation, and will report on these issues as more concrete details emerge**.

IV. Update of Recent Debt Restructuring Cases

11. **Since March 2005, progress has continued in a number of sovereign debt restructuring cases.** More generally, countries seeking debt restructurings have also put in place supporting macroeconomic and structural reform policies. This section provides an update of these cases (see Appendix, Table 5 for selected debt indicators for these countries).

Argentina

12. **Argentina concluded its global debt exchange on June 10, 2005, after some delays related to court proceedings in New York.** Settlement of the debt exchange, initially scheduled for April 1, was delayed due to attempts by some nonparticipating creditors to attach bonds tendered in the exchange. However, following the appeals court's affirmation of the lower court's decision to vacate the initial attachment orders, settlement of the debt exchange was finally initiated on June 2, and completed on June 10.[8]

13. **In settling the debt exchange, the authorities issued US$35.2 billion in new bonds,** comprising US$15 billion of par bonds, US$11.9 billion of discount bonds and US$8.3 billion of quasi par bonds. Upon settlement, eleven new bonds were issued—the par and discount bonds are denominated in pesos, U.S. dollars (under both Argentine and New York laws), euros, and yen, and the quasi par bonds are denominated only in pesos (Appendix, Table 6). Each new bond has GDP-linked securities attached to it that will be eligible to trade independently after November 29, 2005.[9] The new bonds, other than those governed by Argentine law, were issued under a trust structure and include CACs with an

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[8] The US Court of Appeals for the Second Circuit held on May 13, 2005 that the lower court "acted within its discretionary authority to vacate the remedies in order to avoid a substantial risk to the successful conclusion of the debt restructuring. That restructuring is obviously of critical importance to the economic health of a nation. We conclude that it is unnecessary to rule definitively on any of the legal issues disputed by the parties."

[9] A "when-and-if market" for the GDP-linked securities has emerged where forward trades can be made and delivered after November 29. Trading prices in this market indicate a value for the GDP-linked securities ranging from 2.5 cents to 4 cents (per dollar of nominal value).

aggregate voting feature. Two of the three major credit rating agencies raised Argentina's long-term foreign currency issuer rating to the lowest "B" category in June, and applied this rating to the newly issued bonds. On June 30, JP Morgan rebalanced its family of EMBI indices to include the new U.S. dollar par and discount bonds (governed by New York law) while dropping all of the defaulted bonds from the indices. As a result of the rebalancing, spreads on Argentina's external debt fell immediately from over 6000 basis points to 462 basis points.

14. **Argentina's debt exchange constitutes an important step toward normalizing relations with creditors, and has facilitated domestic market reaccess.** With 76 percent participation in the exchange, Argentina's debt structure and debt-service profile have improved significantly.[10] In early May, the authorities regained domestic market access for the first time since mid-2001 with the issuance of a AR$1 billion (about US$347 million) peso-denominated inflation-indexed bond maturing in 2014. This was followed by two other domestic market placements of AR$1 billion each of the same bond in early July, and two domestic issuances of a dollar-denominated bond maturing in 2012 in late July (US$442 million) and early August (US$350 million).[11] Demand for the domestic issues was supported by abundant liquidity in local and international markets, and regulatory changes allowing both local banks and pension funds to increase their exposure to government securities.

15. **Notwithstanding the debt restructuring, there are still unresolved principal claims amounting to almost US$20 billion**. The April 2005 IMFC Communiqué called on Argentina to formulate a forward-looking strategy to resolve the remaining arrears to private creditors consistent with the Fund's LIA policy.

The Dominican Republic

16. **The Dominican Republic embarked on an economic adjustment program supported by a Stand-by Arrangement in early 2005.** The financing strategy of the program aimed at eliminating the residual financing needs during 2005–06 through a debt exchange offer encompassing non-Brady foreign-currency denominated bonds, a rescheduling of external private banks loans and suppliers' credits, credit from Venezuela to finance oil imports, and support from the IDB and the World Bank. The successful completion of the private debt restructurings was also a means to fulfill the Dominican Republic's commitment to seek comparable treatment from private creditors as called for in its April 2004 agreement with the Paris Club. The Dominican Republic launched its debt

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[10] The federal debt stock has declined from about 147 percent of GDP in 2002 to an estimated 84 percent of GDP in 2005 (including unrestructured debt). About 37 percent of the federal government debt stock is denominated in pesos, a sizable increase from 3 percent before the restructuring. At the same time, payment on the restructured debt for the first ten years entails about 3 percent of GDP in savings compared to before the restructuring.

[11] The domestic bonds were issued at a discount so that total net financing raised amounted to US$1.5 billion, about US$283 million less than indicated by the aggregate face value of the bonds. Separately, Argentina has also directly placed some US$500 million of the Boden 2012 with the Venezuelan government.

exchange offer on April 20, 2005, stipulating that two bonds were eligible for the exchange (see Box 1 for a summary of the key terms of the offer).[12]

17. **The Dominican Republic maintained a market-friendly approach to the debt restructuring.** The authorities sought to involve bondholders through an informal consultation process on the terms of the exchange offer. They held road shows in New York and London in late 2004, while conducting meetings with key investors at the same time and immediately prior to the launch. In this context, market participants considered as the main incentive to participate in the offer the potential upside on the new bonds resulting from the improvement in the country's capacity to pay and the reduction in the rollover risk. They also viewed favorably the minimal initial net present value (NPV) losses, amounting to only one percent when discounted at the implicit exit yield of 10 percent, that would result from accepting the offer.

18. **The debt exchange was completed on May 11, 2005, with high participation**. The tendering principal reached US$1.03 billion, representing nearly 94 percent of eligible bonds, and exceeding the minimum participation threshold of 85 percent. The offer was reopened in July with a view to achieving further cash-flow relief. An additional US$36.5 million of principal was tendered, representing 52 percent of the bonds that had not entered the original exchange, and as a result, the overall participation rate increased to 97 percent. The offer provided significant cash-flow relief of US$576 million for the government during 2005–06, and resulted in an increase in the maturity profile of the debt by five years. Spreads on the new bonds have declined by over 130 basis points since mid-May, clearly outperforming the overall market.

19. **In June, the Dominican Republic also reached an agreement with commercial banks to reschedule about US$200 million in principal falling due in 2005–06**. The agreement established (i) a two-year grace period and a three-year repayment period; (ii) a reduction in the average interest rate of the restructured loans of around 2 percentage points; and (iii) the repayment of about US$35 million in arrears accumulated through end-2004.

20. **In August, an agreement was reached for the government to buy back the debt owed by the nationalized electricity distribution companies to Union Fenosa, a foreign electricity and gas company**. The authorities have not yet executed the buy back.

[12] The US$500 million, 9.5 percent Global bond 2006 and the US$600 million, 9.04 percent Global bond 2013 were eligible for the exchange. Two Brady Bonds (US$408 million in remaining principal) and one private placement domestic currency denominated bond (US$200 million in principal at the then current exchange rate) were excluded.

Box 1. Dominican Republic: Financial Terms and Legal Features of the Debt Exchange

Financial terms

- The offer involved a five-year maturity extension, where the Global bond due in 2006 could be exchanged for a new Global bond due in 2011, and the Global bond due in 2013 could be exchanged for a new Global bond due in 2018.

- The new bonds included an amortizing structure with ten equal semi-annual principal installments beginning in 2007 and 2013 for the Global bond 2011 and Global bond 2018, respectively (the existing bonds were bullet-style bonds).

- No principal or interest haircut was involved; but remaining interest payments in 2005, and half of interest payments due in 2006, were capitalized.

Legal features

- To reduce the incentives for non-participation, the offer utilized exit consents to amend the old bonds to limit the ability of holders of these bonds to attach payments on the new bonds and to eliminate the cross-default and cross-acceleration clauses and the negative pledge covenant.

- The new bonds include CACs with an aggregate voting feature and are issued under a trust indenture (the old bonds had a fiscal agency structure) which would make future litigation by bondholders more difficult.

- To encourage participation, the Dominican Republic set a nonbinding minimum participation threshold of 85 percent (which could be waived at the sole discretion of the Dominican Republic).

Antigua and Barbuda

21. **After taking office in March 2004, the newly elected government initiated a dialogue with several key creditors with a view to regularizing creditor relations**—most loans have been in arrears for many years. A major step included an agreement with the Italian government to clear US$196 million debt (one-third of external debt) through a bullet payment of US$18.5 million, thus providing about US$177.5 million of debt stock reduction. Antigua and Barbuda's debt renegotiations continue to take place outside the framework of a Fund-supported program. The authorities are in the process of hiring debt advisors.

Belize

22. **Belize announced on May 26, 2005 that it would put in place measures to attain a sustainable fiscal and external position, and, in this context, seek a restructuring of its debts.** These measures would aim to: (i) maintain the exchange rate peg; (ii) achieve fiscal sustainability; and (iii) stabilize the country's public debt. To this end, the authorities indicated their intention to undertake a debt restructuring to ease pressures on debt-service payments. In the wake of the debt-restructuring announcement, Standard & Poor's lowered Belize's long-term foreign currency rating from CCC to CCC-, while maintaining a negative outlook.

23. **Prompted by the downgrade, Belize clarified its debt management strategy in a subsequent statement issued on June 3**. The statement stressed that the debt restructuring would involve neither unilateral action, nor a request for a reduction of principal or interest. Rather, the authorities would seek an extension of commercial debt maturities. In addition, contacts with creditors would take place only after fiscal adjustment measures had been put in place. The authorities indicated their commitment to seeking a flexible debt restructuring, aimed at balancing the short- and long-term needs of the country with those of its external creditors. Finally, they noted that funds would be set aside to meet obligations falling due during the remainder of 2005. The authorities are now in the process of hiring financial advisors.

Dominica

24. **In April 2004, Dominica launched its debt exchange, aimed at preemptively restructuring its sovereign debt and achieving long-term debt sustainability**. As of end-May 2005, official and private creditors holding over 72 percent of debt to be restructured had participated in the restructuring. The authorities have been in contact with remaining creditors and they also are making payments in line with the terms of the restructuring into escrow accounts for these creditors.

Grenada

25. **Following their announcement in December 2004 to seek a comprehensive debt restructuring, the Grenadian authorities have worked toward towards this objective in the context of a regular dialogue with their creditors**. With the assistance of financial and legal advisors, the authorities have followed a market friendly process. There has been a regular dialogue with creditors, including with a creditor committee composed mainly of regional banks that hold a large proportion of the debt. Grenada has also been in contact with its official bilateral creditors. However, the process is complicated by the fact that Grenada no longer has diplomatic relations with its largest bilateral creditor, Taiwan Province of China. Moreover, some Paris Club creditors have expressed a preference for a restructuring in the context of a Fund-supported program.

26. **On September 9, the Grenadian authorities launched an exchange offer to restructure its commercial debt.**[13] Holders of eligible claims, amounting to US$275 million including past due interest, can exchange these for two new bonds, one in U.S. dollars and the other in Eastern Caribbean (EC) dollars, with maturities falling due during 2021–2025. The interest rate on the new bonds will be 0.85 percent for the first thee years, and will step up gradually to 8 percent after 10 years. The offer does not involve a principal reduction nor upfront cash payments. The new U.S. dollar bonds will be governed by New York law and use a trust structure, while the new E.C. dollar bonds will be governed by Grenada law and use a fiscal agency structure. The new bonds contain collective action clauses. The closing

[13] The exchange covers 85 percent of Grenada's domestic and external commercial debt and about 30 percent of government-guaranteed debt—in all, 50 percent of the total stock of debt. Treasury bills will not be restructured.

date for creditors to accept the offer is October 7, 2005 and the authorities have set a minimum participation threshold of 85 percent for the exchange to be concluded. The Fund provided an assessment letter to accompany the offer.

27. **A successful exchange offer will provide substantial cash flow relief over the coming years and reduce external vulnerability.** In the event that full participation is achieved, Grenada's commercial debt service payments would be reduced by over 90 percent over the next three years and by 80 percent over the following five years. The offer represents an NPV "haircut" of 45–50 percent for exit yields in the 9–10 percent range.

Iraq

28. **Following the agreement in November 2004 with Paris Club creditors, Iraq began to take steps to settle claims with private creditors**. To this end, Iraq retained legal and financial advisors for the private debt restructuring, and appointed an accounting firm to assist with the debt reconciliation process.[14] The total amount of commercial claims (principal and imputed late interest) is estimated by the authorities to be around US$20 billion (out of an estimated total debt of US$125 billion).[15] Iraq's commercial debt is held by a broad range of creditors, including suppliers, trading firms, banks, and other financial institutions.

29. **The Iraqi authorities invited those creditors who had submitted claims to meet with them in Dubai on May 4, 2005**. In the meeting, the authorities stated their intention to base any offer to settle private creditor claims on the requirement of comparability of treatment set forth in the November 2004 agreement with the Paris Club, and the principle of equal treatment for all creditors. Following the meeting in Dubai, Iraq's financial advisors met with various creditors to explain Iraq's objectives in settling the claims of the private sector. A group of seven banks that claims the support of 60 financial institutions organized a London Club Coordinating Group to represent the interests of these creditors. This group has urged the authorities to negotiate a settlement with private creditors, and presented its own debt restructuring offer to the authorities in July. Other creditor groups have also been formed to represent the interests of suppliers and trading firms.

30. **On July 26, 2005, Iraq announced an offer to settle private claims, and reopened the claims registration process until August 8, 2005**. Negotiations did not take place with creditors prior to this announcement. The proposed offer is based on Iraq's interpretation of the comparability of treatment clause under the Paris Club agreement, and includes options for both "large" (i.e., those with individual aggregate claims greater than US$35 million) and "small" (i.e., those with individual aggregate claims less than US$35 million) claimants. A first option for large claimants is to enter into a syndicated loan which replicates the cash

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[14] Iraq's Debt Reconciliation Office set up a website (http://www.eyidro.com) which provided information on the reconciliation procedure, and a vehicle for private creditors to submit their claims. The deadline for submission of commercial claims was April 15, 2005.

[15] These estimated claims include both principal and imputed past due interest, calculated using a uniform interest rate. Under this methodology, past due interest represents about 54 percent of the total claims.

flows agreed with the Paris Club, including a cancellation of 80 percent of the total claims in three installments, with the residual 20 percent to be repaid over a 23-year period with six years of principal grace at an interest rate of Libor plus 50 basis points.[16] A second option is for large claimants to exchange claims for a bond with somewhat different cash flows than the loan, but identical value in net present value terms.[17] On the basis of Iraq's valuation, using a commercial discount rate of about 11.5 percent, these debt-for-debt options would confer a "haircut" of 90 percent in net present value terms. Applying a lower discount rate typical of official creditors would imply a lesser net present value "haircut". In addition, the offer entails a cash buyback proposal which would be available only to small claimants. To maintain comparability across the different options, the creditors would receive 10.25 cents for each dollar of their claims.

31. **On August 8, Iraq launched an initial tender for the cash buyback of US$750 million of eligible claims.** The period for submitting tenders closed on September 9, with the exchange to be settled on September 22. Preliminary results show that holders of about 78 percent of the eligible claims accepted the offer, while holders of about 20 percent postponed a decision until all of their claims were reconciled. Holders of about 2 percent of the eligible claims rejected the offer or failed to respond. Further cash buyback tenders will occur during the course of 2005 and 2006 as claims are reconciled. The authorities announced that the debt-for-debt exchange would be launched following Fund approval of a Stand-by Arrangement.

Serbia and Montenegro

32. **Following several years of negotiations, Serbia and Montenegro reached agreement in July 2004 with its London Club creditors to restructure its commercial bank debt.** The terms are comparable to those provided by the Paris Club in 2001. After a write-down of about 62 percent, the remaining debt is to be converted into bonds. The debt conversion process, which began with the listing of bonds at the Luxembourg stock exchange in April 2005, has been completed for 95 percent of the debt. The process is expected to be completed by end-October 2005.

V. Progress Under the Evian Approach and Other Paris Club Issues

33. **Since March 2005, no debt treatments under the Evian approach have been completed.**[18] In April, Paris Club creditors concluded that Gabon's debt position was

[16] The offer indicates that (i) the loan matures in January 2028; (ii) principal amortizations on a semiannual basis begin in July 2011; (iii) interest accruing through end 2007 is capitalized, while interest accruing during 2008–10 is partially capitalized; and (iv) the loan can be denominated in dollars, yen, and euros.

[17] The offer states that (i) the bond matures in 2028; (ii) principal amortizations on a semiannual basis begin in July 2020; (iii) the coupon on the bond is set at 50 basis points over LIBOR or fixed at an equivalent rate; and (iv) the bond is denominated in dollars. The bond would be privately placed.

[18] Additional information on the Evian Approach and other Paris Club issues is available on the Paris Club's website, http://www.clubdeparis.org/en/presentation/presentation.php?BATCH=B06WP14.

sustainable and thus did not warrant the provision of additional debt relief under the "goodwill clause" included in its 2004 Agreed Minute.

34. **In June, Paris Club creditors agreed in principle to provide a comprehensive debt treatment to Nigeria.** Nigeria has expressed interest in using exceptional oil revenues to finance an exit treatment from the Paris Club and in regularizing its relations with international financial institutions. Paris Club creditors expressed their willingness to provide debt reduction up to Naples terms on eligible debt, and to participate in a buyback of the remaining debt at a market-related discount. Consistent with the Evian Approach, the debt treatment would be phased and would aim at providing a definitive solution to Nigeria's debt problems. It would be contingent on the full clearance of Nigeria's arrears to the Paris Club, and the approval of a Policy Support Instrument by the Fund.

35. **The Paris Club has made public its framework for debt buybacks, and three countries have offered to make early repayments** (Box 2). Following Poland's offer in February to buy back of all of its outstanding Paris Club debt, Russia, in May, offered to repay over a third of its Paris Club debt, and Peru, in June, offered to retire about half of its outstanding debt stock.

Box 2. The Paris Club's Framework for Early Debt Repayment

Favorable global liquidity conditions and low international interest rates are providing opportunities for debtors to refinance high, fixed-interest-rate obligations at a lower cost. Against this background, Paris Club creditors defined a common framework for early repayment operations, based on the following principles:

- Early repayment is not a substitute for a debt treatment and should only be considered by debtors with a good payment record and a sustainable financial situation.
- To foster inter-creditor solidarity, the principle and terms of repayment operations must be agreed by the Club as a whole and the offer presented to all creditors under similar terms. Participation remains voluntary, however.
- Early repayment may cover all or only a portion of outstanding Paris Club claims.
- Repayment can be either at par, or at a price reflecting the net present value of the remaining cash flows on the basis of a common market-based discount rate (e.g., spreads on sovereign bonds of similar duration). Thus, in principle, the buyback price may be lower or higher than par.

The framework was made public in a June 2005 meeting of the Paris Club with the private sector. Three early repayment operations have thus far been announced, all of which involved pre-payments at par. In only one case (Poland) did the debtor offer to repay all of its obligations to the Paris Club.

Table. Prepayments of Paris Club Debt
(In billions of US dollars)

	Date of agreement	Total Paris Club debt	Debt eligible for prepayment
Poland	February 2005	14.0	14.0
Russia	May 2005	40.0	15.0
Peru	June 2005	4.2	2.0

VI. Assessing the Determinants and Prospects for the Pace of Market Access by Countries Emerging from Crisis[19]

36. **In a follow-up to the Fund's work on issues of crisis prevention and resolution, in May 2005, the Executive Board discussed the determinants and prospects for the pace of market access by countries emerging from a crisis**. Directors welcomed the opportunity to revisit the issue following the return to international capital markets by some countries that had restructured their debt and the increased attention to market reaccess issues in both the public and private sectors. It was noted that the issue of market reaccess is highly relevant to the Fund—especially in the context of crisis prevention and resolution, including the exceptional access framework. Staff's findings were considered to hold important lessons regarding the steps that countries emerging from a crisis need to take in order to reaccess international capital markets, in particular, the need to build and sustain credibility in the country's policies.

37. **The circumstances underpinning the loss of market access are a key determinant of how and when a country regains market access,** including adverse developments in international capital markets and the deterioration of domestic macroeconomic conditions. Countries that lose access because of adverse market developments normally regain access quickly if there is only a minor decline in investors' risk appetite which does not affect the assessment of the country's creditworthiness, while significant declines in investors' risk appetite imply countries will take considerably longer to regain market access.

38. **The length of time taken to regain markets access varies when the loss of access reflects policy slippages or severe market turbulence that give rise to concerns about the country's ability to service its debt**. In these cases, no country has regained access without committing to policy adjustments. Experience has shown that when conditions in international capital markets are favorable, market reaccess takes anywhere from several months to approximately a year and a half. The timing of reaccess depends heavily on the strength of the corrective policies the country implements which should improve the country's ability to repay its obligations and set the debt dynamics on a credible sustainable course.

39. **Countries that undertook a debt restructuring regained market access only after demonstrating a commitment to strong corrective policies**. The timing of the reaccess again depends on the nature of the external environment and the success of the policy efforts. In recent years, countries that have restructured their bonds have taken anywhere from 18 months to five or more years to restore external market access, or four months to four years after completion of the debt restructuring. In this respect, Fund policy advice and the Fund's financial assistance, including precautionary arrangements to countries during the crisis period before access is regained, can play an active role in helping countries regain market access.

[19] See *Assessing the Determinants and Prospects for the Pace of Market Access by Countries Emerging from Crisis—Further Considerations* (SM/05/76, 3/2/05, and BUFF/05/82, 5/17/05).

40. **Countries seeking to reaccess capital markets should put in place a strong communication strategy to explain to investors the nature and the objective of the corrective policies, including the expected results**. Data and other information need to be made available on a timely basis particularly on the early results of the adjustment effort. This would allow investors to manage better the information risk associated with a country emerging from a crisis, and to reassess the risk-return tradeoff of possibly increasing their holdings of a country's debt. Countries would benefit from an open two-way dialogue with investors to get feedback regarding the success of the efforts to strengthen their creditworthiness.

41. **Countries need to give careful attention to the characteristics of the "reaccess bond" and should evaluate the selection of the target investors, as well as size and maturity of the bond**. While fixed-coupon, bullet-payment bonds are most common because they are easy to price which promotes liquidity, smaller countries which are relatively infrequent issuers could consider amortizing structures that could facilitate the management of certain risks, including rollover risk.

42. **Directors supported continued work by staff to develop an analytic framework to evaluate factors affecting market reaccess**. They looked forward to an analysis of the effects of Fund support and its signaling role on market reaccess and the implications for Fund work.

VII. Managing Systemic Banking Crises in the Context of Sovereign Debt Restructuring[20]

43. **Against the background of the IMFC's request to continue working on issues of general relevance for the orderly resolution of financial crises, Directors, on July 22, had a preliminary discussion on the difficult circumstances where banking system distress is associated with a sovereign debt crisis**. While considering the paper timely, Directors agreed that the limited experience to date, the second-best nature of the measures considered, and the diversity in country circumstances, precluded drawing firm conclusions.

44. **Directors agreed that prevention remains the first line of defense in shielding bank balance sheets from sovereign debt vulnerabilities**. Beyond the importance of sound and consistent macroeconomic policies, a number of Directors expressed interest in the possibility of pursuing more ambitious prudential standards in highly indebted economies, including through setting higher liquidity and capital requirements and tighter asset classification and provisioning. Directors emphasized, however, the need for a careful balance between improving bank resilience to shocks and preserving the system's efficiency. Higher capital and other prudential requirements, for instance, could lower financial intermediation, adversely affect growth and possibly encourage unregulated and informal channels of financing. Also, in many countries the sovereign relies heavily on bank

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[20] See *Managing Systemic Banking Crises in the Context of Sovereign Debt Restructurings* (SM/05/249, 07/01/05) and the Concluding Remarks by the Chairman (BUFF/05/121). As the Board has decided not to publish the staff paper this section will be deleted from the published version of the progress report.

financing, and a tightening of the prudential framework cannot be considered independently of the broader framework for fiscal financing.

45. **Directors agreed that, when debt restructuring is unavoidable, the initial priorities for the banking system should be to restore confidence, safeguard the payments system, and minimize disruptions to credit flows**. It was generally agreed that in cases where the impact on the banking system was limited, conventional crisis management tools should be considered first. However, if the impact of the sovereign debt restructuring on the banking system is severe, traditional policy options may not be available or credible. Emergency liquidity provision may be constrained where a large part of bank liabilities are denominated in foreign currency, or may evaporate in capital flight where the central bank lacks the instruments to sterilize its domestic currency liquidity support. Public sector support of bank recapitalization may not be feasible, and the government's inability to meet its debt-service obligations will undermine the credibility of any general guarantee to protect depositors. In such circumstances, more extreme policy measures may need to be considered. Directors stressed that these are inherently second-best and largely untested options, and should be considered as a last resort.

46. **Directors discussed a number of crisis containment measures, including the extension of deposit maturities, securitization of deposits and deposit freezes**. Most Directors emphasized the need to design these types of administrative measures in a way that minimized disruption to the payments system and household and corporate liquidity. Directors also stressed the need to be mindful of socially acceptable wealth effects. Approaches that could be considered included allowing securitized deposits to be traded, limiting withdrawal restrictions to only a portion of deposits, and allowing longer-dated deposits to be used for transactions within the banking system.

47. **On the issue of restructuring and resolving undercapitalized or insolvent banks, most Directors were of the view that, to the extent possible, granting banks more time to meet capital requirements is preferable to easing valuation rules**. However, in countries that prohibit the continued operation of insolvent banks, this may require the authorities to intervene or close a large part of the banking system. In this regard, Directors noted that easing valuation rules for government securities could allow banks and shareholders some time to adjust to new realities. Most Directors emphasized that this should be strictly limited in time and restricted to sovereign debt only. A few Directors expressed the view that the inclusion of other assets could also be contemplated.

48. **As regards other possible options, most Directors noted that the closure of an insolvent bank that plays an essential role in the payments system could at times be a worse solution than allowing it to operate under stringent prudential safeguards**. However, allowing an insolvent bank to stay open under private control was considered an extreme measure that could give rise to serious moral hazard issues and increases the risk of asset stripping by shareholders and managers. A better alternative would be to allow for a temporary takeover by the government, and to pass ownership and control to a bank resolution agency, with a view to privatizing the bank as soon as the crisis has passed.

49. **Most Directors noted that in extreme circumstances, the authorities may have no choice but to recognize shareholders' losses and then impose haircuts on bank**

creditors, including depositors. However, the critical question is whether it would be possible to reconstruct a viable banking sector in the aftermath of such policies and whether private sector confidence could be regained. For these reasons, some Directors argued that haircuts on depositors should be avoided, while others called on the staff to examine further ways in which depositor losses could be mitigated, including by giving depositors equity in restructured banks.

50. **Several Directors expressed interest in some of the more direct ways in which Fund resources could be used to support the banking system, including through the provision of liquidity advances in foreign exchange and bolstering the credibility of deposit guarantees**. However, Directors also cautioned about the risks of such operations. They stressed that the justification for the use of Fund resources should be particularly strong, that it would be important to try to assess accurately the nature and permanence of outflows that are occurring, and that program conditionality should be based on properly addressing underlying imbalances to ensure that Fund financing is temporary and addresses balance of payments needs. Directors noted that explicit discussion of exit strategies and the member's capacity to repay would need to be reflected in staff reports.

51. **Directors underscored the preliminary nature of the discussion, and urged staff to pursue further work aimed at a deeper analysis of key issues in this area**.

Table 1. Emerging Markets Sovereign Bond Issuance by Jurisdiction 1/

	2003				2004				2005 5/	
	Q1	Q2 3/	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2 4/
With CACs 1/										
Number of issues	9	31	10	5	25	19	19	15	18	39
Of which: NY law	1	22	5	4	14	12	12	13	11	23
					(In billions of U.S. dollars)					
Value of issues	5.6	18.0	6.4	4.3	18.5	15.9	10.7	9.1	22.3	35.1
Of which: NY law	1.0	12.8	3.6	4.0	10.6	9.5	6.5	7.7	11.1	20.2
Without CACs 2/										
Number of issues	14	4	7	7	2	1	1	4	0	1
					(In billions of U.S. dollars)					
Value of issues	8.1	2.5	3.5	4.2	1.5	0.1	0.2	2.7	0.0	0.3

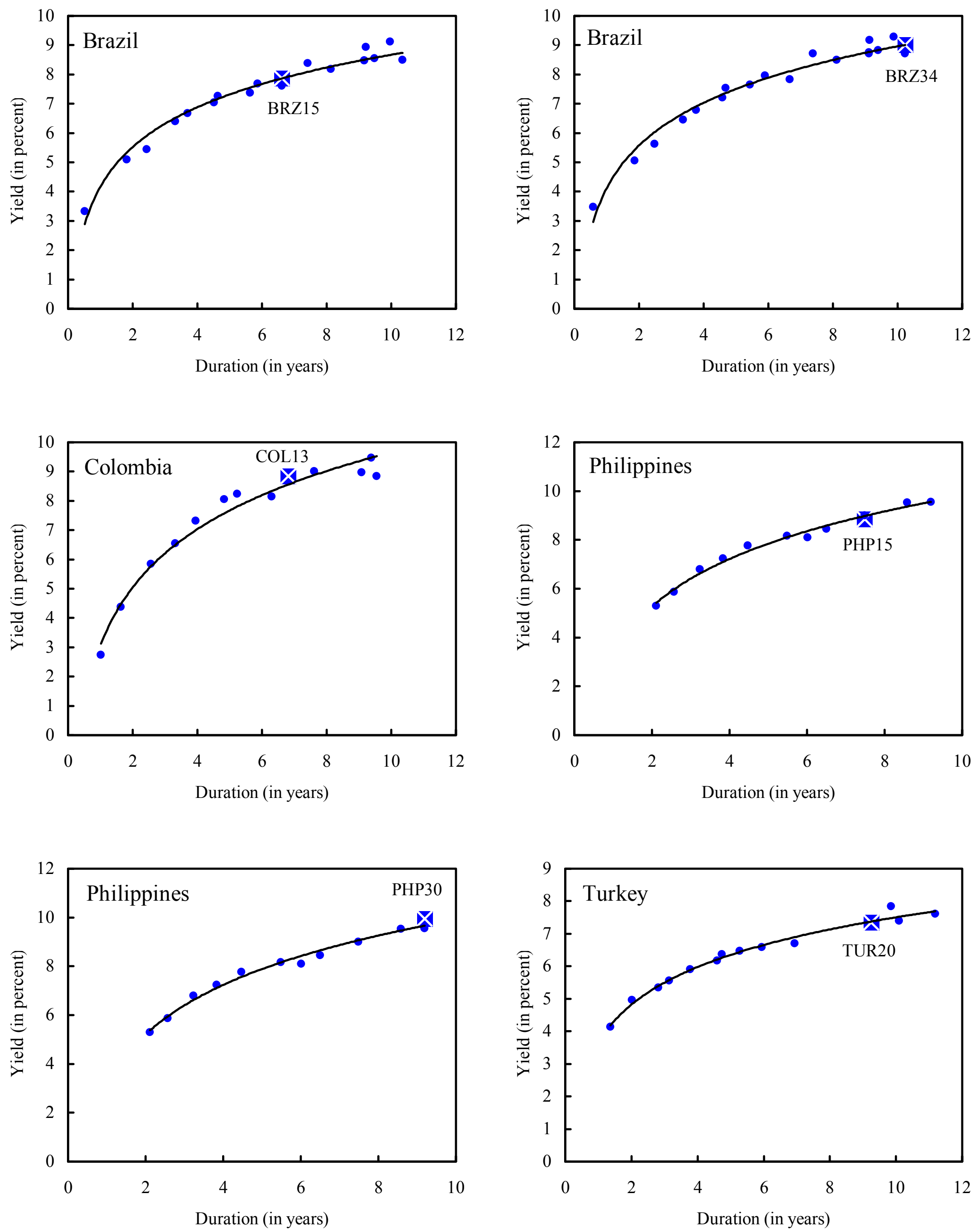
Source: Dealogic.
1/ English and Japanese laws, and New York law where relevant.
2/ German and New York laws (includes reopenings of previously issued bonds without CACs).
3/ Includes bonds issued by Uruguay in the debt exchange.
4/ Includes bonds issued by Argentina and The Dominican Republic in their respective debt exchanges.
5/ Data as of June 30, 2005.

Table 2. Emerging Market Sovereign Bonds Outstanding Issuance by Governing Law

	Number of Issues		Value of Issues	
	(In number)	(In percent)	(In billions of U.S. dollars)	(In percent)
New York	435	62	264	63
English	182	26	120	29
German	45	6	20	5
Japanese	41	6	12	3
Total	703	100	416	100
Of which: with CACs	338	48	220	53

Sources: Dealogic; Bloomberg; and IMF staff calculations (as of June 30, 2005).

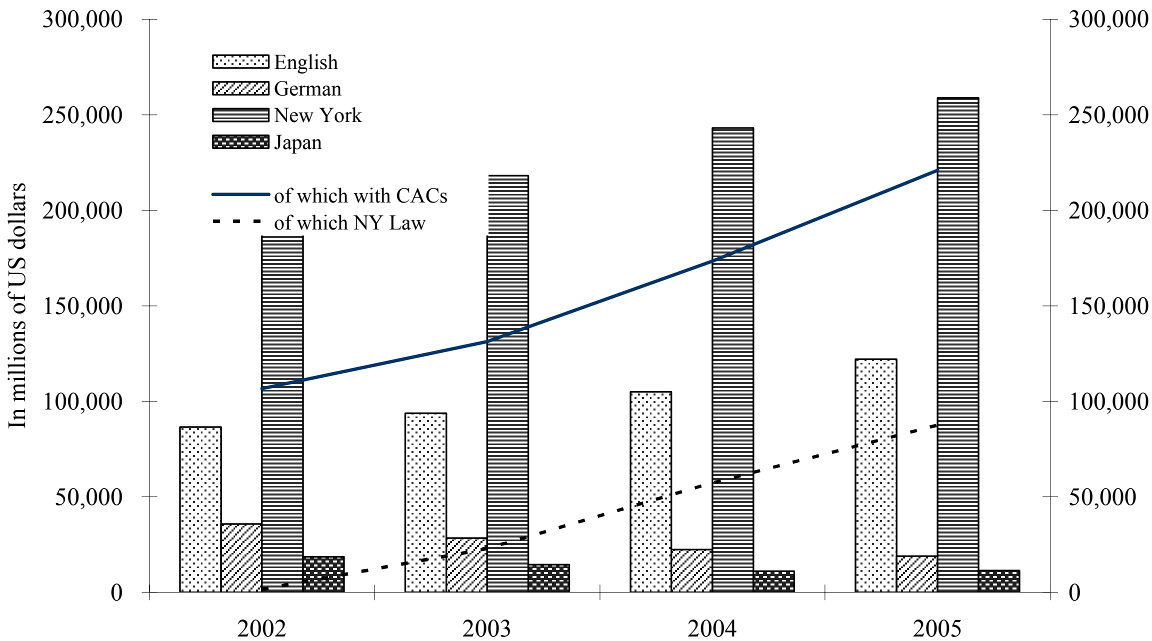
Figure 1. Yields on Selected Recent Issues of U.S. Dollar Bonds with Collective Action Clauses 1/



Sources: Capital Data and Merrill Lynch.

1/ As of date of issuance.

Figure 2. Emerging Market Outstanding Sovereign Issuance by Governing Law



Source: Dealogic; Bloomberg and Fund staff calculations.

Table 3. Emerging Markets Sovereign Bonds—Outstanding Issuances by Region and Governing Law, 2002 and 2005 1/

	2002		2005	
	In billions of US dollars	In percent	In billions of US dollars	In percent
Africa				
Total outstanding issuances	10.0	100.0	12.4	100.0
Total with CACs	4.2	42.5	7.6	61.3
New York	4.3	42.7	6.8	55.0
Of which: with CACs	...	...	2.4	19.5
English	2.0	20.4	3.6	29.1
German	0.3	3.1	...	...
Japanese	2.2	22.1	1.6	12.7
Asia				
Total outstanding issuances	29.8	100.0	43.9	100.0
Total with CACs	8.9	30.0	18.4	41.8
New York	19.0	63.7	30.6	69.8
Of which: with CACs	...	...	8.0	18.1
English	6.4	21.3	8.2	18.6
German	0.7	2.5	0.7	1.7
Japanese	2.6	8.6	2.2	5.1
Eastern Europe				
Total outstanding issuances	74.8	100.0	107.7	100.0
Total with CACs	45.0	60.2	86.0	79.9
New York	14.5	19.3	26.0	24.2
Of which: with CACs	...	...	10.9	10.1
English	39.7	53.1	70.2	65.2
German	14.8	19.8	6.3	5.8
Japanese	5.3	7.1	4.9	4.6
Latin America				
Total outstanding issuances	146.9	100.0	172.0	100.0
Total with CACs	30.6	20.8	68.2	39.7
New York	90.7	61.8	133.4	77.5
Of which: with CACs	...	...	49.5	28.8
English	22.3	15.2	15.7	9.1
German	19.9	13.6	12.2	7.1
Japanese	8.3	5.7	3.0	1.8
Middle East				
Total outstanding issuances	16.2	100.0	20.7	100.0
Total with CACs	8.8	54.6	13.2	63.5
New York	12.5	77.2	16.0	77.0
Of which: with CACs	5.2	31.8	8.6	41.7
English	3.5	21.7	4.3	21.0
German	...	...	...	...
Japanese	0.2	1.1	0.2	0.9

Sources: Dealogic; Bloomberg; and Fund staff calculations.
1/ End of period, data for 2005 are for July.

Table 4. Collective Action Clauses:
G-10 Recommendations and Bonds Issued under New York Law Since March 2005

Provisions	G-10 Recommendations	Argentina, Brazil, Colombia, Dominican Republic, El Salvador, Indonesia, Italy, Lebanon, Mexico, Peru, Philippines, Turkey, Uruguay, and Venezuela
Amendment of Key Terms	75 percent threshold based on either outstanding principal or principal held by those present at a duly convened meeting.	75 percent based on outstanding principal (except the Lebanon bond, where the threshold is based on duly convened meeting).
Aggregate Voting	None.	Argentina, Dominican Republic, and Uruguay: 85 percent of the aggregate outstanding principal of all affected series (taken in aggregate) and 66⅔ percent of outstanding principal of each affected series (taken individually).
Disenfranchise-ment	Bonds owned or controlled directly or indirectly by the issuer or its public sector instrumentalities.	Generally bonds owned directly or indirectly by the issuer or its public sector instrumentalities.
Acceleration	25 percent of outstanding principal.	25 percent of outstanding principal (except the Lebanon bond, where each bondholder has the right to accelerate upon default).
De-acceleration	Between 50 and 66⅔ percent of outstanding principal.	• Argentina, Colombia, Dominican Republic, Indonesia, Mexico, Peru, Philippines and Venezuela: 50 percent of outstanding principal. • Uruguay: 66 percent of the outstanding principal. • Brazil, El Salvador, Italy and Turkey: 66⅔ percent of outstanding principal • Lebanon: none.
Initiation of Proceedings	• Mandate the use of a trust or an equivalent legal structure where the trustee can be instructed by 25 percent to initiate lawsuits. • Pro rata distribution of recovered proceeds under trust structure.	Individual bondholder, except the Argentina, Dominican Republic, Indonesia and Uruguay bonds where the trustee has a limited monopoly over initiation of proceedings whose recovery would be distributed pro rata.
Engagement Provision	• Appoint a bondholder representative for the life of the bond. • 66⅔ percent to appoint at any time any person to represent all holders in negotiation with the issuer or other creditors.	None.
Information Provision	A covenant requiring the issuer to provide certain types of information over the life of the bond and following a default.	None.
Documentation	Trust or an equivalent legal structure.	Fiscal agency agreement, except Argentina, Dominican Republic, Indonesia, and Uruguay which utilized a trust structure.

Table 5. Selected Countries: Debt Indicators, 1999-2004 1/

	1999	2000	2001	2002	2003	2004
Antigua and Barbuda						
Gross public sector debt as a share of GDP	117.2	125.4	123.6	137.6	132.0	99.4
External debt service as a share of total exports	5.6	8.6	8.5	8.4	8.8	40.2
External debt service as a share of GDP	5.0	7.4	6.3	8.6	6.9	26.1
Argentina						
Gross public sector debt as a share of GDP	47.6	50.9	62.2	164.2	144.5	133.9
External debt service as a share of total exports	100.1	105.0	108.3	55.8	61.1	35.8
External debt service as a share of GDP	9.9	11.5	12.5	15.8	16.1	9.3
Belize						
Gross public sector debt as a share of GDP	53.1	75.8	84.1	89.6	103.1	102.3
External debt service as a share of total exports	8.7	13.8	20.6	43.8	28.7	50.9
External debt service as a share of GDP	4.9	7.3	10.5	23.3	14.4	24.9
Dominica						
Gross public sector debt as a share of GDP 2/	71.0	76.8	87.4	95.4	121.9	118.4
External debt service as a share of total exports	5.0	7.4	10.9	11.8	19.5	20.8
External debt service as a share of GDP	2.9	4.0	5.0	5.8	8.9	9.9
Dominican Republic						
Gross public sector debt as a share of GDP	26.8	25.9	23.6	26.8	54.3	52.1
External debt service as a share of total exports	6.5	6.4	9.7	10.8	11.4	8.4
External debt service as a share of GDP	3.0	2.9	3.7	4.1	6.4	4.2
Grenada						
Gross public sector debt as a share of GDP	51.9	56.2	63.7	109.6	110.0	129.4
External debt service as a share of total exports	5.1	5.6	8.2	17.4	18.9	25.0
External debt service as a share of GDP	2.9	3.2	4.1	7.4	7.7	10.1
Serbia and Montenegro						
Gross public sector debt as a share of GDP 3/	...	119.1	123.2	85.4	79.2	60.2
External debt service as a share of total exports	5.9	2.8	5.1	7.1	13.6	24.0
External debt service as a share of GDP	1.0	0.7	0.9	1.2	2.2	4.1
Iraq						
Debt stock as a share of GDP	...	...	...	...	...	306.2
External debt service as a share of total exports 4/	...	...	...	...	...	0.0
External debt service as a share of GDP 4/	...	...	...	...	...	0.0

1/ For Antigua and Barbuda, central government only; for Argentina and Serbia and Montenegro, consolidated government; for Belize and Dominica, nonfinancial public sector; for Dominican Republic nonfinancial public sector and central bank; for Grenada, general government.
2/ Data presented on a fiscal year (July-June) basis; figures shown for a given calendar year relate to the fiscal year beginning on July 1 of the previous year.
3/ Covers gross external debt and net domestic debt.
4/ On cash basis.

Sources: WEO, IMF country staff reports.

Table 6. Argentina: New Bonds Issued, by Currency and Governing Law

(In billions of US dollars, unless otherwise indicated)

Bond	US dollars		Euros	Yen	Pesos	Total
	NY law	Arg law	English law	Japanese law	Arg law	
Par	5.3	1.2	6.4	0.2	1.9	15.0
percent of total	15.1	3.5	18.1	0.6	5.3	42.5
Discount	3.1	0.6	2.9	0.1	5.3	11.9
percent of total	8.8	1.6	8.2	0.2	15.2	33.8
Quasi-par	0.0	0.0	0.0	0.0	8.3	8.3
percent of total	0.0	0.0	0.0	0.0	23.6	23.6
Total	8.4	1.8	9.3	0.2	15.5	35.3

INTERNATIONAL MONETARY FUND

Progress Report on Crisis Resolution

Prepared by Policy Development and Review, International Capital Markets, and Legal Departments
In consultation with other Departments

Approved by Gerd Häusler, Mark Allen, and Sean Hagan

September 20–, 2005

Table of Contents Page

I. INTRODUCTION

1. **In its recent Communiqué, the International Monetary and Financial Committee (IMFC) considered progress on crisis resolution initiatives**.[1] It welcomed the increased inclusion of collective action clauses (CACs) in international sovereign bonds, and called on the Fund to continue to promote progress in this area. It also noted the "Principles for Stable Capital Flows and Fair Debt Restructuring in Emerging Markets" (henceforth, the "Principles") developed by a number of sovereign issuers and the investor community, and encouraged further efforts to improve the Principles aimed at achieving a broad consensus. The IMFC looked forward to further work on the orderly resolution of financial crises, including the implementation of the Fund's lending into arrears (LIA) policy.

2. **A number of countries have continued the process of restructuring their sovereign debt and several have secured agreements with their private creditors**. This has occurred, in some cases, as part of a comprehensive debt restructuring strategy following earlier agreements with the Paris Club to reschedule official debt. In a separate development, a number of countries have prepaid portions of their Paris Club debt under the Club's new framework for early repayments.

3. **The Executive Board considered two staff papers on issues related to the orderly resolution of financial crises**. The first paper assessed the determinants and prospects for the pace of market access by countries emerging from crisis. A second staff paper provided a preliminary discussion of the difficult policy challenges members face when banking system distress is associated with a sovereign debt crisis.[2]

4. **This report focuses on these crisis resolution issues**. Section II describes progress in the inclusion of CACs in international sovereign bonds. Section III provides an update of efforts to broaden the consensus on the Principles. Section IV reports on developments in recent sovereign debt restructuring cases. Section V discusses progress in the Evian Approach and other Paris Club issues. Sections VI and VII provide summaries of the aforementioned papers on the determinants and prospects for regaining market access and managing systemic banking crises in the context of sovereign debt restructuring.

II. COLLECTIVE ACTION CLAUSES

5. **Since the last progress report in March 2005, with one exception, all newly issued international sovereign bonds have included CACs that are broadly in line with**

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[1] *Communiqué of the International Monetary and Financial Committee of the Board of Governors of the International Monetary Fund*, Washington, April 16, 2005.

[2] See *Assessing the Determinants and Prospects for the Pace of Market Access by Countries Emerging from Crisis—Further Considerations* (SM/05/76, 3/2/05) and *Managing Systemic Banking Crises in the Context of Sovereign Debt Restructurings* (SM/05/249, 7/1/05).

the G-10 recommendations.[3] As to New York law-governed issues, this reflects the newly established market practice of including CACs in bonds in that jurisdiction.[4] The only country that did not include CACs in its New York law-governed bond was Jamaica. International sovereign bonds governed by English and Japanese laws have continued the existing practice of including such provisions (Appendix, Table 1).[5] There were no issues under German law.[6] To date, the inclusion of CACs has not had any observable impact on bond pricing (Appendix, Figure 1).

6. **As a result, the outstanding stock of emerging market sovereign bonds that include CACs has increased** from approximately 31 percent at end-2002, in value terms, to approximately 53 percent as of end-June 2005(Appendix, Table 2 and Figure 2). Importantly, recent sovereign debt exchanges have replaced a large volume of bonds that did not include CACs with bonds that included these clauses. Correspondingly, this increase reflected a rather even pattern of growth of bonds with CACs across regions (Appendix, Table 3).

7. **Staff has continued to take a proactive role in promoting the inclusion of CACs in international sovereign bonds**. In particular, staff continues to maintain an active dialogue with private market participants and debt managers from a number of emerging market countries, including through the Forum for Public Debt Managers, and to encourage the use of CACs both in the context of the use of Fund resources and the Fund's surveillance activities.

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[3] See *Review of G-10 Working Group on Contractual Clauses,* 9/26/02, www.bis.org/publ/gten08.htm, and *Acting Chair's Summing Up: Collective Action Clauses—Recent Developments and Issues* (BUFF/03/52, 4/10/03).

[4] Fourteen countries issued bonds under New York law including CACs: Argentina, Brazil, Colombia, the Dominican Republic, El Salvador, Indonesia, Italy, Lebanon, Mexico, Peru, the Philippines, Turkey, Uruguay, and Venezuela. The Lebanon bonds include only majority restructuring provisions. See Appendix Table 4 for a detailed description of CACs contained in New York law-governed bonds issued since March 2005, and a comparison of these provisions with the G-10 recommendations.

[5] Seven countries issued bonds under English law: Austria, the Czech Republic, Hungary, Poland, Spain, Sweden, and Tunisia; and three countries issued under Japanese law: Hungary, Poland, and Thailand. Hungary continued to include an engagement clause in its English law governed bonds which allows bondholders with at least 50 percent of outstanding principal to appoint "any persons as a committee to represent the interests" of bondholders in the event of a default or acceleration or following any public announcement by the issuer of a restructuring.

[6] Bonds governed by German law have not included CACs. Legal questions have been raised as to whether the inclusion of CACs in international sovereign bonds governed by German law could be voided by individual bondholders based on consumer protection law. Notably, on June 28, 2005, the German Supreme Court substantially resolved this question in holding that commercial bonds are not subject to certain consumer protection provisions in the German Civil Code. Following the general elections scheduled for September 2005, legislation is expected to be adopted, which will, inter alia, codify the legality of the inclusion of CACs in bonds and set out the limitations for their application (e.g. in terms of required minimum majorities).

III. PRINCIPLES FOR STABLE CAPITAL FLOWS AND FAIR DEBT RESTRUCTURING IN EMERGING MARKETS[7]

8. **Efforts have been made by the Institute of International Finance (IIF) to broaden the consensus on the Principles among emerging market issuers and private sector creditors**. Staff from the IIF has conducted briefings in major financial centers aimed at advancing awareness and developing a better understanding of the Principles. The IIF reports that about 30 countries have expressed support for the Principles. In addition, senior private sector leaders are exchanging views on how best to effectively integrate the Principles within firms' day-to-day practices.

9. **Discussions~~According to the IIF, discussions~~ among emerging market issuers and private sector creditors on a process for implementing the Principles are unfolding**. The IIF has proposed a three-tier process for monitoring implementation of the Principles, which remains the subject of discussion among stakeholders, including emerging marker issuers and private sector participants. Fund staff has not been involved in these discussions. ~~Fund staff has not been involved in these discussions. Several envisaged features of the IIF's proposed implementation process are as follows:~~

- The implementation process envisaged by the IIF would have four main functions: (i) to identify circumstances where early course correction in specific cases could prevent crises from unfolding; (ii) to offer guidance for the restructuring process in cases where debt restructuring is needed; (iii) to evaluate the overall effectiveness of the Principles, including whether the right balance has been achieved between providing sufficient guidance and allowing flexibility; and (iv) to ensure the continued relevance of the Principles in light of changing characteristics of international capital and credit markets.

- The three tiers suggested by the IIF include~~The proposed implementation process entails three tiers~~:

  - *Technical Work (Tier One)*. An analysis of the Principles' implementation by key emerging market issuers and creditors would be undertaken, based on the IIF's ongoing work on emerging market countries. This is envisaged to involve close consultation with the marketplace and, in selected circumstances, country authorities. Trends in international capital markets as they pertain to the Principles will also be examined.

  - *Principles Consultative Group (PCG) (Tier Two)*. Based on the technical work undertaken in Tier 1, the PCG—comprised of emerging market officials and market participants—would consider specific country circumstances with a view to providing suggestions to authorities and creditors on how better to align their policies and/or actions with the expectations set out in the Principles. The PCG

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[7] The section is based on information provided by the Institute for International Finance. The Principles can be found at http://www.iif.com/data/public/principles-final_0305.pdf.

would also review general market trends to help advise the Trustees (see below) whether the Principles remain relevant or require amendment. All parties involved in the discussions would adhere to a code of conduct to ensure confidentiality.

- *Group of Trustees (Tier Three)*. The Group of Trustees—comprising senior officials and senior representatives of the financial industry—would provide overall guidance on the implementation of the Principles, with the aim of ensuring the legitimacy and objectivity of the review process. The Trustee Group's role~~mandate~~ would include ~~assessing the evolution of the international financial system as it relates to the emerging markets,~~ reviewing development of the Principles, including their implementation, and modifying the Principles, if needed. It is anticipated that the Trustees would not be involved in specific cases except in exceptional circumstances. Individual countries or market participants could consider seeking the guidance of the Trustees individually or as a group on a confidential basis.

10. **Staff will continue to monitor developments in broadening the consensus on the Principles and in their implementation, and will report on these issues as more concrete details emerge**.

IV. Update of Recent Debt Restructuring Cases

11. **Since March 2005, progress has continued in a number of sovereign debt restructuring cases.** More generally, countries seeking debt restructurings have also put in place supporting macroeconomic and structural reform policies. This section provides an update of these cases (see Appendix, Table 5 for selected debt indicators for these countries).

Argentina

12. **Argentina concluded its global debt exchange on June 10, 2005, after some delays related to court proceedings in New York.** Settlement of the debt exchange, initially scheduled for April 1, was delayed due to attempts by some nonparticipating creditors to attach bonds tendered in the exchange. However, following the appeals court's affirmation of the lower court's decision to vacate the initial attachment orders, settlement of the debt exchange was finally initiated on June 2, and completed on June 10.[8]

13. **In settling the debt exchange, the authorities issued US$35.2 billion in new bonds,** comprising US$15 billion of par bonds, US$11.9 billion of discount bonds and US$8.3 billion of quasi par bonds. Upon settlement, eleven new bonds were issued—the par and discount bonds are denominated in pesos, U.S. dollars (under both Argentine and New ~~New~~ York laws), euros, and yen, and the quasi par bonds are denominated only in pesos (Appendix, Table 6). Each new bond has GDP-linked securities attached to it that will be

[8] The US Court of Appeals for the Second Circuit held on May 13, 2005 that the lower court "acted within its discretionary authority to vacate the remedies in order to avoid a substantial risk to the successful conclusion of the debt restructuring. That restructuring is obviously of critical importance to the economic health of a nation. We conclude that it is unnecessary to rule definitively on any of the legal issues disputed by the parties."

eligible to trade independently after November 29, 2005.[9] The new bonds, other than those governed by Argentine law, were issued under a trust structure and include CACs with an aggregate voting feature. Two of the three major credit rating agencies raised Argentina's long-term foreign currency issuer rating to the lowest "B" category in June, and applied this rating to the newly issued bonds.~~On June 1, Standard and Poor's assigned a B- rating to the new bonds.~~ On June 30, JP Morgan rebalanced its family of EMBI indices to include the new U.S. dollar par and discount bonds (governed by New York law) while dropping all of the defaulted bonds from the indices. As a result of the rebalancing, spreads on Argentina's external debt fell immediately from over 6000 basis points to 462 basis points.

14. **Argentina's debt exchange constitutes an important step toward normalizing relations with creditors, and has facilitated domestic market reaccess.** With 76 percent participation in the exchange, Argentina's debt structure and debt-service profile have improved significantly.[10] In early May, the authorities regained domestic market access for the first time since mid-2001 with the issuance of a AR$1 billion (about US$347 million) peso-denominated inflation-indexed bond maturing in 2014. This was followed by two other domestic market placements of AR$1 billion each of the same bond in early July, and two domestic issuances of a dollar-denominated bond maturing in 2012 in late July (US$442 million) and early August (US$350 million).[11] Demand for the domestic issues was supported by abundant liquidity in local and international markets, and regulatory changes allowing both local banks and pension funds to increase their exposure to government securities.

15. **Notwithstanding the debt restructuring, there are still unresolved principal claims amounting to almost US$20 billion**. The April 2005 IMFC Communiqué called on Argentina to formulate a forward-looking strategy to resolve the remaining arrears to private creditors consistent with the Fund's LIA policy. ~~The major rating agencies have continued to maintain the default rating on bonds not tendered in the exchange even as they raised the credit risk ceilings on Argentina, citing concerns about the large amount of untendered debt that remains in default and the potential actions by litigating creditors to attach assets.~~

The Dominican Republic

[9] A "when-and-if market" for the GDP-linked securities has emerged where forward trades can be made and delivered after November 29. Trading prices in this market indicate a value for the GDP-linked securities ranging from 2.5 cents to 4 cents (per dollar of nominal value).

[10] The federal debt stock has declined from about 147 percent of GDP in 2002 to an estimated 84 percent of GDP in 2005 (including unrestructured debt). About 37 percent of the federal government debt stock is denominated in pesos, a sizable increase from 3 percent before the restructuring. At the same time, payment on the restructured debt for the first ten years entails about 3 percent of GDP in savings compared to before the restructuring.

[11] The domestic bonds were issued at a discount so that total net financing raised amounted to US$1.5 billion, about US$283 million less than indicated by the aggregate face value of the bonds. Separately, Argentina has also directly placed some US$500 million of the Boden 2012 with the Venezuelan government.

16. **The Dominican Republic embarked on an economic adjustment program supported by a Stand-by Arrangement in early 2005.** The financing strategy of the program aimed at eliminating the residual financing needs during 2005–06 through a debt exchange offer encompassing non-Brady foreign-currency denominated bonds, a rescheduling of external private banks loans and suppliers' credits, credit from Venezuela to finance oil imports, and support from the IDB and the World Bank. The successful completion of the private debt restructurings was also a means to fulfill the Dominican Republic's commitment to seek comparable treatment from private creditors as called for in its April 2004 agreement with the Paris Club. The Dominican Republic launched its debt exchange offer on April 20, 2005, stipulating that two bonds were eligible for the exchange (see Box 1 for a summary of the key terms of the offer).[12]

17. **The Dominican Republic maintained a market-friendly approach to the debt restructuring.** The authorities sought to involve bondholders through an informal consultation process on the terms of the exchange offer. They held road shows in New York and London in late 2004, while conducting meetings with key investors at the same time and immediately prior to the launch. In this context, market participants considered as the main incentive to participate in the offer the potential upside on the new bonds resulting from the improvement in the country's capacity to pay and the reduction in the rollover risk. They also viewed favorably the minimal initial net present value (NPV) losses, amounting to only one percent when discounted at the implicit exit yield of 10 percent, that would result from accepting the offer.

18. **The debt exchange was completed on May 11, 2005, with high participation**. The tendering principal reached US$1.03 billion, representing nearly 94 percent of eligible bonds, and exceeding the minimum participation threshold of 85 percent. The offer was reopened in July with a view to achieving further cash-flow relief. An additional US$36.5 million of principal was tendered, representing 52 percent of the bonds that had not entered the original exchange, and as a result, the overall participation rate increased to 97 percent. The offer provided significant cash-flow relief of US$576 million for the government during 2005–06, and resulted in an increase in the maturity profile of the debt by five years. Spreads on the new bonds have declined by over 130 basis points since mid-May, clearly outperforming the overall market.

19. **In June, the Dominican Republic also reached an agreement with commercial banks to reschedule about US$200 million in principal falling due in 2005–06**. The agreement established (i) a two-year grace period and a three-year repayment period; (ii) a reduction in the average interest rate of the restructured loans of around 2 percentage points; and (iii) the repayment of about US$35 million in arrears accumulated through end-2004.

[12] The US$500 million, 9.5 percent Global bond 2006 and the US$600 million, 9.04 percent Global bond 2013 were eligible for the exchange. Two Brady Bonds (US$408 million in remaining principal) and one private placement domestic currency denominated bond (US$200 million in principal at the then current exchange rate) were excluded.

20. **In August**~~Moreover, in July~~**, an agreement was reached for**~~giving~~ **the government** ~~the option~~ **to buy back the debt owed by**~~prepay a bank, Union Fenosa, debts resulting from~~ **the nationalized** ~~nationalization of the~~ **electricity distribution companies to Union Fenosa, a foreign electricity and gas company**. The authorities have not yet executed the buy back~~in 2003. The authorities have yet to define the financing instrument to effect such prepayment~~.

Box 1. Dominican Republic: Financial Terms and Legal Features of the Debt Exchange

Financial terms

- The offer involved a five-year maturity extension, where the Global bond due in 2006 could be exchanged for a new Global bond due in 2011, and the Global bond due in 2013 could be exchanged for a new Global bond due in 2018.
- The new bonds included an amortizing structure with ten equal semi-annual principal installments beginning in 2007 and 2013 for the Global bond 2011 and Global bond 2018, respectively (the existing bonds were bullet-style bonds).
- No principal or interest haircut was involved; but remaining interest payments in 2005, and half of interest payments due in 2006, were capitalized.

Legal features

- To reduce the incentives for non-participation, the offer utilized exit consents to amend the old bonds to limit the ability of holders of these bonds to attach payments on the new bonds and to eliminate the cross-default and cross-acceleration clauses and the negative pledge covenant.
- The new bonds include CACs with an aggregate voting feature and are issued under a trust indenture (the old bonds had a fiscal agency structure) which would make future litigation by bondholders more difficult.
- To encourage participation, the Dominican Republic set a nonbinding minimum participation threshold of 85 percent (which could be waived at the sole discretion of the Dominican Republic).

Antigua and Barbuda

21. **After taking office in March 2004, the newly elected government initiated a dialogue with several key creditors with a view to regularizing creditor relations**—most loans have been in arrears for many years. A major step included an agreement with the Italian government to clear US$196 million debt (one-third of external debt) through a bullet payment of US$18.5 million, thus providing about US$177.5 million of debt stock reduction. Antigua and Barbuda's debt renegotiations continue to take place outside the framework of a Fund-supported program. The authorities are in the process of hiring debt advisors.

Belize

22. **Belize announced on May 26, 2005 that it would put in place measures to attain a sustainable fiscal and external position, and, in this context, seek a restructuring of its debts.** These measures would aim to: (i) maintain the exchange rate peg; (ii) achieve fiscal sustainability; and (iii) stabilize the country's public debt. To this end, the authorities indicated their intention to undertake a debt restructuring to ease pressures on debt-service payments. In the wake of the debt-restructuring announcement, Standard & Poor's lowered Belize's long-term foreign currency rating from CCC to CCC-, while maintaining a negative outlook.

23. **Prompted by the downgrade, Belize clarified its debt management strategy in a subsequent statement issued on June 3**. The statement stressed that the debt restructuring would involve neither unilateral action, nor a request for a reduction of principal or interest. Rather, the authorities would seek an extension of commercial debt maturities. In addition, contacts with creditors would take place only after fiscal adjustment measures had been put in place. The authorities indicated their commitment to seeking a flexible debt restructuring, aimed at balancing the short- and long-term needs of the country with those of its external creditors. Finally, they noted that funds would be set aside to meet obligations falling due during the remainder of 2005. The authorities are now in the process of hiring financial advisors.

Dominica

24. **In April 2004, Dominica launched its debt exchange, aimed at preemptively restructuring its sovereign debt and achieving long-term debt sustainability**. As of end-May 2005, official and private creditors holding over 72 percent of debt to be restructured had participated in the restructuring. The authorities have been in contact with remaining creditors and they also are making payments in line with the terms of the restructuring into escrow accounts for these creditors.

Grenada

25. **Following their announcement in December 2004 to seek a comprehensive debt restructuring, the Grenadian authorities have worked~~are working~~ toward towards this objective in the context of a regular ~~debt restructuring offer in the context of maintaining a~~ dialogue with their creditors**. With the assistance of financial~~Financial~~ and legal advisors~~, are assisting~~ the authorities have followed a market friendly process. There ~~in designing their strategy, and a creditor committee~~ has been a regular dialogue with ~~formed. Official~~ creditors, including with a creditor committee composed mainly of regional banks that hold a large proportion of the debt. Grenada has ~~are~~ also been in contact with its official bilateral creditors. However, the process is ~~being contacted, but the process has become~~ complicated by the fact that Grenada no longer has diplomatic relations with its largest bilateral ~~on account of difficulties in negotiation with the principal~~ creditor, Taiwan Province of China. Moreover, ~~, and the preference of~~ some Paris Club creditors have expressed a preference for a restructuring in the context of a Fund-supported program. ~~Grenada remains in "selective default" according to Standard and Poor's because of missed interest payments on international sovereign bonds. An exchange offer is expected to be launched by early September.~~

26. **On September 9, the Grenadian authorities launched an exchange offer to restructure its commercial debt.**[13] Holders of eligible claims, amounting to US$275 million including past due interest, can exchange these for two new bonds, one in U.S. dollars and

[13] The exchange covers 85 percent of Grenada's domestic and external commercial debt and about 30 percent of government-guaranteed debt—in all, 50 percent of the total stock of debt. Treasury bills will not be restructured.

the other in Eastern Caribbean (EC) dollars, with maturities falling due during 2021–2025. The interest rate on the new bonds will be 0.85 percent for the first thee years, and will step up gradually to 8 percent after 10 years. The offer does not involve a principal reduction nor upfront cash payments. The new U.S. dollar bonds will be governed by New York law and use a trust structure, while the new E.C. dollar bonds will be governed by Grenada law and use a fiscal agency structure. The new bonds contain collective action clauses. The closing date for creditors to accept the offer is October 7, 2005 and the authorities have set a minimum participation threshold of 85 percent for the exchange to be concluded. The Fund provided an assessment letter to accompany the offer.

27. **A successful exchange offer will provide substantial cash flow relief over the coming years and reduce external vulnerability.** In the event that full participation is achieved, Grenada's commercial debt service payments would be reduced by over 90 percent over the next three years and by 80 percent over the following five years. The offer represents an NPV "haircut" of 45–50 percent for exit yields in the 9–10 percent range.

Iraq

28. **Following the agreement in November 2004 with Paris Club creditors, Iraq began to take steps to settle claims with private creditors**. To this end, Iraq retained legal and financial advisors for the private debt restructuring, and appointed an accounting firm to assist with the debt reconciliation process.[14] The total amount of commercial claims (principal and imputed late interest) is estimated by the authorities to be around US$20 ~~20~~ billion (out of an estimated total debt of US$125 billion).[15] Iraq's commercial debt is held by a broad range of creditors, including suppliers, trading firms, banks, and other financial institutions.

29. **The Iraqi authorities invited those creditors who had submitted claims to meet with them ~~and some private creditor representatives met~~ in Dubai on May 4, 2005**. In the meeting, the authorities stated their intention to base any offer to settle private creditor claims on the requirement of comparability of treatment set forth in the November 2004 agreement with the Paris Club, and the principle of equal treatment for all creditors. Following the meeting in Dubai, Iraq's financial advisors met with various creditors to explain Iraq's objectives in settling the claims of the private sector. A group of seven banks that claims the support of 60 financial institutions organized a London Club Coordinating Group to represent the interests of these creditors. This group has urged the authorities to negotiate a settlement with private creditors, and presented its own debt restructuring offer to the authorities in July. Other~~Several~~ creditor groups have also been formed to represent the interests of suppliers and trading firms.

[14] Iraq's Debt Reconciliation Office set up a website (http://www.eyidro.com) which provided information on the reconciliation procedure, and a vehicle for private creditors to submit their claims. The deadline for submission of commercial claims was April 15, 2005.

[15] These estimated claims include both principal and imputed past due interest, calculated using a uniform interest rate. Under this methodology, past due interest represents about 54 percent of the total claims.

30. **On July 26, 2005, Iraq announced an offer to settle private claims, and reopened the claims registration process until August 8, 2005**. Negotiations did not take place with creditors prior to this announcement. The proposed offer is based on Iraq's interpretation of the comparability of treatment clause under the Paris Club agreement, and includes options for both "large" (i.e., those with individual aggregate claims greater than US$35 million) and "small" (i.e., those with individual aggregate claims less than US$35 million) claimants. A first option for large claimants is to enter into a syndicated loan which replicates the cash flows agreed with the Paris Club, including a cancellation of 80 percent of the total claims in three installments, with the residual 20 percent to be repaid over a 23-year period with six years of principal grace at an interest rate of Libor plus 50 basis points.[16] A second option is for large claimants to exchange claims for a bond with somewhat different cash flows than the loan, but identical value in net present value terms.[17] On the basis of Iraq's valuation, using a commercial discount rate of about 11.5~~7~~ percent, these debt-for-debt options would confer a "haircut" of 90 percent in net present value terms. Applying a lower discount rate typical of official creditors would imply a lesser net present value "haircut". In addition, the offer entails a cash buyback proposal which would be available only to small claimants. To maintain comparability across the different options, the creditors would receive 10.25 cents for each dollar of their claims.

31. **On August 8, Iraq launched an initial tender for the cash buyback of US$750 million of eligible claims.~~offer.~~** The period for submitting tenders closed~~is scheduled to close~~ on September 9, with the exchange to be settled on September 22. Preliminary results show that holders of about 78 percent of the eligible claims accepted the offer, while holders of about 20 percent postponed a decision until all of their claims were reconciled. Holders of about 2 percent of the eligible claims rejected the offer or failed to respond. Further cash buyback tenders will occur during the course of 2005 and 2006 as claims are reconciled. The authorities announced that the debt-for-debt exchange would~~will~~ be launched following Fund approval of a Stand-by Arrangement.

Serbia and Montenegro

32. **Following several years of negotiations, Serbia and Montenegro reached agreement in July 2004 with its London Club creditors to restructure its commercial bank debt.** The terms are comparable to those provided by the Paris Club in 2001. After a write-down of about 62 percent, the remaining debt is to be converted into bonds. The debt conversion process, which began with the listing of bonds at the Luxembourg stock exchange in April 2005, has been completed for 95 percent of the debt. The process is expected to be completed by end-October 2005.

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[16] The offer indicates that (i) the loan matures in January 2028; (ii) principal amortizations on a semiannual basis begin in July 2011; (iii) interest accruing through end 2007 is capitalized, while interest accruing during 2008–10 is partially capitalized; and (iv) the loan can be denominated in dollars, yen, and euros.

[17] The offer states that (i) the bond matures in 2028; (ii) principal amortizations on a semiannual basis begin in July 2020; (iii) the coupon on the bond is set at 50 basis points over LIBOR or fixed at an equivalent rate; and (iv) the bond is denominated in dollars. The bond would be privately placed.

V. Progress Under the Evian Approach and Other Paris Club Issues

33. **Since March 2005, no debt treatments under the Evian approach have been completed.**[18] In April, Paris Club creditors concluded that Gabon's debt position was sustainable and thus did not warrant the provision of additional debt relief under the "goodwill clause" included in its 2004 Agreed Minute.

34. **In June, Paris Club creditors agreed in principle to provide a comprehensive debt treatment to Nigeria.** Nigeria has expressed interest in using exceptional oil revenues to finance an exit treatment from the Paris Club and in regularizing its relations with international financial institutions. Paris Club creditors expressed their willingness to provide debt reduction up to Naples terms on eligible debt, and to participate in a buyback of the remaining debt at a market-related discount. Consistent with the Evian Approach, the debt treatment would be phased and would aim at providing a definitive solution to Nigeria's debt problems. It would be contingent on the full clearance of Nigeria's arrears to the Paris Club, and the approval of a Policy Support Instrument by the Fund.

35. **The Paris Club has made public its framework for debt buybacks, and three countries have offered to make early repayments** (Box 2). Following Poland's offer in February to buy back of all of its outstanding Paris Club debt, Russia, in May, offered to repay over a third of its Paris Club debt, and Peru, in June, offered to retire about half of its outstanding debt stock.

[18] Additional information on the Evian Approach and other Paris Club issues is available on the Paris Club's website, http://www.clubdeparis.org/en/presentation/presentation.php?BATCH=B06WP14.

~~**Box 2. The Paris Club's Framework for Early Debt Repayment**~~

~~Favorable global liquidity conditions and low international interest rates are providing opportunities for debtors to refinance high, fixed-interest-rate obligations at a lower cost. Against this background, Paris Club creditors defined a common framework for early repayment operations, based on the following principles:~~

- ~~Early repayment is not a substitute for a debt treatment and should only be considered by debtors with a good payment record and a sustainable financial situation.~~
- ~~To foster inter-creditor solidarity, the principle and terms of repayment operations must be agreed by the Club as a whole and the offer presented to all creditors under similar terms. Participation remains voluntary, however.~~
- ~~Early repayment may cover the all or only a portion of outstanding Paris Club claims.~~
- ~~Repayment can be either at par, or at a price reflecting the net present value of the remaining cash flows on the basis of a common market-based discount rate (e.g., spreads on sovereign bonds of similar duration). Thus, in principle, the buyback price may be lower or higher than par.~~

~~The framework was made public in a June 2005 meeting of the Paris Club with the private sector. Three early repayment operations have thus far been announced, all of which involved pre-payments at par. In only one case (Poland) did the debtor offer to repay all of its obligations to the Paris Club.~~

Table. Prepayments of Paris Club Debt
(In billions of US dollars)

	Date of agreement	Total Paris Club debt	Debt eligible for prepayment
Poland	February 2005	14.0	14.0
Russia	May 2005	40.0	15.0
Peru	June 2005	4.2	2.0

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VI. Assessing the Determinants and Prospects for the Pace of Market Access by Countries Emerging from Crisis[19]

36. **In a follow-up to the Fund's work on issues of crisis prevention and resolution, in May 2005, the Executive Board discussed the determinants and prospects for the pace of market access by countries emerging from a crisis**. Directors welcomed the opportunity to revisit the issue following the return to international capital markets by some countries that had restructured their debt and the increased attention to market reaccess issues in both the public and private sectors. It was noted that the issue of market reaccess is highly relevant to the Fund—especially in the context of crisis prevention and resolution, including the exceptional access framework. Staff's findings were considered to hold important lessons regarding the steps that countries emerging from a crisis need to take in order to reaccess international capital markets, in particular, the need to build and sustain credibility in the country's policies.

37. **The circumstances underpinning the loss of market access are a key determinant of how and when a country regains market access,** including adverse developments in international capital markets and the deterioration of domestic macroeconomic conditions. Countries that lose access because of adverse market developments normally regain access quickly if there is only a minor decline in investors' risk appetite which does not affect the assessment of the country's creditworthiness, while significant declines in investors' risk appetite imply countries will take considerably longer to regain market access.

38. **The length of time taken to regain markets access varies when the loss of access reflects policy slippages or severe market turbulence that give rise to concerns about the country's ability to service its debt**. In these cases, no country has regained access without committing to policy adjustments. Experience has shown that when conditions in international capital markets are favorable, market reaccess takes anywhere from several months to approximately a year and a half. The timing of reaccess depends heavily on the strength of the corrective policies the country implements which should improve the

[19] See *Assessing the Determinants and Prospects for the Pace of Market Access by Countries Emerging from Crisis—Further Considerations* (SM/05/76, 3/2/05, and BUFF/05/82, 5/17/05).

country's ability to repay its obligations and set the debt dynamics on a credible sustainable course.

39. **Countries that undertook a debt restructuring regained market access only after demonstrating a commitment to strong corrective policies**. The timing of the reaccess again depends on the nature of the external environment and the success of the policy efforts. In recent years, countries that have restructured their bonds have taken anywhere from 18 months to five or more years to restore external market access, or four months to four years after completion of the debt restructuring. In this respect, Fund policy advice and the Fund's financial assistance, including precautionary arrangements to countries during the crisis period before access is regained, can play an active role in helping countries regain market access.

40. **Countries seeking to reaccess capital markets should put in place a strong communication strategy to explain to investors the nature and the objective of the corrective policies, including the expected results**. Data and other information need to be made available on a timely basis particularly on the early results of the adjustment effort. This would allow investors to manage better the information risk associated with a country emerging from a crisis, and to reassess the risk-return tradeoff of possibly increasing their holdings of a country's debt. Countries would benefit from an open two-way dialogue with investors to get feedback regarding the success of the efforts to strengthen their creditworthiness.

41. **Countries need to give careful attention to the characteristics of the "reaccess bond" and should evaluate the selection of the target investors, as well as size and maturity of the bond**. While fixed-coupon, bullet-payment bonds are most common because they are easy to price which promotes liquidity, smaller countries which are relatively infrequent issuers could consider amortizing structures that could facilitate the management of certain risks, including rollover risk.

42. **Directors supported continued work by staff to develop an analytic framework to evaluate factors affecting market reaccess**. They looked forward to an analysis of the effects of Fund support and its signaling role on market reaccess and the implications for Fund work.

VII. Managing Systemic Banking Crises in the Context of Sovereign Debt Restructuring[20]

43. **Against the background of the IMFC's request to continue working on issues of general relevance for the orderly resolution of financial crises, Directors, on July 22, had a preliminary discussion on the difficult circumstances where banking system distress is associated with a sovereign debt crisis**. While considering the paper timely,

[20] See *Managing Systemic Banking Crises in the Context of Sovereign Debt Restructurings* (SM/05/249, 07/01/05) and the Concluding Remarks by the Chairman (BUFF/05/121). As the Board has decided not to publish the staff paper this section will be deleted from the published version of the progress report.

Directors agreed that the limited experience to date, the second-best nature of the measures considered, and the diversity in country circumstances, precluded drawing firm conclusions.

44. **Directors agreed that prevention remains the first line of defense in shielding bank balance sheets from sovereign debt vulnerabilities**. Beyond the importance of sound and consistent macroeconomic policies, a number of Directors expressed interest in the possibility of pursuing more ambitious prudential standards in highly indebted economies, including through setting higher liquidity and capital requirements and tighter asset classification and provisioning. Directors emphasized, however, the need for a careful balance between improving bank resilience to shocks and preserving the system's efficiency. Higher capital and other prudential requirements, for instance, could lower financial intermediation, adversely affect growth and possibly encourage unregulated and informal channels of financing. Also, in many countries the sovereign relies heavily on bank financing, and a tightening of the prudential framework cannot be considered independently of the broader framework for fiscal financing.

45. **Directors agreed that, when debt restructuring is unavoidable, the initial priorities for the banking system should be to restore confidence, safeguard the payments system, and minimize disruptions to credit flows**. It was generally agreed that in cases where the impact on the banking system was limited, conventional crisis management tools should be considered first. However, if the impact of the sovereign debt restructuring on the banking system is severe, traditional policy options may not be available or credible. Emergency liquidity provision may be constrained where a large part of bank liabilities are denominated in foreign currency, or may evaporate in capital flight where the central bank lacks the instruments to sterilize its domestic currency liquidity support. Public sector support of bank recapitalization may not be feasible, and the government's inability to meet its debt-service obligations will undermine the credibility of any general guarantee to protect depositors. In such circumstances, more extreme policy measures may need to be considered. Directors stressed that these are inherently second-best and largely untested options, and should be considered as a last resort.

46. **Directors discussed a number of crisis containment measures, including the extension of deposit maturities, securitization of deposits and deposit freezes**. Most Directors emphasized the need to design these types of administrative measures in a way that minimized disruption to the payments system and household and corporate liquidity. Directors also stressed the need to be mindful of socially acceptable wealth effects. Approaches that could be considered included allowing securitized deposits to be traded, limiting withdrawal restrictions to only a portion of deposits, and allowing longer-dated deposits to be used for transactions within the banking system.

47. **On the issue of restructuring and resolving undercapitalized or insolvent banks, most Directors were of the view that, to the extent possible, granting banks more time to meet capital requirements is preferable to easing valuation rules**. However, in countries that prohibit the continued operation of insolvent banks, this may require the authorities to intervene or close a large part of the banking system. In this regard, Directors noted that easing valuation rules for government securities could allow banks and shareholders some time to adjust to new realities. Most Directors emphasized that this should

be strictly limited in time and restricted to sovereign debt only. A few Directors expressed the view that the inclusion of other assets could also be contemplated.

48. **As regards other possible options, most Directors noted that the closure of an insolvent bank that plays an essential role in the payments system could at times be a worse solution than allowing it to operate under stringent prudential safeguards**. However, allowing an insolvent bank to stay open under private control was considered an extreme measure that could give rise to serious moral hazard issues and increases the risk of asset stripping by shareholders and managers. A better alternative would be to allow for a temporary takeover by the government, and to pass ownership and control to a bank resolution agency, with a view to privatizing the bank as soon as the crisis has passed.

49. **Most Directors noted that in extreme circumstances, the authorities may have no choice but to recognize shareholders' losses and then impose haircuts on bank creditors, including depositors**. However, the critical question is whether it would be possible to reconstruct a viable banking sector in the aftermath of such policies and whether private sector confidence could be regained. For these reasons, some Directors argued that haircuts on depositors should be avoided, while others called on the staff to examine further ways in which depositor losses could be mitigated, including by giving depositors equity in restructured banks.

50. **Several Directors expressed interest in some of the more direct ways in which Fund resources could be used to support the banking system, including through the provision of liquidity advances in foreign exchange and bolstering the credibility of deposit guarantees**. However, Directors also cautioned about the risks of such operations. They stressed that the justification for the use of Fund resources should be particularly strong, that it would be important to try to assess accurately the nature and permanence of outflows that are occurring, and that program conditionality should be based on properly addressing underlying imbalances to ensure that Fund financing is temporary and addresses balance of payments needs. Directors noted that explicit discussion of exit strategies and the member's capacity to repay would need to be reflected in staff reports.

51. **Directors underscored the preliminary nature of the discussion, and urged staff to pursue further work aimed at a deeper analysis of key issues in this area**.

Table 1. Emerging Markets Sovereign Bond Issuance by Jurisdiction 1/

	2003				2004				2005 5/	
	Q1	Q2 3/	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2 4/
With CACs 1/										
Number of issues	9	31	10	5	25	19	19	15	18	39
Of which: NY law	1	22	5	4	14	12	12	13	11	23
	(In billions of U.S. dollars)									
Value of issues	5.6	18.0	6.4	4.3	18.5	15.9	10.7	9.1	22.3	35.1
Of which: NY law	1.0	12.8	3.6	4.0	10.6	9.5	6.5	7.7	11.1	20.2
Without CACs 2/										
Number of issues	14	4	7	7	2	1	1	4	0	1
	(In billions of U.S. dollars)									
Value of issues	8.1	2.5	3.5	4.2	1.5	0.1	0.2	2.7	0.0	0.3

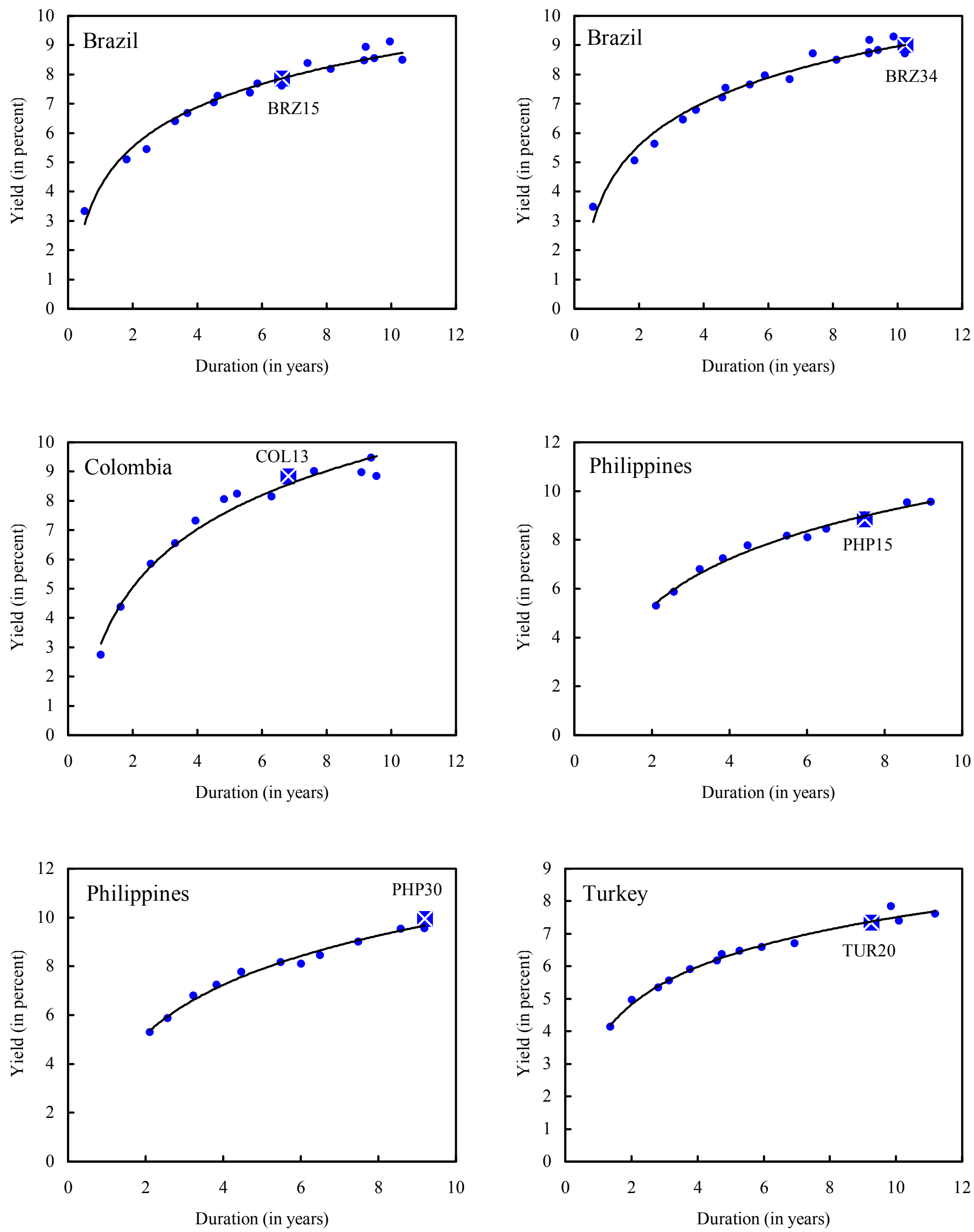
Source: Dealogic.
1/ English and Japanese laws, and New York law where relevant.
2/ German and New York laws (includes reopenings of previously issued bonds without CACs).
3/ Includes bonds issued by Uruguay in the debt exchange.
4/ Includes bonds issued by Argentina and The Dominican Republic in their respective debt exchanges.
5/ Data as of June 30, 2005.

Table 2. Emerging Market Sovereign Bonds Outstanding Issuance by Governing Law

	Number of Issues		Value of Issues	
	(In number)	(In percent)	(In billions of U.S. dollars)	(In percent)
New York	435	62	264	63
English	182	26	120	29
German	45	6	20	5
Japanese	41	6	12	3
Total	703	100	416	100
Of which: with CACs	338	48	220	53

Sources: Dealogic; Bloomberg; and IMF staff calculations (as of June 30, 2005).

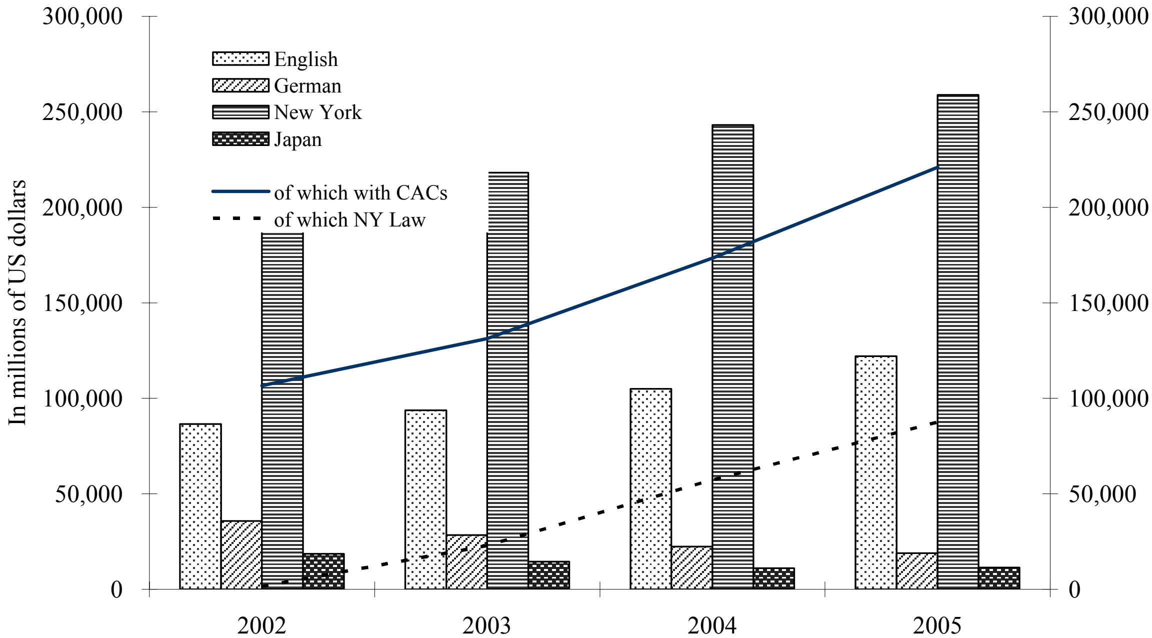
Figure 1. Yields on Selected Recent Issues of U.S. Dollar Bonds with Collective Action Clauses 1/



Sources: Capital Data and Merrill Lynch.

1/ As of date of issuance.

Figure 2. Emerging Market Outstanding Sovereign Issuance by Governing Law



Source: Dealogic; Bloomberg and Fund staff calculations.

Table 3. Emerging Markets Sovereign Bonds—Outstanding Issuances by Region and Governing Law, 2002 and 2005 1/

	2002		2005	
	In billions of US dollars	In percent	In billions of US dollars	In percent
Africa				
Total outstanding issuances	10.0	100.0	12.4	100.0
Total with CACs	4.2	42.5	7.6	61.3
New York	4.3	42.7	6.8	55.0
Of which: with CACs	...	...	2.4	19.5
English	2.0	20.4	3.6	29.1
German	0.3	3.1	...	...
Japanese	2.2	22.1	1.6	12.7
Asia				
Total outstanding issuances	29.8	100.0	43.9	100.0
Total with CACs	8.9	30.0	18.4	41.8
New York	19.0	63.7	30.6	69.8
Of which: with CACs	...	...	8.0	18.1
English	6.4	21.3	8.2	18.6
German	0.7	2.5	0.7	1.7
Japanese	2.6	8.6	2.2	5.1
Eastern Europe				
Total outstanding issuances	74.8	100.0	107.7	100.0
Total with CACs	45.0	60.2	86.0	79.9
New York	14.5	19.3	26.0	24.2
Of which: with CACs	...	...	10.9	10.1
English	39.7	53.1	70.2	65.2
German	14.8	19.8	6.3	5.8
Japanese	5.3	7.1	4.9	4.6
Latin America				
Total outstanding issuances	146.9	100.0	172.0	100.0
Total with CACs	30.6	20.8	68.2	39.7
New York	90.7	61.8	133.4	77.5
Of which: with CACs	...	...	49.5	28.8
English	22.3	15.2	15.7	9.1
German	19.9	13.6	12.2	7.1
Japanese	8.3	5.7	3.0	1.8
Middle East				
Total outstanding issuances	16.2	100.0	20.7	100.0
Total with CACs	8.8	54.6	13.2	63.5
New York	12.5	77.2	16.0	77.0
Of which: with CACs	5.2	31.8	8.6	41.7
English	3.5	21.7	4.3	21.0
German	...	...	...	...
Japanese	0.2	1.1	0.2	0.9

Sources: Dealogic; Bloomberg; and Fund staff calculations.

1/ End of period, data for 2005 are for July.

Table 4. Collective Action Clauses:
G-10 Recommendations and Bonds Issued under New York Law Since March 2005

Provisions	G-10 Recommendations	Argentina, Brazil, Colombia, Dominican Republic, El Salvador, Indonesia, Italy, Lebanon, Mexico, Peru, Philippines, Turkey, Uruguay, and Venezuela
Amendment of Key Terms	75 percent threshold based on either outstanding principal or principal held by those present at a duly convened meeting.	75 percent based on outstanding principal (except the Lebanon bond, where the threshold is based on duly convened meeting).
Aggregate Voting	None.	Argentina, Dominican Republic, and Uruguay: 85 percent of the aggregate outstanding principal of all affected series (taken in aggregate) and 66⅔ percent of outstanding principal of each affected series (taken individually).
Disenfranchise-ment	Bonds owned or controlled directly or indirectly by the issuer or its public sector instrumentalities.	Generally bonds owned directly or indirectly by the issuer or its public sector instrumentalities.
Acceleration	25 percent of outstanding principal.	25 percent of outstanding principal (except the Lebanon bond, where each bondholder has the right to accelerate upon default).
De-acceleration	Between 50 and 66⅔ percent of outstanding principal.	• Argentina, Colombia, Dominican Republic, Indonesia, Mexico, Peru, Philippines and Venezuela: 50 percent of outstanding principal. • Uruguay: 66 percent of the outstanding principal. • Brazil, El Salvador, Italy and Turkey: 66⅔ percent of outstanding principal • Lebanon: none.
Initiation of Proceedings	• Mandate the use of a trust or an equivalent legal structure where the trustee can be instructed by 25 percent to initiate lawsuits. • Pro rata distribution of recovered proceeds under trust structure.	Individual bondholder, except the Argentina, Dominican Republic, Indonesia and Uruguay bonds where the trustee has a limited monopoly over initiation of proceedings whose recovery would be distributed pro rata.
Engagement Provision	• Appoint a bondholder representative for the life of the bond. • 66⅔ percent to appoint at any time any person to represent all holders in negotiation with the issuer or other creditors.	None.
Information Provision	A covenant requiring the issuer to provide certain types of information over the life of the bond and following a default.	None.
Documentation	Trust or an equivalent legal structure.	Fiscal agency agreement, except Argentina, Dominican Republic, Indonesia, and Uruguay which utilized a trust structure.

Table 5. Selected Countries: Debt Indicators, 1999-2004 1/

	1999	2000	2001	2002	2003	2004
Antigua and Barbuda						
Gross public sector debt as a share of GDP	117.2	125.4	123.6	137.6	132.0	99.4
External debt service as a share of total exports	5.6	8.6	8.5	8.4	8.8	40.2
External debt service as a share of GDP	5.0	7.4	6.3	8.6	6.9	26.1
Argentina						
Gross public sector debt as a share of GDP	47.6	50.9	62.2	164.2	144.5	133.9
External debt service as a share of total exports	100.1	105.0	108.3	55.8	61.1	35.8
External debt service as a share of GDP	9.9	11.5	12.5	15.8	16.1	9.3
Belize						
Gross public sector debt as a share of GDP	53.1	75.8	84.1	89.6	103.1	102.3
External debt service as a share of total exports	8.7	13.8	20.6	43.8	28.7	50.9
External debt service as a share of GDP	4.9	7.3	10.5	23.3	14.4	24.9
Dominica						
Gross public sector debt as a share of GDP 2/	71.0	76.8	87.4	95.4	121.9	118.4
External debt service as a share of total exports	5.0	7.4	10.9	11.8	19.5	20.8
External debt service as a share of GDP	2.9	4.0	5.0	5.8	8.9	9.9
Dominican Republic						
Gross public sector debt as a share of GDP	26.8	25.9	23.6	26.8	54.3	52.1
External debt service as a share of total exports	6.5	6.4	9.7	10.8	11.4	8.4
External debt service as a share of GDP	3.0	2.9	3.7	4.1	6.4	4.2
Grenada						
Gross public sector debt as a share of GDP	51.9	56.2	63.7	109.6	110.0	129.4
External debt service as a share of total exports	5.1	5.6	8.2	17.4	18.9	25.0
External debt service as a share of GDP	2.9	3.2	4.1	7.4	7.7	10.1
Serbia and Montenegro						
Gross public sector debt as a share of GDP 3/	...	119.1	123.2	85.4	79.2	60.2
External debt service as a share of total exports	5.9	2.8	5.1	7.1	13.6	24.0
External debt service as a share of GDP	1.0	0.7	0.9	1.2	2.2	4.1
Iraq						
Debt stock as a share of GDP	...	...	...	...	...	306.2
External debt service as a share of total exports 4/	...	...	...	...	...	0.0
External debt service as a share of GDP 4/	...	...	...	...	...	0.0

1/ For Antigua and Barbuda, central government only; for Argentina and Serbia and Montenegro, consolidated government; for Belize and Dominica, nonfinancial public sector; for Dominican Republic nonfinancial public sector and central bank; for Grenada, general government.
2/ Data presented on a fiscal year (July-June) basis; figures shown for a given calendar year relate to the fiscal year beginning on July 1 of the previous year.
3/ Covers gross external debt and net domestic debt.
4/ On cash basis.

Sources: WEO, IMF country staff reports.

Table 6. Argentina: New Bonds Issued, by Currency and Governing Law

(In billions of US dollars, unless otherwise indicated)

Bond	US dollars		Euros	Yen	Pesos	Total
	NY law	Arg law	English law	Japanese law	Arg law	
Par	5.3	1.2	6.4	0.2	1.9	15.0
percent of total	15.1	3.5	18.1	0.6	5.3	42.5
Discount	3.1	0.6	2.9	0.1	5.3	11.9
percent of total	8.8	1.6	8.2	0.2	15.2	33.8
Quasi-par	0.0	0.0	0.0	0.0	8.3	8.3
percent of total	0.0	0.0	0.0	0.0	23.6	23.6
Total	8.4	1.8	9.3	0.2	15.5	35.3