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INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 05/80-1

10:20 a.m., September 16, 2005

**1. Progress Report on Crisis Resolution**

Documents: SM/05/342 and Correction 1, and Revision 1; and Revision 1, Correction 1

Staff: Srinivasan, PDR; Medeiros, ICM; Laryea, LEG

Length: 1 hour, 24 minutes

## **Executive Board Attendance**

A. Krueger, Acting Chair

<b>Executive Directors</b>	<b>Alternate Executive Directors</b>
K. Bischofberger (GR)	A. Al Nassar (SA), Temporary
P. Duquesne (FF)	
N. Jacklin (UA)	T. Miyoshi (JA), Temporary
	S. Rottier (BE), Temporary
	M. Roovers (NE), Temporary
K. Lynch (CO)	
A. Mirakhor (MD)	V. Srinivas (IN), Temporary
	L. Palei (RU), Temporary
	P. Gakunu (AE)
	R. Murray (AU)
	L. Rutayisire (AF)
A. Sadun (IT)	
E. Loyo (BR)	R. Newton-Smith (UK), Temporary
M. Schwartz (CE)	
A.S. Shaalan (MI)	D. Farelus (NO)
	J. Costa (AG), Temporary
	D. Wang (CC), Temporary
F. Zurbrugg (SZ)	
H. Phang (ST)	

A. Linde, Acting Secretary  
S. Negrete-Cardenas, Assistant

### **Also Present**

IBRD: G. Bauche. Asia and Pacific Department: B. Mercereau. European Department: E. van der Mensbrugghe. External Relations Department: T. Dawson. International Capital Markets Department: A. Bertuch-Samuels, C. Blitzer, C.H. Lim, C. Medeiros, S. Medina Cas, Y. Xiao, L. Zanforlin. Institute: L. Lipschitz. Legal Department: D. Eastman, T. Laryea, R. Mundkur, N. Rendak. Middle East and Central Asian Department: M. Savastano. Policy Development and Review Department: M. Allen, P. Brukoff, H. Finger, D. Hoffman, R. Kincaid, J. Kozack, A. MacArthur, M. Mecagni, K. Srinivasan, G. Sterne, D. Tzanninis. Secretary's Department: P. Ramlogan. Western Hemisphere Department: P. Khandelwal, D. Robinson. Senior Advisors to Executive Directors: S. Beidas (MI), R. Calderón-Colín (CE), C. Gola (IT), O. Hollensen (NO), M. Kruger (CO), M. Melhem (SA), H. Mori (BR), K. Nauphal (MI), S. Rouai (MD). Advisors to Executive Directors: M. Martínez (CE), B. Seong (AU), J. Kanu (AE), T. May (ST), F. Meyerhoefer (GR), T. Nguema-Affane (AF), S. Segal (UA), W. Wesaratchakit (ST).

## 1. **PROGRESS REPORT ON CRISIS RESOLUTION**

Mr. Loyo and Mr. Mori submitted the following statement:

We welcome the discussion of the recent progress on crisis resolution and thank the staff for preparing a succinct document.

We noted further progress in the inclusion of the collective action clauses (CACs) in sovereign bonds issued by emerging market countries—in our constituency, Brazil, Colombia and the Dominican Republic included CACs in the new issuances of sovereign bonds. The share of bonds with CACs has been increasing, as stated in the report, reaching 53 percent of issuances outstanding by end-June 2005, in value terms. This figure may have become even higher since the report's closing date, because of the new issuances and debt exchanges that have recently taken place. For instance, Brazil placed a new set of bonds with CACs—US\$4.4 billion in July, in exchange for outstanding bradies (the C-bond), and US\$1 billion in September, referring to the anticipated refinancing of debt maturing in 2006. Brazil also announced earlier this month the intention to call the remaining US\$1.2 billion of C-bonds in their next amortization date, October 15<sup>th</sup>.

Progress has also been achieved in broadening the support for the Principles for Stable Capital Flows and Fair Debt Restructuring in Emerging Markets. The draft text defining the process for implementation of the Principles is currently under consideration by emerging market issuers and private sector creditors. Therefore, at this stage, it seems premature to present the “envisaged features” as described in the two bullets of paragraph 9, to the extent that there are pending issues where agreement has yet to be reached. Some specific items included in the bullets seem to be taken from a previous draft of the Principles that has already been modified. We wonder whether those two bullets should not be deleted as the features they describe may be the object of further substantive changes before the final text is approved by the interested parties.

On the issue of “Assessing the Determinants and Prospects for the Pace of Market Access by Countries Emerging from Crisis,” it is evident that developments in international capital markets play a significant role in determining both the loss and the regaining of market access by emerging markets. Adverse domestic factors may magnify the severity of crises triggered by external shocks, demanding a strong policy response by the authorities to restore market confidence in order to mitigate the impact of such shocks and to speed up the restoration of market access. But domestic policies alone may not be sufficient to guarantee the preservation of market access, which remains subject to external conditions beyond the control of emerging market countries.

The paper presented by staff on “Managing Systemic Banking Crises in the Context of Sovereign Debt Restructuring” underscores the economic and

financial costs resulting from a sovereign debt restructuring. These costs may actually be of such dimensions as to wipe out possible short-term cash flow gains for the government. Policies should, hence, be conducted to avoid the occurrence of such extreme events. The Chair's concluding remarks on the issue pointed out that the discussion "was preliminary, and that the limited experience to date, the second-best nature of the measures considered, and the diversity in country circumstances, precluded drawing firm conclusions." We suggest that this disclaimer be added to the report to reflect the current stage of the discussions.

Finally, a note on the Dominican Republic. Paragraph 19 needs to be rectified as Union Fenosa is a foreign electricity company and not a bank as stated in the text. On August 16, an agreement was reached for the Dominican Republic's government to buy back the debt owed by the nationalized electricity distribution companies—EDENORTE and EDERSUR—to Union Fenosa for an amount of US\$302 million, representing a saving of US\$104 million in net present value terms with respect to the original debt.

Mr. Lynch and Mr. Kruger submitted the following statement:

We would like to thank the staff for an informative progress report.

We see recent developments as quite positive. Market practice has evolved toward bonds which can lead to more efficient crisis resolution. A number of countries are making progress in restructuring their debts. Moreover, progress is being made on the Principles for Stable Capital Flows and Fair Debt Restructuring in Emerging Markets. We strongly support these Principles, which should further facilitate future restructurings. In sum, we believe that recent experience shows that existing market practice need not preclude innovation and that financial markets are flexible enough to respond to new situations.

#### Collective Action Clauses and Beyond

We welcome the more widespread use of collective action clauses (CACs). The increase in the stock of bonds that includes CACs, from 31 percent as at end-2002 to 53 percent as at end-June 2005, is very encouraging as is the lack of observable impact on pricing. We feel that it is appropriate for the staff to take a pro-active role in promoting the inclusion of CACs in bonds by explaining the potential benefits to issuers.

While the Progress Report focuses on the acceptance and growth of bonds with CACs, two other developments receive less attention. Argentina, the Dominican Republic and Uruguay all issued bonds with aggregation clauses since March 2005. CACs are issue-specific and, in instances where there are a large number of issues outstanding, it is possible that a "holdout class" could undermine a restructuring. By allowing voting across instruments, aggregation clauses are potentially quite beneficial in promoting an orderly debt restructuring.

However, the flip-side of the benefits of aggregated voting is a loss of bondholders' rights, since a bondholder in a specific issue can be affected by the decisions of bondholders in other issues. We would be interested in the staff's assessment of how the market has accepted bonds with aggregation clauses.

The other interesting development is that since March 2005, Argentina, the Dominican Republic, Indonesia and Uruguay all issued bonds in New York under trust structures rather than fiscal agency structures. Under English law, trust structures contain effective majority enforcement provisions, which confer the right to initiate legal proceedings upon the trustee and dictate that any amount recovered by the trustee must be distributed pro rata among the bondholders. While trustee structures are effective, they have not been standard practice in New York. This seems to be changing. Do the trust structures used in New York have the same features as those under English law? How has the market accepted this second, potentially very useful, modification to standard practice.

#### Principles for Stable Capital Flows and Fair Debt Restructuring in Emerging Markets

We strongly welcome the IIF's efforts to broaden the consensus among emerging market issuers and private sector creditors. The IIF has an ambitious implementation plan for the Principles. In this context, we would appreciate ongoing monitoring of developments by the staff, with periodic reporting to the Board.

#### Update of Recent Restructuring Cases

The staff note that, in early May, Argentina regained domestic market access with a 1 billion inflation-indexed peso issue. This was followed by a similar issue in July as well as those of dollar-denominated bonds. We would be interested in knowing if these bonds attracted significant foreign participation. In other words, has Argentina regained any external market access without having to issue bonds abroad?

Mr. Oh and Mr. Seong submitted the following statement:

We would like to thank the staff for a concise and informative report on the recent progress on crisis resolution. We welcome the progress on the continued complementary roles of Collective Action Clauses (CACs) and the Principles for Stable Capital Flows and Fair Debt Restructuring in Emerging Markets (henceforth, the Principles) towards the Fund's crisis resolution initiatives, and encourage staff to continue to monitor and report the developments to the Board.

It is encouraging that the majority of total emerging market bonds held by investors now contain CACs. While the Principles contain guidelines on how to

negotiate debt restructurings, the use of CACs can complement this by ensuring that the outcomes of such negotiations are not then unreasonably obstructed.

It is pleasing to see that a number of other countries have managed to complete debt restructures without significant levels of creditor hold out since the last Progress Report, and that the Institute for International Finance reports that the Principles are now being used in debt restructurings. Where the Fund's crisis prevention efforts can have traction with borrowing countries, the Principles can complement this on the supply side through encouraging creditors not to be overly hasty in withdrawing their capital. Given its relationship with the Principles, the Fund's Lending Into Arrears policy (LIA), as one of the building blocks of the orderly resolution of financial crises, is in need of clarification and this should be done expeditiously.

Another positive development is the Paris Club's new policy to allow debt buybacks. This will enable borrowers such as Nigeria to reduce their debt vulnerabilities during a period of favorable investor sentiment. (Nigeria represents the Paris Club's second largest debt write-off ever, as well as the first time a restructuring has taken place simultaneously with a debt buyback.) We take good note of steps being taken by Iraq to settle claims with private creditors and a plan for the debt-for-debt exchange following Fund approval of a Stand-by Arrangement.

In the past, the necessary conditionality for Paris Club restructurings has been supplied through conventional IMF programs but at the cost of encumbering the country in question with still more debt. However the new Policy Support Instrument (PSI)—a non-borrowing program—will be used in lieu of a conventional IMF program for Nigeria's Paris Club debt restructuring. The new PSI should help apply conditionality to poor countries without also causing them to incur further indebtedness.

In view of the preliminary nature of discussions on managing systemic banking crisis, we would go along with Messrs. Loyo and Mori's suggestion that the disclaimer be added to the report to reflect the current stage of discussions.

We look forward to seeing that the Principles and CACs can continue to complement the Fund's crisis prevention efforts.

Mr. Misra and Mr. Kanagasabapathy submitted the following statement:

We welcome the comprehensive report on the progress relating to crisis resolution initiatives. We also welcome the proactive role of staff in promoting inclusion of Collective Action Clauses(CACs) in international sovereign bonds. This effort has borne fruits inasmuch as the all new issues, excepting one, carried CACs. The wider adoption of CACs also seems to have removed the stigma of any potential signaling problem, apprehended in earlier discussions.

We commend the efforts being made by the Institute of International Finance (IIF) to broaden the consensus on Principles among emerging market issuers and private sector creditors. We also welcome the work being taken to the next stage of considering a viable process of implementation of these Principles, which has received a fair amount of support from issuers.

Considering that discussions are at a preliminary stage, we do not have any comments on the three-tier process. We note that the Fund, rightly, is not directly involved in these discussions. In this context, we reiterate that the Fund should not be seen as an active party or a signatory to the documents, though it could be facilitating the process, to avoid any potential conflicts of interest as a preferred creditor and as the risk of getting embroiled in legal disputes in courts of law would be detrimental to the whole membership. The Fund's policies, including those on Lending into Arrears, are independent of the Principles and the Fund should not be bound by outside contractual arrangements.

Crisis resolution will always remain the second best situation, since prevention is better than cure. The Fund in its strategic review is therefore, rightly refocusing its attention on crisis prevention and strengthening its surveillance mechanism.

On reporting the discussion on two staff papers in a seminar mode, the fact that the conclusions were preliminary and there were no Board decisions on any of these issues must be prominently reported to the IMFC, as also recommended by Mr. Loyo.

Mr. Mirakhor submitted the following statement:

We welcome staff's update on the important issue of crisis resolution. It is particularly encouraging to note the expanding array of initiatives in this context and the progress made by several countries in restructuring their sovereign debt.

Notably, collective action clauses (CACs) are being increasingly included in emerging market sovereign bonds. Staff indicate that, since March 2005, all but one of the newly-issued bonds included CACs that were broadly in line with the G-10 recommendations. The inclusion of CACs seems to have become the established practice under the dominant New York law-governed issues. Recent sovereign debt exchanges have, noticeably, replaced a large volume of bonds that did not include CACs with those that include these clauses; it is significant that the increase appears to reflect an even pattern across regions. The rise in the stock of CAC-included sovereign bonds, in value terms, to 53 percent at end-June 2005 (compared with 31 percent at end-2002) is significant. However, this still leaves some 47 percent without CACs, indicating scope for acceleration of the process. One also wonders why the inclusion of CACs does not appear to have had any perceptible impact on bond pricing. Staff's proactive role in promoting the

inclusion of CACs in international sovereign bonds is well directed, as are their efforts to encourage the use of CACs in the context of UFR and surveillance.

The principles for capital flows and fair debt restructuring represent an important, additional vehicle for preventing crises from evolving and for guiding debt restructuring, where necessary. Notably, several emerging market issuers and private sector creditors have indicated interest in and support for the initiative, and plans are underway to integrate the principles into firms' day-to-day practices. The principles are, however, still work in progress, and the implementation process is still being developed. While staff are not currently involved in the discussions, it is expected that they would continue to monitor developments, while seeking to define an appropriate role for the Fund. Staff may also clarify any differences with the Fund's lending into arrears policy (LAP). In Tier Three of the proposed implementation process for the principles, the Trustee Group's mandate includes "assessing the evolution of the international system as it relates to the emerging markets," which seems to be the mandate of the Fund. Staff clarification is welcome.

We welcome the continued progress in debt restructuring efforts since staff's last progress report. The seven concluded or ongoing debt-restructuring cases presented by staff are based on varying approaches, reflecting countries' unique circumstances, and indicate the complexity of the issues involved. Among others, debt restructuring has involved an exchange, buyback, or stock reduction. Obviously, some countries have been more successful than others, regarding creditor participation and restructuring terms. Litigations, including potential to attach assets, have plagued some debt restructurings, calling for concerted international response. The implementation of supporting macroeconomic and structural reform policies, within or outside the framework of a Fund-supported program, has, expectedly, been a key feature of most of the debt restructurings.

While no new debt treatments under the Evian approach have been concluded since March 2005, the Paris Club has, welcomingly, agreed to provide a comprehensive debt treatment to Nigeria that is consistent with the approach and is to be backed by the Fund's Policy Support Instrument (PSI). It is also noted that Poland, Russia, and Peru have offered to make early repayments under the Paris Club's newly-announced framework for debt buybacks.

On the prospects of market reaccess after crisis, while the source of the crisis is an important factor, the approach adopted is also crucial. The case studies presented in staff's report to the Board in May 2005 indicated the importance for market reaccess of domestic policy adjustment, an appropriately-designed debt restructuring and reaccess bond, target investor selection, and a strong communication strategy. While staff indicated that the effect of Fund support on market reaccess could not be conclusively determined, it was considered that the Fund had an important role to play, especially in the context of the PSI framework, and staff are expected to undertake further work in that area.



Whenever banking system distress coexists with debt crisis, it presents additional challenges. In that context, prevention should remain a high priority in insulating the banking system from debt vulnerabilities. Staff elaborate several avenues to this end—along with sound policies—including more stringent oversight, strengthened payments system, bank restructuring, and other crisis containment and resolution measures. While Fund resources could conceivably be used to support the banking system in this instance, such a need should be particularly strong. Moreover, appropriate safeguards would be necessary, including program conditionality to correct underlying financial imbalances, adequate repayment capacity, and suitable exit strategies.

Mr. Ngumbullu and Mr. Kanu submitted the following statement:

We thank staff for the valuable report, which makes today's discussions possible. Following the last Executive Board meeting that reviewed progress made on crisis resolution, and in accordance with the IMFC communiqué, the increased inclusion of CACs in international sovereign bonds is a welcome development. There were also calls for continued progress by the Fund in this area, including on further efforts to improve the Principles for stable capital flows and fair debt restructuring in emerging markets. We note that a number of countries are still pursuing this process of restructuring their sovereign debt, with several of them being able to secure agreements with their private creditors.

A significant increase in sovereign market bonds, that includes CACs, has been recorded between 2003 and 2005. Given this development, it is encouraging to note the continued proactive role being undertaken by staff in promoting the inclusion of CACs in international sovereign bonds, including its use both in the context of use of Fund resources and Fund's surveillance activities.

We note the efforts being made by the Institute of International Finance (IIF) to broaden the consensus on the principles for stable capital flows and fair debt restructuring among emerging market issuers and private sector creditors. We consider as appropriate, the ongoing discussions among participants on a process for implementing the principles. In this regard, we encourage the parties concerned to view the proposed features with an open mind in order to achieve the objectives of the debt restructuring mechanism. The determination by the staff to continue monitoring developments towards broadening the consensus is, therefore, welcome.

Although progress under the Evian approach has been mixed, with no debt treatments being completed, we welcome the agreement in principle by the Paris Club creditors to provide comprehensive debt treatment to Nigeria. As the debt treatment will be phased with the objective of providing a definitive solution to Nigeria's debt problems, we note that such action will be contingent upon the full clearance of Nigeria's arrears to the Paris Club and the approval of a Policy Support Instrument by the Fund. We therefore urge the Fund to expedite

finalization of the PSI to facilitate Nigeria's conclusion of the required arrangements to its debt problem. In addition, we welcome the principle of transparency applied by the Paris Club as regards its framework for debt buybacks and the progress by countries offering to make early repayments.

Mr. Shaalan and Mr. Nauphal submitted the following statement:

We thank the staff for the paper updating the Board on the progress on issues related to crisis resolution.

During the last Board meeting in April 2005 on the same topic, we have argued, along with other Directors, that a more active role for the Fund in the area of crisis resolution is called for, given the centrality of the subject for the institution, and we encouraged staff to elaborate further their research agenda and policy prescriptions in this matter. In this regard, we were pleased to have the opportunity to discuss recently at the Board two staff papers related to crisis resolution. We are not sure, however, of the usefulness of including in this report (section VI and VII) the summary of the Board discussion on these two staff papers in the current format. The summaries provided here are slightly shorter than the respective Acting Chair Concluding Remarks and do not bring anything new to the attention of Directors. Moreover, since they paraphrase the Concluding Remarks and omit certain references, especially regarding the nuanced view of Directors, they could be misleading. This is particularly relevant if this paper is to be published, presenting a possibly inaccurate description of the range of views on the subjects. It would have been better to attach the Concluding Remarks 'as is.' Moreover, further analytical input by staff on how to take these issues forward and integrate them in an explicit agenda for the Fund would have been useful.

Regarding Collective Action Clauses (CACs), we are encouraged by the continuing progress regarding their inclusion in international sovereign bonds issuance. The near absolute pervasiveness of CACs in sovereign bonds since March 2005 and the crossing of the critical mark of 50 percent, in terms of the share of issues with CACs in the total value of outstanding stocks of sovereign bonds for emerging markets, is reassuring. As in the past, there appear to be no evidence of an adverse effect on pricing, and therefore no premium appears to be implied by the inclusion of CACs in the design of the bonds. We encourage staff to continue their proactive role in this respect.

The effort to broaden the acceptance of the Principles for Stable Capital Flows and Fair Debt Restructuring in Emerging Markets by the IIF is beneficial, especially if it entails a deepening dialogue between creditors and debtors. The emphasis on transparency, close dialogue, cooperation and good faith should be emphasized. We are not sure, however, about the degree of flexibility of the Principles at this juncture to reflect the concerns that might be raised by sovereigns, in the broad outreach effort being currently undertaken. Could staff shed some light on the matter? Moreover, we wonder about the issues raised last

April on the relationship of the Principles to Fund policies, which raised some concerns in the Board, in particular, our Lending Into Arrears policy, and the inclusion of interbank credit in debt restructuring. We wonder whether the staff is providing any guidance to member countries involved in this dialogue on the Fund's policies in these areas.

Finally, regarding the restructuring of Iraqi sovereign debt. As Directors are well aware, Iraq agreed with the Paris Club on November 21, 2004 on a comprehensive debt treatment of the public external debt owed to Club's creditors, providing a total amount of debt reduction of 80 percent in three phases. Iraq has vigorously pursued comparable agreements with the non-Paris Club countries, and the progress in reconciling claims has been steady, with several reconciliation processes being in an advanced stage. On August 18, 2005, Iraq signed a bilateral agreement with Romania cancelling 80 percent of Iraqi's debt with that country.

Moreover, as we reported during the Article IV discussion on Iraq in August of this year, Iraq made a debt offer on July 26 to settle the claims of all the commercial creditors who registered their claims at the close of business in London on August 8, 2005, retaining Ernst & Young as the reconciliation agent for the Government of Iraq. According to the financial advisors of the government, the debt offer was carefully designed to adhere to the principle of the comparability of treatment of the Paris Club's restructuring terms. The offer included a cash buyback for all outstanding claims amounting to US\$35 million or less, with the cash purchase price of 10.25 percent of the reconciled outstanding amount of those claims. On August 8, 2005, the Iraqi authorities sent invitations to participate in a cash buyback to the commercial claimants whose claim's reconciliation were in an advanced stage at this date. These 58 claimants hold registered claims totaling about \$800 million, or about 20 percent of all claims submitted that, when reconciled, will be eligible to participate in the cash buyback offer. Preliminary results indicate a high degree of acceptance, with more than three quarter of claimants accepting the offer, the majority of the remaining claimants opting to defer the decision until the reconciliation process advances further. Additional rounds of invitations are expected to be sent to the claimants eligible for the cash buyback, as their claims are being reconciled. Altogether, these claimants represent more than 85 percent (by number) of the commercial creditors.

Mr. Al-Turki submitted the following statement:

I thank the staff for a clear and informative report on the recent progress on crisis resolution. As detailed in the report, there has been a number of encouraging developments. In particular, I welcome the substantial increase in the inclusion of collective action clauses (CACs) in sovereign bonds issued by emerging market countries. Indeed, in the span of just 2½ years, the share of the outstanding stock of emerging market sovereign bonds that includes CACs has

risen from approximately 31 percent to approximately 53 percent. Here, I would like to stress the Fund's efforts in promoting the inclusion of CACs and welcome the staff's continued active involvement in this area.

Another encouraging development is the progress made by a number of countries in their debt restructuring efforts. It is essential, however, to advance these efforts further with a view to completing these restructurings in a timely manner. It is also important to ensure that resolving the issue of arrears to creditors is consistent with the Fund's LIA policy.

The Institute of International Finance (IIF) deserves credit for its efforts to broaden consensus on the Principles for Stable Capital Flows and Fair Debt Restructuring in Emerging Markets. These efforts are paying off as evidenced by the growing number of countries that have expressed support for the Principles and by the ongoing discussions on a process for implementing the Principles. In this connection, I agree with Mr. Mirakhor that the Trustee Group's mandate in Tier Three of the proposed implementation process appears to overlap with the Fund's mandate.

Turning to the issue of "Assessing the Determinants and Prospects for the Pace of Market Access by Countries Emerging from Crisis," it is not surprising that investors' risk appetite has a large and significant impact on countries' ability to reaccess international capital markets. At the same time, the importance of domestic determinants to restoring market access cannot be overstated. Demonstrating a commitment to the necessary policy adjustments is all the more important for a crisis country that undertook a debt restructuring. Engaging in a collaborative approach to debt restructuring and putting in place a strong communications strategy to explain the country's efforts to strengthen its creditworthiness should also help in reducing the time to reaccess markets.

On managing systemic banking crisis, I agree with the suggestion of Mr. Loyo and Mr. Mori to add a disclaimer to the report to reflect the current stage of the discussion.

Mr. Ngumbullu submitted the following statement:

We thank staff for the valuable report, which makes today's discussions possible. Following the last Executive Board meeting that reviewed progress made on crisis resolution, and in accordance with the IMFC communiqué, the increased inclusion of CACs in international sovereign bonds is a welcome development. There were also calls for continued progress by the Fund in this area, including on further efforts to improve the Principles for stable capital flows and fair debt restructuring in emerging markets. We note that a number of countries are still pursuing this process of restructuring their sovereign debt, with several of them being able to secure agreements with their private creditors.

A significant increase in sovereign market bonds, that includes CACs, has been recorded between 2003 and 2005. Given this development, it is encouraging to note the continued proactive role being undertaken by staff in promoting the inclusion of CACs in international sovereign bonds, including its use both in the context of use of Fund resources and Fund's surveillance activities.

We note the efforts being made by the Institute of International Finance (IIF) to broaden the consensus on the principles for stable capital flows and fair debt restructuring among emerging market issuers and private sector creditors. We consider as appropriate, the ongoing discussions among participants on a process for implementing the principles. In this regard, we encourage the parties concerned to view the proposed features with an open mind in order to achieve the objectives of the debt restructuring mechanism. The determination by staff to continue monitoring developments towards broadening the consensus is, therefore, welcome.

Although progress under the Evian approach has been mixed, with no debt treatments being completed, we welcome the agreement in principle by the Paris Club creditors to provide comprehensive debt treatment to Nigeria. As the debt treatment will be phased with the objective of providing a definitive solution to Nigeria's debt problems, we note that such action will be contingent upon the full clearance of Nigeria's arrears to the Paris Club and the approval of a Policy Support Instrument by the Fund. We therefore urge the Fund to expedite finalization of the PSI to facilitate Nigeria's conclusion of the required arrangements to its debt problem. In addition, we welcome the principle of transparency applied by the Paris Club as regards its framework for debt buybacks and the progress by countries offering to make early repayments.

Mr. Farelius and Mr. Hollensen submitted the following statement:

We thank staff for an interesting paper and once again welcome this discussion of a progress report concerning measures to facilitate crisis resolution.

We are pleased to observe the progress with respect to the inclusion of CACs in international sovereign bonds. Indeed, as noted by other colleagues, the progress has been much faster than expected with an increase in the stock of bonds that includes CACs, from 31 percent at the end of 2002 to 53 percent at the end of June 2005. It is also a welcome development that the CAC clauses now used by the markets are in conformity with the G10 standards. We support staff's efforts to encourage the use of such clauses through the Forum of Public Debt Managers and in its contacts with emerging market country authorities.

As Mr. Lynch and Mr. Krueger, we would be interested in staff's comments on the use of aggregation clauses and trust structures. Like them, we see much potential in such measures in facilitating future debt restructurings.

We note that it has been representatives from the International Institute of Finance who most actively have promoted and promulgated acceptance of the so-called Principles For Stable Capital Flows and Fair Debt Restructuring in Emerging Markets. Important work has been done in this area, which is welcome. We also find it important that the Fund stays in close contact with the partners involved in these discussions so it is on top of developments. We understand from the progress report that partners are moving ahead step-by-step with the ultimate aim of getting the principles agreed and implemented. We find it important that the principles are implemented so they can guide crisis resolution in the future. When it comes to principles of fair debt restructuring, it is important that the principles are not too general, but that they actually can be applied to concrete situations that may arise.

As we have stated on previous occasions, more can be done, and should be done, by the Fund in the area of crisis resolution. As we argued at the time of our last discussion on this issue, the Fund should leave its position from the sidelines and “once again resort to its leadership in this field.” In particular, we keep repeating that the Fund’s Lending into Arrears Policy needs to be revisited, as also repeatedly called for by the IMFC. But we are yet to have progressed further on this issue.

Finally, on determinants of factors which made countries emerging from crisis regain market access, we wish once again to emphasize, as we did in the discussion in May this year, that an important lesson is that there is no escaping taking corrective action. Even if this finding appears trivial and self-evident, it is important to keep it in mind. Moreover, we agree with Mr. Bischofberger and Mr. Meyerhofer on their point that Fund financial assistance for countries trying to regain market access must remain within normal access limits.

Mr. Duquesne submitted the following statement:

We thank the staff for this interesting report which shows that some further progress has been made since the last IMFC meeting.

Like other Directors we very much welcome the fact that the Collective Action Clauses (CACs) are becoming market standards and we commend the authorities whose decision to issue sovereign bonds with CACs is contributing to strengthen the international financial architecture. We welcome the fact that, contrary to some vocal expectations, the inclusion of CACs has not influenced bond pricing. We encourage the staff to keep monitoring and promoting the use of CACs. We note that Jamaica was the only country that did not include CACs in its New York law-governed bond; considering the country’s external vulnerability, this seems unfortunate. The staff’s comments would be welcome.

We certainly concur that efforts to broaden the consensus on the Principles are welcome, and form a good basis to improve relations between creditors and

debtors. But the effectiveness of these recommendations will obviously have to be assessed on the basis of concrete cases. We thank the staff for continuing to monitor concrete developments.

Concerning the policy issues discussed by the Board since the last IMFC, we agree with Messrs. Loyo and Mori that domestic policies alone may not be sufficient to restore market access by countries emerging from crisis, and that external market conditions play a great role. On the issue of managing systemic banking crisis in the context of sovereign debt restructuring, we concur that its preliminary nature could explicitly be mentioned in the report ; we would like to thank the staff for providing some thorough analysis on a crucial topic in line with the IMFC's request. We are looking forward to a follow-up discussion.

Finally, we take the opportunity of this progress report on crisis resolution to reiterate our conviction that the Fund has a precautionary role to play in preventing financial crises. We therefore welcome the Managing Director's report to the IMFC on Fund Medium-Term Strategy which clearly announces a second round of debate on both high access precautionary arrangements and a successor to the Contingent Credit Line, under the broader topic of "Financing and Insurance."

Ms. Jacklin and Ms. Segal submitted the following statement:

We join other Directors in welcoming this clear and concise update on market-based solutions to crisis resolution, including the ongoing application of Collective Action Clauses (CACs) to sovereign debt issuances, status of the Principles for Stable Capital Flows and Fair Debt Restructuring in Emerging Markets (the Principles), updates of recent sovereign debt restructuring cases and discussion of developments in the Paris Club, as well as summaries of recent Board discussions related to market reaccess and management of systemic banking crises. It is probably time, however, to consider issuing these updates on a less frequent basis.

Since the last progress report in March 2005, all but Jamaica's international sovereign bond issuance have included CACs, bringing to more than 50 percent the outstanding stock of emerging market sovereign bond issues which include CACs. Such performance further solidifies CACs as the market standard in New York law-governed sovereign bonds. We would like the staff to comment on whether they had actively advised Jamaica on the CACs issue and what the exchange with the authorities was on the matter. We continue to encourage Jamaica as well as other sovereigns to adopt the market standard in future international issuances.

We appreciate the staff's monitoring of the ongoing evolution of the Principles. As we emphasized at the time of the last progress report, one of the most important factors in enhancing crisis prevention and resolution is for market

participants to understand the risks associated with the decisions to invest in or to issue debt and the process of resolving payments difficulties when they arise. We view the IIF's efforts to advance awareness of the Principles as an important step in this direction, and we support outreach efforts by the IIF to emerging market issuers and private sector creditors for this purpose.

Along these same lines of advancing awareness in order to ensure smooth functioning markets, we once again would like to ask the Fund staff to survey members to determine the degree to which the national laws and regulations of major security markets require clear information and risk disclosure in sovereign debt offerings and the extent to which those laws have protections for unsophisticated investors from improper sales practices by brokers or investment advisors. This is one important way advanced economies can help to assure investors are knowledgeable of the risks of their decisions and can bear those risks. This, in turn, should improve the likelihood of successful crisis resolution.

Lastly, we appreciate inclusion in the report of summaries of the recent Board discussions on assessing the pace of market reaccess by countries emerging from crisis and managing systemic banking crises in the context of sovereign debt restructuring. In particular, we take note of the finding that 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. This reinforces the importance of advancing awareness and information flow among all market participants in order to ensure better functioning markets.

Mr. Torres and Mr. Costa submitted the following statement:

We thank the staff for updating the different crisis resolution issues that are of interest to the Fund. We welcome the progress made in particular with respect to the recent sovereign debt restructuring cases of which the Argentine one is possibly the most relevant due to the legal complexities and magnitudes involved.

As regards the creditors that voluntarily decided not to participate in the debt exchange, we would like to reiterate that the Argentine authorities intend to address this issue, as called for by the April 2005 IMFC Communiqué, in the context of a new Fund program. We would also like to point out that the statement on paragraph 15 of the report on the Argentina's recent debt restructuring seems to us to be rather obvious and somehow misleading at the same time. It states the obvious in saying that the rating agencies have continued to maintain the default rating on bonds not tendered in the exchange. What else could rating agencies do? It is somehow misleading in adding that this happens "even as they raised the credit risk ceilings on Argentina," as the new rating applies to the new bonds, which have no direct connections with those that remained in the hands of the hold-outs. The confusion is compounded by the sentence's ending with a



reference to “the potential actions by litigating creditors to attach assets.” We believe the whole last sentence of paragraph 15 should be eliminated or rewritten.

We welcome the several successful cases of recent debt restructuring mentioned in the progress report. It appears from the results that formalizing the Principles for Stable Capital Flows and Fair Debt Restructuring in Emerging Markets in the directions mentioned in the crisis resolution report, as reflected by the three tiers of the proposed implementation process of paragraph 9, was, in fact, not needed. Countries’ authorities, in consultation with their creditors and with the assistance of financial advisors, were able to arrive at mutually convenient outcomes. In any event, if something is missing in the current international financial architecture this is not a set of general principles that are unable to contemplate the important characteristics of individual cases but a formal procedure such as the one envisaged by the SDRM where precise rights and responsibilities for all parties involved would be clearly established, including *inter alia*, the process of determining creditor’s representation.

As to the efforts that have purportedly been made by the Institute of International Finance (IIF) to broaden the consensus of the principles among emerging market issuers (referred to in paragraph 8 of the report) we would like to underscore that the Argentine authorities have not been approached by the IIF, despite the fact that they had to deal with the most difficult and large debt workout in history.

The continuous progress in the inclusion of CACs in international sovereign bonds is encouraging, in particular the fact that the outstanding stock of emerging market sovereign bonds that include CACs has increased 22 percentage points since end-2002, and has now surpassed the 50 percent mark. For all practical purposes, the market has fully accepted the introduction of CACs in sovereigns bonds, without this having had any observable impact on the level of returns being demanded. Thus, the staff’s task of promoting the inclusion of CACs across the Fund’s membership in the context of the use of Fund resources and Article IV consultations is becoming increasingly easier.

On progress under the Evian Approach and other Paris Club issues, we welcome that the new framework for debt buybacks has become operational, having already benefited several countries, in particular Poland which has bought back all of its Paris Club debt. Peru has already bought back, in turn, half of its debt with the Paris Club. Even though the prepayment has been in all cases at par value, substituting high-cost debt by a lower-cost one entails clear financial benefits for these countries. In the case of Russia, which has also benefited from this scheme, it is not a low cost-debt what they used to cancel Paris Club obligations but the unremunerated OSF reserves, making the financial benefit even more evident.

The report also provides summaries of two issues discussed by the Board related to the orderly resolution of financial crises. Regarding the determinant and prospects for regaining market access, we agree on the importance of the circumstances underpinning the loss of market access, the commitment to undertake corrective actions once the access was lost and the role the Fund can play through the provision of policy advice and financial assistance in helping countries to regain market access.

Finally, regarding the summary of the management of systemic banking crises in the context of sovereign debt restructuring, we would like to highlight that several of the crisis containment measures listed in the report as well as the policy measures to address the issue of undercapitalized or insolvent banks have been successfully implemented in the case of Argentina, as evidenced by the rapid recovery of private sector confidence in the banking system that took place in the aftermath of a most serious crisis.

Mr. Wang and Ms. Wang submitted the following statement:

We thank the staff for the informative paper and welcome the opportunity to discuss the progress report on crisis resolution.

We are pleased to note progress with respect to the inclusion of CACs in international sovereign bonds. The outstanding stock of emerging market sovereign bonds that include CACs has increased from 31 percent to 53 percent within two and a half years. We are encouraged to see that the inclusion of CACs has not had any observable impact on bond pricing to date. We also welcome the staff's proactive role in this area.

We welcome the efforts made by the Institute of International Finance to broaden the consensus on the Principles for Stable Capital Flows and Fair Debt Restructuring among emerging market issuers and private sector creditors. We note the number of countries supporting the Principles is increasing and the discussions among emerging market issuers and private creditors on a process for implementation the Principles are unfolding. We encourage the staff to continue to monitor developments in this regard and look forward to a more detailed report.

We are encouraged by the developments of a number of countries in their debt restructuring efforts. We should emphasize that resolving the issue of arrears to creditors should be consistent with the Fund's LIA policy. We also share Mr. Misra and Mr. Kanagasabapathy's view that crisis resolution will always remain the second best situation and the Fund has rightly refocused its attention on crisis prevention and strengthening of the surveillance mechanism in its strategic reviews.

On the issue of "Assessing the Determinants and Prospects for the Pace of Market Access by Countries Emerging From Crisis," the staff points out the need

to build and sustain credibility in the country's policies when it takes steps to reaccess international capital markets. However, domestic policy alone may not be sufficient to guarantee the preservation of market access, as external conditions are beyond the control of emerging market countries.

On managing systemic banking crisis, we also agree with the suggestion of Mr. Loyo and Mr. Mori to add a disclaimer to the report to reflect the current stage of the discussions.

Mr. Schwartz and Mr. Calderón-Colín submitted the following statement:

The main objective of this discussion is to overview the report that will be presented to the IMFC regarding progress on crisis resolution. While the report fulfills its purpose by presenting in haste the latest developments with respect to CACs, the Principles for Stable Capital Flows and Fair Debt Restructuring in Emerging Markets, as well as providing an update on progress on recent debt restructuring cases under the Evian approach, and summarizing a couple of topics the Board discussed this semester, it would be important that staff begins analyzing the topic from a broader view, seen from the optic of the Medium-Term Strategy. We hope that in the discussion on the latter, crisis prevention and resolution, as well as a deep analysis of the international financial architecture, will be essential elements.

#### Crisis Prevention Continues to be Key and Challenges are Still Present

Since by preventing crises we will avoid having to resolve them, crisis prevention continues to be one of the Funds more valuable assets and at the core of its responsibilities. Since the expiration of the CCL, the IMFC Communiqué has often called for the IMF to study the ways to design a precautionary instrument for those members that despite having implemented strong policies, could still be vulnerable to contagion in financial markets, and that could be added to the fund's toolkit. The quest would be to design an instrument that does not contain all the known flaws of the CCL but that could be a useful precautionary arrangement. An adequate response to this call has—to the date—been absent.

We understand that, at the moment, there may not be consensus to reopen the discussion since neither advocates nor opposers to the CCL seem to have new convincing arguments that would help create a consensus on the convenience or not of such an instrument, but believe that, after the Annual Meetings, staff should analyze with a fresh pair of eyes and from the optic of the Medium-Term Strategy what the challenges for emerging markets are and will be in the foreseeable future, and how the Fund can be useful addressing their concerns. The current build up of reserves by emerging markets, as well as the increased signs of cooperation by some countries of East Asia in case of a major financial disruption

are strong signals that the Fund may not be up to the challenge to serve properly these countries.

### Update on Crisis Resolution

The report takes note of recent developments on crisis resolution that we all know are taking place but fails short of making a deeper analysis. The relatively benign performance of the global economy, ample liquidity in financial markets and absence of new crises should not lead us to complacency and to consider crisis resolution as business as usual. As we have seen from the recent WEO and GFSR, there are important risks surrounding the global economy and markets and the Fund should be well prepared in case problems begin to emerge.

As other Directors, we welcome the more widespread use of CACs in international sovereign bond issues, as well as staff's role in promoting them. The role of CACs in the resolution of future crises would be paramount. We notice that most CACs are broadly in line with the G-10 recommendations and that the outstanding stock of emerging market sovereign bonds that include CACs is approximately 53 percent. We continue to call for a more widespread use of CACs by mature issuers in order to support making them common practice in international financial markets and encouraging their use among other debtors. In particular, we hope legislation in Germany codifying the legality of the inclusion of CACs in bonds will be adopted soon.

We also look forward to a more widespread acceptance of the Principles for Stable Capital Flows and Fair Debt Restructuring in Emerging Markets. We are convinced that, as with CACs, the voluntary nature and consistency of the principles are gradually gaining support and could eventually be common practice. The process of implementation will progress slowly and the market will have to assess their usefulness.

The study assessing the determinants and prospects for the pace of market access by countries emerging from crises—an update from the 2001 exercise—did not really surprise with its findings, much related to common sense. The study could have benefited from analyzing the role of the Fund in cases where countries attempt to reaccess markets after financial crises. Looking forward, econometric analysis quantifying the impact of Fund support in designing a program and also comparing it to the impact on markets when financial support is granted by the institution could be warranted. In addition, it would also be interesting to analyze, for example, the trade-off that may arise between gaining a rapid reaccess to markets and perhaps, not achieving debt sustainability.

The recent discussion on managing systemic banking crises in the context of sovereign debt restructuring was interesting and useful as a first step. However, we should be mindful that the issue is work in progress and that the discussion, besides being preliminary, should embed other important factors. First of all, it

should be reminded that prudential regulations do not substitute for weak fundamentals in the economy. In second place, we should be cautious and acknowledge the risk caused by the Fund's acceptance of some questionable practices, simply because there seems to be no other viable alternative.

Ms. Phang and Mr. Wesaratchakit submitted the following statement:

Like other Directors, we welcome staff's concise progress report on developments which are relevant to crisis resolution. On the whole, we are encouraged by the progress made on many areas of crisis resolution associated with sovereign debts. However, we are somewhat concerned with the report's narrow coverage as it was widely acknowledged that the Asian crisis was triggered by private-sector debt flows. In this connection, we encourage staff to also examine ways in which a proper framework can be created to promote the orderly restructuring process of private-sector debts.

On collective action clauses (CACs), we join other Directors in welcoming the increase in the proportion of emerging market sovereign bonds that include CACs. This augurs well for a higher probability of orderly debt restructuring. In particular, we are encouraged by the lack of adverse impact on bond prices from the inclusion of CACs since this probably reflects that investors now view CACs as a generally accepted trend, not something that sends a negative signal. Like Messrs. Lynch and Kruger, we are concerned about the issue-specific feature of CACs which therefore puts into question its effectiveness in yielding an orderly debt restructuring in the case of a large number of bond issues. In this regard, we would appreciate if staff could look into the benefits of the 'aggregate clause.'

We welcome the efforts by the Institute of International Finance to broaden the consensus on the principles for stable capital flows and fair debt restructuring in emerging markets (the Principles). In particular, we would like to stress the importance of making the Principles operational by integrating them within private sector firms' day-to-day operations. With the enormous size of capital flows, emerging markets as well as the global financial system are always exposed to the risk of disorderly movement of capital.

On assessing the determinants and prospects for the pace of market access by countries emerging from crises, we agree with staff that an appropriate communication strategy is a critical element of the country's effort to emerge from the crisis. In this regard, we emphasize that staff should not insist on countries having to publish IMF staff reports when the authorities feel that the reports contain market sensitive information that can cause confusion and panic in the markets, since they are in the best position to assess the sensitivity of country specific information. In addition, we encourage staff to conduct further studies on the movement of capital flows as countries, despite maintaining good macroeconomic policies to prevent crises, could still be faced with crisis

situations owing to contagion effects which are exogenous and outside their control.

On banking crises and sovereign debt restructuring, we reiterate our position that prevention is the first and foremost line of defense. The Fund should continue to strengthen its surveillance to highlight to the authorities, vulnerabilities and weaknesses in the banking sector, either through bilateral surveillance or in a wider context of the WEO and the GFSR. We again stress the importance of efficient coordination and integration of the work among the functional departments and the area departments and as such, look forward to the findings and recommendations of the Financial Market Review Group

Mr. Bischofberger and Mr. Meyerhoefer submitted the following statement:

We thank the staff for another informative progress report on crisis resolution, including the useful updates of recent debt restructuring cases and the progress made under the Evian approach and other Paris Club issues. We have a number of comments on the sections dealing with collective actions clauses (CACs), the “Principles for Stable Capital Flows and Fair Debt Restructuring in Emerging Markets,” the assessment of the determinants and prospects for the pace of market access by countries emerging from crisis, and the management of systemic banking crises in the context of sovereign debt restructuring.

The outstanding stock of emerging market sovereign bonds that include CACs has further increased to 53 percent. This is very welcome. Like Mr. Lynch and Mr. Kruger, we commend the staff for its proactive role in promoting the inclusion of CACs in international sovereign bonds. Regarding the validity of CACs in bonds issued under German law, the German Federal Court, on June 28th, 2005, ruled that such clauses are not subject to the controls of the Standard Contracts provisions of the German Civil Code, as noted in footnote 6 of the report. We would like to emphasize that this ruling has practically eliminated the risk perceived by German bank lawyers that CACs could be voided by individual investors based on consumer protection law. Moreover, on February 14th, 2000, the Federal Government had already expressed a legal opinion to the effect that no legal impediments to the usage of CACs exist under German law. Nevertheless, we expect that the new German parliament will expressly codify the legality of CACs containing the features recommended by the G10 in September 2002.

As to the Principles, we support the staff in continuing to monitor developments in this area. We are looking forward to regular updates on these issues. The IIF reports that about 30 countries have expressed support for the principles. This is good news. The international official community has a great interest in the success of this informal initiative, which could complement the use of CACs and provide a valuable contribution to crisis prevention and orderly debt restructurings in cases of insolvency. In this context, we would like to reiterate

our position on the need to review the Fund's LIA-policy with a view to bringing it in line with the Principles regarding debt restructuring negotiations between a debtor country and its private creditors. In particular, a higher degree of clarity is needed concerning the application of the good-faith criterion in such cases.

We broadly agree with the report's presentation of the Board discussion of market access by countries emerging from a crisis. In particular, we concur with the differentiation between crises that required a debt restructuring to be resolved and those that did not, based on an assessment of the sustainability of a country's overall indebtedness. The prospects of reaccessing markets differ according to the severity of the crisis that the country is emerging from and the strength and credibility of the corrective policies the country implements. We also agree that Fund policy advice and the Fund's financial assistance can play an active role in helping the country to regain market access. However, we would like to emphasize that the Fund's financial assistance during this period must remain within normal access limits. If these limits are reached, we do not see room for additional Fund financing. On the contrary, we would see a need to reduce an already existing excessive credit exposure of the Fund.

We deem the state of the discussion of managing systemic banking crises in the context of sovereign debt restructuring as being preliminary, as also noted by Mr. Loyo and Mr. Mori. We support their suggestion that a disclaimer be added to the report to reflect this preliminary stage. On substance, we would like to emphasize that systemic banking crises resulting from the restructuring of a country's government debt are to a lesser degree a balance-of-payments problem but rather an internal problem that should be addressed by domestic policy measures. The Fund's role should, in our view, remain limited to balance of payment imbalances. Financial support from the Fund in the context of a banking crisis would only be justified if the banking crisis resulted in a balance of payments need, whereas the Fund's resources should not be used to finance deposit outflows of the banking system. In any case, normal access limits must apply.

Mr. Rutayisire submitted the following statement:

We welcome the increasing use of CACs by bond issuers and the ongoing revision of the German legislation to allow for the inclusion of CACs in sovereign bonds in that jurisdiction. Given that 21 of 22 included CACs in their bond since our last meeting, we are inclined to say that the use of CACs is becoming standard in bond issues. We note that the inclusion of CACs in bond issues has not influenced bond repricing when creditors should have imputed an additional risk premium in the pricing. Could it be that the use of CACs offers claims, which are higher than what creditors would get in the event of a sovereign debt crisis without CACs? Could the possible built in excess claim also explain why some sovereign debtors reject CACs? Staff explanations are welcome.

We welcome the efforts made by the Institute of International Finance (IIF) to promote the Principles and reach a broader consensus on their content and coverage among the market participants. We would like the staff to shed some light on what the Fund's role in advancing awareness and developing a better understanding of these Principles could be.

We note that there have been successful debt restructurings lately among the emerging market countries in a context of improved policy management and implementation by these countries. We welcome the important steps taken by Argentina toward normalizing relations with creditors and its reaccess to market. We look forward to the authorities' resolution of the remaining issue of non participating creditors.

As regards the pace of market access by countries emerging from crisis, we view that the communication strategy followed by countries on their adjustment policy intentions played an important role in securing these debt restructurings. However, there are instances where improved domestic policies were not enough to regain market access, leading to the adoption of supplementary second-best policies to manage crises in the absence of debt restructuring. This rightly warrants a further analysis by the staff on the factors affecting market reaccess. Furthermore, as many of low-income countries are graduating to mature stabilizers and expressing the need to access international capital markets, we think that staff should have the same involvement in identifying the steps and the time these countries should take to access these markets. Given that the short-term tactical investors could be destabilizing for these countries, we think that the target in regaining market access should be on attracting long term-oriented strategic investors. We would wish to see staff analysis on how this can be possible.

We welcome the summary on the management of banking crises in the context of sovereign debt restructuring. We note that higher prudential regulations could lower financial intermediation, adversely affect growth and possibly encourage unregulated and informal channels of financing. Cannot the same assumption be posed at the international level? We believe that it is relevant to examine the regulatory regimes that could cause the same problem. We agree that second-best options may be considered in the case that sovereign debt restructuring impacts adversely the banking system. We would however request staff to examine ways to protecting depositors in the event of banking crisis.

We note that the Paris Club's early repayment framework unveiled recently seems to be an attractive addition to its debt restructuring toolkit. While we welcome the agreement in principle between Nigeria and the Paris Club creditors on a comprehensive debt treatment, we note that the beginning of negotiations is pending on an agreement of a PSI with the Fund. We do hope that this new instrument will be operational soon.



Mr. Sadun and Mr. Gola submitted the following statement:

We thank staff for having drafted this careful report, which provides an update on several specific and important aspects of the Fund's crisis resolution strategy.

#### The Inclusion of CACs in New Sovereign Bonds is now a Standard

We take note that, since the last staff report in March 2005, almost all newly issued international sovereign bonds have included CACs, as recommended by the G-10. We encourage staff to continue taking a proactive role in this area, maintaining a close dialogue with market participants, including the Forum for Public Debt Managers. From the last review, we know that the Trust (or an equivalent legal structure) seems much less frequently used by market participants than the Fiscal agency, despite a substantial decline in the cost of the trust. The recent minor increase of the use of this instrument under the New York jurisdiction does not seem to change the fact that market participants prefer the Fiscal Agency. Does the staff not think that, given the situation, a proactive role, aimed at improving the legal robustness of the Fiscal Agency, would be desirable from the Fund's perspective? Comments are welcome.

#### Debt Restructuring and Progress Under the Evian Approach

Helped by favorable macroeconomic trends, including ample global liquidity, several countries made progress in sovereign debt restructuring and early debt repayment. In particular, we are pleased to see that the Paris Club has made public its framework for debt buybacks, and three countries (Poland, Russia, and Peru) have offered to make early repayments.

On Argentina, however, there are still unresolved principal claims for US\$20 billion. As noted by staff, several rating agencies have continued to maintain the default rating on bonds not tendered in the exchange, citing concerns about the large amount of untendered debt that remains in default and the risk of litigation.

We followed with attention the recent development of Iraq's debt restructuring. The authorities are committed to respect the requirement of comparability of treatment between Paris Club members and other creditors and to negotiate a settlement with private creditors. Should the country have a Stand-by-Agreement, as required by Paris Club, the LIA policy would apply, including the principle of "in good faith."

#### On the "Principles" and LIA Policy

We welcome the effort to broaden the consensus and to further improve the draft of Principles for Stable Capital Flows and Fair Debt Restructuring in

Emerging Markets. We also note that the Fund's staff has not been involved in this discussion, but will continue to monitor closely developments in this area. The accumulation of evidence on LIA policy shows that more progress needs to be done to lay out operational guidance, especially as regards the explicit steps debtors should take to meet the good faith criterion. The Fund should further improve the LIA policy (and in particular the good faith criterion) so as to contain moral hazard and to increase the incentives for a rapid debt restructuring.

#### We Encourage the Staff to Continue Working on the Issue of Managing Banking Crises in a Context of Sovereign Debt Restructuring

While we agree that prevention is the first line of defense in protecting the banking sector in the case of sovereign debt crisis, we believe that the recent interesting staff paper on this issue scratched only the surface of the problem. In particular, we think that further analysis of the legal, institutional and financial framework is needed in the area of unconventional crisis management, both from the banking and the fiscal side. As noted during the Board's discussion on this topic, the lack of emergency liquidity for crisis containment calls for carefully designed administrative measures on deposits. The staff considers different options which pose various trade-offs and several policy implications. Can the staff elaborate further as to which area they think deserves deeper analysis? Comments are welcome.

Mr. Roovers made the following statement:

I thank staff for a concise Progress Report on Crisis Resolution. This report is factual and I can subscribe to its substance. In particular, I welcome its main messages on the use of collective action clauses, now firmly established in the international sovereign bond markets, and further progress made in establishing the principles of stable capital flows and fair debt restructuring. It only leaves the question of what is not in the report. Indeed, it appears that reflections on the Fund's own role and judgment are becoming increasingly absent. Thus, I note the Fund staff has not been involved in recent efforts by the IIF to broaden the consensus on the principles. Given its dependency on external sources, this section of the report risks not only being inaccurate, as Mr. Loyo highlights, but lacks an informed judgment. It is difficult to judge the proposed implementation process and have an informed view on the substance of the principles set against the Fund's own policies and advice on crisis resolution. In contrast to the previous report, the latter is now left unaddressed.

Like Mr. Mirakhor, I encourage staff to closely monitor and assess the development of the principles, including their interaction with the Fund's own role, as well as the perceptions among market participants. This not to say the Fund should be an active party in this process at this stage. Perhaps staff can clarify what involvement it judges to be sufficient to exercise a monitoring role. In the same vein, like Mr. Solheim, I reiterate the need for the Fund to self-assess

its role in crisis resolution in a more fundamental way. Several issues remain outstanding that need more concrete follow-up. This pertains to the Fund's lending into arrears policy and the Fund's role in communicating and disseminating information at times of sovereign debt restructuring. Moreover, exit strategies for exceptional access cases remain on the table. While these issues are dealt with in various policy discussions, future progress reports should anchor this policy agenda, making the Fund's own role and strategy in crisis resolution more visible.

Ms. Newton-Smith made the following statement:

Like other Directors, we thank staff for their concise report, which provides an informative summary of recent developments, and we also welcome this opportunity to discuss the Fund's work in this area. As we have said in previous discussions, and as Mr. Roovers has just highlighted, we would support, however, a shift from a more retrospective look at developments over the past six months toward a more forward looking and engaged look at the role of the Fund in crisis resolution, and possible future policy developments in this area. This would require input, both from Fund staff and Directors. We wonder whether in future papers it could be useful to include a series of questions for discussion to try to elucidate more views. In this spirit, we would like to draw out our thoughts on where the Fund and others can usefully add to this agenda in the future and staff's views would also be very welcome.

Turning first to the principles, we continue to feel that the principles can make a valuable contribution to the framework for crisis prevention and resolution, by reducing uncertainty and improving dialogue. The details on the proposed implementation process in the paper are very welcome, but we have two concerns. The first is there is a need for greater transparency. In part, to address the issue highlighted by Mr. Roovers: it is difficult to make an informed judgment on the nature of the implementation process and the support for the principles. The IIF have said that 30 countries have endorsed the principles. But the lack of transparency as to which these countries are, and the extent of their engagement, undermines the clarity and the uncertainty reduction that we hope the principles will bring. It also makes it difficult for market participants, for the Fund and other interested parties, to assess the effectiveness of the principles. Secondly, the groups responsible for improving the application of the principles in different countries will need to have enough independence to be credible. These two elements of transparency and independence will be particularly important since the development of the principles is likely to be an ongoing process.

Turning to another issue, we strongly endorse the conclusion in the Managing Director's strategic review for an appraisal in the near future on the effectiveness of the Fund's instruments to facilitate crisis resolution, including the lending into arrears policy. In the spirit of contributing to that discussion, here are some genuine questions which could be considered in that review: How does IMF

financial assistance influence the conduct and outcome of debt restructuring negotiations and the pace of market access? Can the IMF improve the overall efficiency of the restructuring process by acting as an independent information provider? Perhaps, for instance, by publishing its debt sustainability analyses? Is it appropriate for the Fund to determine the financial parameters for post-default sovereign restructuring, or indeed what would be the appropriate level? What lessons can be learned from recent episodes of sovereign default? To what extent are standard access policies sufficient in the aftermath of a sovereign default? Indeed, is the separate lending into arrears policy strictly necessary?

Turning to the policy agenda in crisis resolution more generally, providing greater clarity on the exception access criteria remains important. For instance, the introduction of a fully risk assessment framework for IMF lending and perhaps a role for the IEO in conducting a more automatic ex post assessment of all exceptional access decisions could be considered.

Turning to CACs, their widespread adoption under New York law, detailed in the report, are very welcome. We wonder whether in the future the Fund could consider options for further contractual innovation and perhaps some of the cost and benefits of different approaches. The proactive role of staff in encouraging members to include CACs in their new bond issues, as noted in paragraph 7, is certainly appreciated.

Like Ms. Jacklin, we certainly appreciated the inclusion of the summaries of the Board's discussion on market reaccess and managing of systemic banking crises, which were valuable contributions to our thinking in this area. In particular, on the market reaccess work, we would welcome an update from staff on the work program which Directors called for, noted in paragraph 39 of this report, on the signaling role of Fund support in market reaccess, and the implications for Fund facilities.

Finally, to comment on an issue raised by Ms. Jacklin and Ms. Segal, our preliminary view is that we would not be in favor of considering these updates on a less frequent basis at this stage, since these reports provide an informative assessment of recent developments and, more importantly, a good opportunity to discuss the Fund's work in crisis resolution on a regular basis.

Mr. Miyoshi made the following statement:

Like other Directors, we welcome this concise report. We see recent developments as being quite positive and would like to offer five comments.

First, we welcome the more widespread use of collective action clauses, or CACs. The staff's proactive role in encouraging adoption of CACs is appropriate. On this issue, I broadly agree with the comments made by Mr. Lynch and Mr. Kruger. I thought that greater attention could have been paid to other

developments in CACs than the rate of their adoption, namely, aggregate clauses and trust structure. Therefore I would appreciate the staff's response to the questions they raised. Admittedly, this Chair has been cautious about these two elements regarding CACs, but we note that, even under Japanese law, a trust structure was adopted in the context of Argentina's bond exchange. It remains to be seen whether these practices will be accepted more widely, and it would perhaps be premature for the Fund to recommend these features as possible standards. Nevertheless, these are important and interesting developments that need to be monitored closely.

Second, we see favorably the progress being made in the efforts to broaden consensus on the Principle for Stable Capital Flows and Fair Debt Restructuring in Emerging Markets, henceforth the Principles, and welcome the efforts made by the Institute of International Finance in that respect. We support the staff in continuing to monitor developments in this area. At the same time, we also find it appropriate that the staff is not directly involved in the discussions. As some Directors suggest, the Fund's lending into arrears policy may be in need of clarification at some point in time, in light of its relationship with the Principles. However, we are of the view that this may be still premature at that stage, in view of the level of acceptance, and the fact that the process is still new and ongoing. We would also stress the importance of ensuring fair representation of both debtors and creditors in the work. In this respect, I support Ms. Newton-Smith's call for greater clarity and transparency of the process.

Third, we welcome a good summary of recent debt restructuring cases. At the same time, regarding Argentina's case, we would emphasize that reducing debt stock per se would not be sufficient for Argentina to normalize its relations with creditors. Although it is one of the important steps, other critical steps remain to be taken, including formulation of a credible strategy toward holdout creditors consistent with the Fund's lending into arrears policy. Also, the risk of further litigation should not be underemphasized.

Fourth, we would like to reiterate our belief that, even though we welcome positive developments in the area of crisis resolution, prevention is always far better than cure. Like Mr. Duquesne and Mr. Schwartz, we would call for further work on adapting a precautionary arrangement for crisis prevention purposes, and welcome the Managing Director's statement about initiating a second round of debate on this issue.

Finally, we support Mr. Loyo and Mr. Mori's suggestion for a disclaimer of the reference to the two items the Board discussed in the seminar format, and Ms. Jacklin and Ms. Segal's comment on the frequency of this progress report.

Mr. Palei said that, like Mr. Lynch, Mr. Kruger, and other Directors, he was surprised how little attention was paid in the report to aggregation clauses. Reading it, the impression left was that the only, or at least its key concern, was the introduction of CACs. However, CACs

were only one of the prerequisites for a successful debt restructuring. And they were not a substitute for the SDRM. As Mr. Torres and Mr. Costa, he believed that the principles for stable capital flows and fair debt restructuring were not likely to address the lack of a formal procedure based on either contractual obligations through inclusion of the aggregation features or the SDRM. The discussion of the aggregation features had direct links to the necessary clarification of the lending into arrears policy, something many Directors had mentioned. So, additional information on the aggregation features was necessary. He also supported the proposal made by Messrs. Loyo and Mori to include a disclaimer to reflect the current stage of the discussions. On the frequency of the reports, he shared the position taken by Ms. Newton-Smith.

Mr. Farelius said that, in reference to the comments made by Ms. Jacklin, the reports were very useful, and to reduce their frequency would probably not be adequate.

Mr. Loyo clarified that the call in his gray to delete some of the materials contained in Section III of the paper on the principles for stable capital flows and fair debt restructuring was made as it would be inappropriate to report the specific language proposed by the IIF, language that was still being negotiated among the parties. That preliminary status should be reported in a clear and extensive disclaimer or, preferably, not making reference to it. That disclaimer should be as comprehensible as the one requested on the discussions on the resolution of banking crises. On that latter topic, it was indeed necessary to state the quite preliminary stage of the discussion, as no decisions had been made and the findings of the report were preliminary, because there was little experience on that kind of events.

Mr. Murray said that he had two comments. One was on the transparency issue that Ms. Newton-Smith, among others, had raised. The IIF, according to Messrs. Mr. Torres and Costa, had not consulted Argentina. That meant a large gap, particularly if the IIF considered that the principles addressed not only crisis resolution, but crisis prevention. On the banking crises issue, the summing up just raised more questions than the ones it solved, as the devastating cases of Uruguay and Indonesia showed. It was not only preliminary, but there was still much to sort out. So, it was crucial, as Mr. Loyo had proposed, to have a disclaimer.

Ms. Jacklin supported Mr. Murray on the two points he made.

The staff representative from the Policy Development and Review Department (Mr. Srinivasan), in response to questions and comments from Executive Directors, made the following statement:

I would like to note that, as in the past, the report will be revised to reflect recent developments and the Board discussion prior to being issued to the IMFC. Speaking of recent developments, one relates to Grenada. On September 9, the government launched an exchange offer to restructure debt owed to domestic and external creditors. Existing claims can be exchanged for two series of new bonds, one denominated in U.S. dollars issued under New York law using a Trust structure, and the other denominated in Eastern Caribbean dollars, governed by Grenada law and using a fiscal agency structure. Both series will contain CACs. The authorities have pursued a market-friendly approach with extensive

consultations with creditors. The offer includes a minimum participation threshold of 85 percent, and will close on October 7, 2005.

I would now like to respond to some of the questions raised in the grays. On the Principles, the discussion was included in the text mainly to inform the Board and the IMFC of the progress being made. Hence, we see merit in retaining it. That said, we will modify the report to incorporate the comments made by Messrs. Loyo and Roovers. Messrs. Mirakhor and Shaalan asked for clarification concerning the differences between the Principles and the Fund's lending into arrears policy. In the previous progress report, that of spring 2005, we discussed those differences. Since then, the Principles have not been modified. Messrs. Rutayisire and Roovers asked what role the Fund could play in advancing and developing a better understanding of the Principles. The Fund has encouraged efforts aimed at drafting the Principles and our views have been laid out in the progress report and have contributed to the ongoing discussion. We believe that efforts aimed at advancing and developing a better understanding of the Principles would be best led by sovereign issuers and market participants. If the Principles develop as a market standard, we will take this into account in our work going forward.

Messrs. Mirakhor and Al-Turki sought clarification on the role of the group in tier three of the proposed implementation process concerning the Principles, and note that the role in assessing the evolution of the international system, as it relates to emerging markets, is the Fund's mandate. It is our understanding, based on discussions with the IIF, that the group will have a narrow focus, with a view to assess whether modifications to the Principles are needed as the role of emerging markets evolves. As underscored by a number of Directors, we will include a disclaimer, making clear in the section pertaining to the management of systemic banking crises that the seminar discussions held in July were very preliminary. Finally, Ms. Newton-Smith raised interesting and substantive questions, pertaining to the role of the Fund in the context of post-default restructurings. These will frame and guide our discussions in the context of a review of the LIA policy as envisaged in the medium-term strategy.

The staff representative from the Legal Department (Mr. Laryea), in response to questions and comments from Executive Directors, made the following statement:

I will address the three legal questions. Messrs. Lynch and Kruger asked whether trust structures under New York law have the same features as those under English law. Bonds issued with trust structures under either New York or English laws have in common the legal features that a trustee is only required to initiate litigation upon decision of the requisite percentage of bondholders and that the proceeds of such trustee-initiated litigation is shared pro rata among bondholders. However, a well known distinction between the typical New York law and English law trust structure is that, in the former, the trust indenture preserves the right of each bondholder to bring an individual enforcement action

against the issuer for missed payments on principal and interest. Accordingly, under the typical New York trust, the right of individual bondholders to initiate litigation with respect to accelerated payments is delegated to the trustee. The application of the above distinction in sovereign bonds is not positively required as matter of law. Rather, it merely results from the borrowing of the New York law treatment of corporate bonds into sovereign bond documentation. Thus, this distinction could in principle be eroded by further developments in sovereign bond market practice.

There was a question by Messrs Sadun and Gola on whether a more proactive role aimed at improving the fiscal agency structure in bonds would be desirable from the Fund's perspective. The Board has recognized the conclusion of the G-10 working group that a trust or equivalent structure offers significant legal advantages compared to that of a fiscal agency arrangement. The principle that a trustee represents the interest of bondholders as a whole in contrast to the fiscal agent which is an agent of the issuer, provides the clear basis under the trust structure for concentrating enforcement proceedings in the hands of the trustee and, as I have just mentioned, also sharing the proceeds of such litigation. As has been previously noted, although enhancements to the fiscal agency structure such as highlighting the right of the fiscal agent to called bondholder meetings are somewhat helpful, they do not effectively approximate the full legal advantages of trust structures. Recent staff initiatives to advance analysis in this area include participation in the workshop organized by the Bank of England in January. As noted in the March progress report, that workshop brought together private and official sector participants to consider, inter alia, the legal advantages of trust structures and potential enhancements to the fiscal agency structure. This is clearly an area where further attention is warranted, and we intend to return to it in future progress reports.

Finally, we take note of the request in Ms. Jacklin and Ms. Segal's gray that the staff surveys the legal disclosure requirements in major securities markets, particularly with respect to protecting unsophisticated investors. The content of such laws is important generally for financial market integrity, and specifically may also affect the modalities of debt restructuring. In the latter regard, most recently, one of the considerations to limit Iraq's proposed debt exchange to larger creditors was to obviate securities laws that require disclosure with respect to categories of less sophisticated investors. To the latter, a cash buyback was directed instead. The Legal Department is looking into covering more fully the securities law dimension within our financial crisis resolution work as we go forward.



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

I will address the questions posed on Argentina, market issues related to CACs, aggregation clauses, trust structures, and Jamaica.

Mr. Lynch asked whether Argentina's recent domestic bond issues had attracted significant foreign participation. *Argentina's domestic bond issues have successfully attracted foreign participation.* Even though most of the bond buyers have been local banks, representatives of these banks and market analysts have indicated that they have bought these bond issues on behalf of foreign institutional investors. This seems to have been particularly the case for the peso-denominated, inflation-indexed bond issued in July, where some 60 percent of the demand came from foreign institutional investors. It will interesting to see what happens when Argentina places a ten-year bond, possibly of about a billion dollars, as early as next week. Also on Argentina, Messrs. Torres and Costa note in their gray that the last sentence of paragraph 15 is not clear. Indeed, this sentence is not as clear as it could have been, and we will offer an alternative formulation that takes into account their concern.

On CACs, a number of Executive Directors asked why their inclusion in bonds issued by emerging markets has not had a perceptible impact on the bonds' pricing. As CACs have become the new standard of bonds issued under New York law, the market now gives little, if any, attention to their presence. In this context, CACs have had little or no impact on the pricing of bonds. In coming months, staff will discuss with a broad range of market participants their views on this issue and on the evolution of mechanisms for crisis prevention and resolution, including those related to the principles and contractual terms such as those of trust structures and CACs that include aggregation clauses. On a related issue, Mr. Lynch asked the staff's assessment of how the market has accepted bonds with aggregation clauses and the introduction of trust structures. The market has accepted the use of both in bond contracts. In particular, it has readily accepted their use in the context of debt restructurings and the reaccess to capital markets by countries emerging from crises. Their use also does not seem to have had an impact on the pricing of these bonds.

On Jamaica, a number of Directors asked what advice Fund staff gave to the country on CACs. In the context of the outreach efforts of Fund staff on issues related to CACs, the staff has been encouraging Jamaica to include CACs in its bond issues for at least a year. On a recent staff visit, the authorities reported that they had not given the use of CACs significant consideration at the time of the spring 2005 issuance, but that they remained open to consider their inclusion in the future. To this end, staff will provide additional information on CACs to the authorities and conduct follow-up discussions with them.

Ms. Newton-Smith said that, on the bullets on the effective implementation of the principles, her preference was for the bullets to be included but, as Mr. Loyo suggested, to outline the preliminary nature of those proposals, in the interest of transparency and to help with the adoption of the principles going forward. It was important to inform the IMFC and others about what proposals were under discussion. Secondly, what were the staff's views on the issue of market reaccess in the work program and its current stage?

Ms. Jacklin said that she thanked the staff for its response to her request on securities law developments, particularly in advanced markets. The issue of adequate disclosure was relevant, as was what was known in the United States as suitability rules. That is, rules that stopped brokers and other investment advisors from selling securities which had an excessive risk in terms of the investor's own financial situation. Experience clearly showed that if the investor who bought the paper did not understand the risks and/or was not in a financial position to take on that risk, it was much harder to get it to take a reasonable position in a restructuring, and take a deep haircut. So, advanced economies had a role to play, helping to ensure that investors who bought emerging market paper understood the risks they were taking and were in a position to afford them. As Mr. Padoan had explained, after the Parmalat problem the introduction of suitability rules was being considered in Italy. So a survey on legislation and possible changes would be useful and provide a useful background for the next discussion.

Mr. Miyoshi raised three additional questions. What was the possible logic behind the foreign investors appetite for Argentinean bonds? Second, why participants in the New York market had started to accept the trust structures or the aggregation clauses, previously regarded by many as having significant implications for creditor rights? Third, on the report itself, was it cost-effective? Was it really necessary to report twice a year on this issue?

Mr. Sadun noted that he was pleased that the staff intended to follow closely the issue of the relative merits of trust vis-à-vis the fiscal agency. Further clarification on the assessment of the risk of litigation, and if market participants had a realistic assessment of such risk, would also be welcomed. On a general note, although it was important to analyze all those factors that helped in solving a crisis, to focus on prevention was equally important.

Mr. Kanagasabapathy requested a clarification from the staff on why the principles stated that the Fund would implement its LIA policy, as there were significant differences between both.

Mr. Zurbrugg said that the discussion showed once again that the progress report on crisis resolution had become a peculiar product, one of those historical objects that just continued and that became difficult to discontinue without losing face. Everybody knew what had happened a couple of years before. Now the Board was trying to discuss substance or, as Ms. Newton-Smith said, trying to really go into policy issues. As Ms. Jacklin had said, was a report in such detail needed? It was strange for ministers to have pages on discussions when there had been, in terms of policy, two seminars. CACs were progressing along, and there was nothing else to do but promote them. On principles, the Fund was an outsider, and did not take a view. A way had to be found to ease out the issue, merging crisis resolution with other policy issues. One step would be

doing so in the IMFC draft communiqué, in order to avoid a similar conundrum in the future. And then, to discuss the lending into arrears policy, to determine really what to do in that area.

Mr. Palei said he shared the sentiments expressed by Mr. Zurbrügg and expressed support for Ms. Jacklin's request to conduct a survey of securities laws in key financial centers. Additionally, would the staff clarify how it evaluated the impact on the market of aggregation clauses in bonds?

Mr. Mirakhor said that Mr. Zurbrügg had opened some deep wounds. It was awkward for the Board to consider reports going to the IMFC where the only substantive part was how far the IIF was going in terms of crisis resolution. The IMF had been given legitimate power to make rules in the international monetary and financial system. The Fund had abdicated its responsibility, and the IIF had occupied the vacuum. If the SDRM was not going to be taken to its final conclusion, at least the Fund should be careful on drumming up business for other institutions. The principles were not going to solve the problems that the SDRM would have addressed. Perhaps, going along with Mr. Zurbrügg's suggestion, the issues could be discussed with the GFSR, including a small section in the Managing Director's umbrella paper.

Mr. Murray said that the sense of a policy vacuum implied that the markets were coping adequately and there was no market failure. However, it was important to be assured that there was indeed no failure and that the markets would cope well in the future. Currently there was a benign environment, that possibly explained that bonds' pricing was not affected by actions such as CACs but, as everybody knew well, many times lending to emerging markets had ended in tears. As Messrs. Zurbrügg and Mirakhor had said, the information to the IMFC should be presented in a more streamlined fashion.

Mr. Duquesne said he shared the mixed feelings of Messrs. Zurbrügg and Mirakhor. There was a policy vacuum, as Mr. Murray had said. However, there was a job that the Fund had, and that was when a crisis broke. No other institution had that role. If there was no crisis, great, but, if there was, it was important to be as ready as possible to confront it.

Mr. Mirakhor said that he sympathized with the position of Messrs. Murray and Duquesne; also with the staff because of the difficulties in writing the report. As the former Economic Counsellor and Director of the Research Department, Mr. Mussa, used to say, it was time to ask whether it was a cost-effective instrument to inform the Board. The GFSR could contain what Mr. Murray had requested and, in the case of the IMFC, the umbrella paper could reflect staff's views.

The Acting Chair (Ms. Krueger) said that Management noted Directors' unease. Her suggestion would be to go through the IMFC as usual, and address the expressed concerns in the work program of the Executive Board. The issue clearly needed rethinking.

The staff representative from the Policy Development and Review Department (Mr. Srinivasan) said that, in response to Mr. Kanagasabapathy's question, as it had been reported in the previous progress report, the Principles did call for the Fund to apply its LIA policy. At the same time, there were differences between the Principles and the LIA policy,

including those concerning the role of creditor committees and the resumption of partial debt service payments as a good faith signal. Those differences still remained.

The staff representative from the Legal Department (Mr. Laryea) said that Mr. Sadun had alluded to the absence of the litigation issue in this progress report. That was because that topic had been dealt with extensively in the previous two reports. The subject continued to be closely monitored by the staff. There had been very few litigation developments during the last six months. If this situation changed, the implications would be analyzed by the Board, in the context of a progress report or a standard paper, as necessary.

The staff representative from the International Capital Markets Department (Mr. Medeiros) said in response to Ms. Newton-Smith's question on the update of the work program on the market reaccess, that there were a number of ideas on how to proceed, including some provided by the Board. In this context, significant progress had been made with respect to an econometric analysis on market access, which was summarized in the Board paper and will be published in a working paper within the next few months. However, it was necessary to coordinate a number of tasks across many departments before putting forward a work program on market reaccess to the Board. That would be done in the context of the next discussion of the work program.

Mr. Miyoshi asked why foreign investors were interested in Argentina. Based on conversations with participants and market reports, three factors explained that interest. The first factor was Argentina's economic growth, which was extremely high and had caught the attention of investors worldwide. The second factor was the continuing search for yield in fixed-income markets and the associated investment in local markets, which was currently a general phenomena. The third factor was the investors' perceived relative value of some Argentine debt instruments. Mr. Miyoshi also asked why market participants had begun to accept market aggregation clauses and trust structures. This reflected to an important extent the fact that both grew out of sovereign debt restructurings that, in light of the many issues that they involved, did not put aggregation clauses and trust structures at the forefront of considerations. In this context, the clearest case had been that of Uruguay, which included CACs, aggregation clauses, and trust structures in its bonds issued to reaccess international capital markets. It was clear that these factors had not played a role on the pricing of these reaccess bonds.

Mr. Duquesne said that, on Argentina, some might consider that investors were optimistic, blind, or had no memory. Some time may be spent illustrating them, but it probably would be wasted. And, knowing what had happened recently, those investors were aware that they had no hope that the country would, in any case, be bailed out. Those investors fell into the categories mentioned by Ms. Jacklin.

Mr. Schwartz said that, according to the report, seemingly CACs had no significant affect on the pricing of bonds. Some years ago, when emerging economies started issuing bonds with CACs, there was a concern that they would signaling possible weaknesses, that the markets would not really understand CACs and see them as a sign of possible future problems. But now, with CACs being common practice, one would perhaps expect the opposite. Possibly too much

had been made of CACs. Should the Fund really be satisfied with the bonds including them in case a problem emerged?

Mr. Loyo said that he had been struck that CACs had not had an effect on the pricing of bonds. What were CACs doing? Was a good or bad effect foreseeable?

The staff representative from the International Capital Markets Department (Mr. Medeiros) said that one of the reasons why Fund staff wanted to conduct a survey of investors was precisely to ask the sort of the questions Mr. Schwartz had asked. It was certainly puzzling why CACs had had little or no impact on the pricing of bonds. Even though many in the Fund had concluded that bonds issued with CACs would have a premium, that had not been the case ever since Mexico decided to include CACs in a bond issued under New York law in March 2003.

Ms. Jacklin said that, as the first responder to the survey the staff wished to conduct, her consideration was that it was rare for a pure documentation factor to affect the price of the bond. What typically happened was that, when documentation became standard, with possible variants, investors relied on the underwriters and their own counsel to check the box. They did not think about pricing according to different clauses. What would have a price impact would be some kind of collateral, additional security, or something that would mean a substantive change in rights, but once legal documentation changes become standard, there was not any kind of focus on pricing differentials. Investors tended not to read the contracts every time they bought a bond, and made the decision on whether to buy in about 30 nanoseconds. Therefore, she was not surprised by the result.

The Acting Chair (Ms. Krueger) said that, possibly, an explanation was that there had been as yet not a situation where CACs actually had to be used. Another possibility was that in no country CACs had not yet covered a sufficiently high fraction of the bonds.

Ms. Jacklin said that CACs had been standard in English bonds for at least several decades, so there had been market experience with them. At least in the firm for which she used to work, many debt restructuring had been done in the late 1980s and early 1990s with bonds with CACs under English law, with the majority action provisions applied.

Mr. Duquesne said that, still, it had been conventional wisdom in the Fund that CACs would have an impact on pricing. His chair was not surprised because any formal mechanism did not have a big impact on price, except, as the Acting Chair had mentioned, when used. So, the survey the staff intended to do was welcomed.

Mr. Schwartz said that, following Ms. Jacklin, if CACs were already the standard, there would be a price from deviating from it, something yet to be seen. So, the work that the staff was to undertake was welcomed.

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SHAIENDRA J. ANJARIA  
Secretary