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AGENDA

EBS/89/140

CONFIDENTIAL

July 11, 1989

To: Members of the Executive Board

From: The Secretary

Subject: Administration by the Fund of "Escrow" Accounts in Support
of Debt and Debt Service Reduction Operations

Attached for consideration by the Executive Directors is a paper on the possible administration by the Fund of "escrow" accounts in support of debt and debt service reduction operations. This subject will be brought to the agenda for discussion on a date to be announced.

Mr. Leddy (ext. 8332), Mr. Munzberg (ext. 6675), or Mr. D. Gupta (ext. 8321) is available to answer technical or factual questions relating to this paper prior to the Board discussion.

Att: (1)

INTERNATIONAL MONETARY FUND

Administration by the Fund of "Escrow" Accounts
in Support of Debt and Debt Service Reduction Operations

Prepared by the Exchange and Trade Relations,
Legal, and Treasurer's Departments

Approved by L.A. Whittome, François Gianviti,
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July 11, 1989

I. Introduction

In the course of the Executive Board's recent discussions on the Fund's role in the strengthened debt strategy, the staff was asked to examine issues relating to the possible administration by the Fund, at the request of members, of "escrow" accounts for the purpose of collateralizing payments obligations to commercial bank creditors for the provision of interest support. Specifically, the question was raised whether there would be reasons that the Fund should, as a general matter, take the position that it would not be prepared to administer such accounts. It was agreed that the matter, including possible advantages of administration of such accounts by the Fund, should be considered before the Fund might need to decide on a specific request.

The Fund's experience in administering accounts is described briefly in Section II. The nature of the accounts envisaged and the Fund's role in their administration are outlined in Section III. Section IV reviews possible advantages and concerns regarding the Fund's administration of escrow accounts, and the final section provides brief concluding remarks.

II. The Fund's Experience with Administered Accounts

Article V, Section 2(b), provides the Fund with authority to perform financial and technical services, including the administration of resources contributed by members, that are consistent with the Fund's

purposes. 1/ Under this authority, which was provided explicitly by the Second Amendment of the Articles that came into effect in April 1978, the Fund has established the SFF Subsidy Account in 1980, the ESAF Trust in 1987, and, at the request of individual members, a number of other accounts that have served a variety of purposes. Prior to the Second Amendment, the Fund acted under implied powers in administering the 1976 Trust Fund and the 1975 Oil Facility Subsidy Account.

The services performed by the Fund in administering such accounts have ranged from that of a trustee, exercising substantial discretion in the arrangement, management, and utilization of resources entrusted to it, to that of an agent, acting only upon instructions. As examples of the former services, the Fund has administered resources for the benefit of low-income developing members through the Oil Facility Subsidy Account, the SFF Subsidy Account, the 1976 Trust Fund and, most recently, the ESAF Trust. In these cases the Fund has taken an active role in arranging the provision of resources, in establishing criteria for eligibility and qualification for use of resources, and in determining whether the criteria are met in individual cases.

In the case of the 1976 Trust Fund, the resources administered were provided largely from the profits on the sale of part of the Fund's gold holdings, for the purpose of making loans on highly concessional terms in support of adjustment programs undertaken by eligible members. Similarly, the ESAF Trust established in 1987 makes concessional loans to eligible members, on the basis of resources arranged by the Fund with contributing countries, in support of members' growth-oriented structural adjustment programs. The Fund has also administered accounts aimed at reducing the costs of use of Fund resources to low-income members: the Oil Facility Subsidy Account, established in 1975, to assist a specified list of eligible members to meet the cost of using resources made available through the Fund's Oil Facility for 1975; and the SFF Subsidy Account, established in 1980, to reduce the cost to eligible members of the Fund's resources under the Supplementary Financing Facility and the policy on exceptional use of the Fund's resources. The Fund solicited contributions to these accounts and arranged for disbursements to eligible members under policies and procedures determined by the Executive Board. Similarly, the purpose of the Subsidy Account of the ESAF Trust is to reduce the cost of using ESAF Trust resources.

1/ Article V, Section 2(b), reads as follows: "If requested, the Fund may decide to perform financial and technical services, including the administration of resources contributed by members, that are consistent with the purposes of the Fund. Operations involved in the performance of such financial services shall not be on the account of the Fund. Services under this subsection shall not impose any obligation on a member without its consent."

In the case of accounts established at the request of individual members, such as those established in recent years at the request of Italy, Bolivia, Japan, and Guyana, the Fund has acted as an agent. In administering these accounts, the Fund does not exercise discretion in the accounts' operations, except in investing resources that may be held in the accounts on a temporary basis pending disbursement. The Fund is not involved in the determination of the amounts placed in the accounts or in the making of decisions regarding disbursements. Transfers to these accounts are at the initiative of members or other entities, and the Fund makes disbursements only upon instruction. 1/

For example, as regards the Voluntary Contribution Account for Italy, resources are deposited in the account at the initiative of Italy, and disbursements are made by the Fund upon instruction from Somalia, which is the sole beneficiary of the account. In the case of the Administered Account-Japan, which has been established at Japan's request in the context of the intensified collaborative approach to assist countries with overdue obligations to the Fund, placements are made to the account at the initiative of Japan, and disbursements are made, on instructions from Japan, by the Fund to the recipient with notification to it of the intention of Japan that disbursements are in support of the recipient's adjustment program. Similar non-discretionary provisions are involved in the accounts that have been established for Bolivia, in connection with the discharge of a portion of Bolivia's indebtedness, and for Guyana, to assist it to meet its payments obligations in connection with the intensified collaborative approach to overdue obligations to the Fund.

The administration of each account is governed by an instrument, which is adopted by decision of the Executive Board and which sets out the terms and conditions under which the account will be administered by the Fund. Although the scope of the services performed by the Fund in administering such accounts can vary widely, the services provided must in all cases be in accord with the principle that the services are to be consistent with the purposes of the Fund.

III. Nature of Escrow Accounts and the Fund's Role as Administrator

The escrow accounts envisaged in the present context--i.e., for the provision of interest support in connection with members' debt and debt service reduction operations--are likely to be an important element in the strengthened debt strategy. In essence, each account would secure

1/ Similar accounts are also being administered by the Fund, for the benefit of the ESAF Trust Subsidy Account, for the central banks of Austria, Belgium, and Greece. Income earned by the accounts above a certain level is transferred from the accounts to the ESAF Trust Subsidy Account to reduce the cost of loans extended by the Trust.

certain obligations of a specified member to commercial bank creditors, with payments from the account in case nonpayment by the member on such obligations. Placement of such accounts with the Fund itself is not integral to the operations, although, as noted in the following section, it may be regarded as beneficial. Before reviewing the possible advantages and concerns associated with the Fund's administration of such accounts, this section outlines briefly the nature of the accounts in question and the role that the Fund would be expected to play in administering them.

In the staff's view, such escrow accounts would serve only a depository function and, if established with the Fund, the Fund's role should be confined to that of agent as with respect to the second type of account described above. The terms and conditions to be established would need to be agreed between the member concerned and its commercial bank creditors. The Fund would not be a party to these negotiations, although it would have to be satisfied that its own legal and operational requirements were met in approving an instrument, and its responsibilities as an agent in administering the account would have to be precisely specified in the instrument. As administrator, the Fund also would not be a party to negotiations regarding the timing of transfers of resources to such an account or the amounts and terms of collateralization for interest support, would have no responsibilities regarding reconstitution of the account, and would not exercise judgment or discretion as regards the disposition of resources placed in the account; the provisions regarding payments from the account, and the beneficiaries of such payments, would have to be specified clearly in the instrument. ^{1/} Procedures for the release of resources as envisaged by the staff are outlined below.

Moreover, the Fund's own resources would not be placed in such accounts, and assets of the Fund in its other accounts could not be used to meet obligations of such an account. The proceeds of a drawing by a member from the Fund that was intended for placement to such an account would be transferred to the member at the time of its purchase and would become part of the resources of the member at that time; the member would have to be in compliance with all of the conditions for purchase. Thus, while the member could instruct the Fund to transfer the proceeds of a purchase to the escrow account, the transferred resources would be resources of the member. It should be noted also that resources placed to such accounts need not originate only in purchases by the member from the Fund. There would be scope for placement of other resources available to the member and, possibly, contributions from others. The resources held in the escrow account, deriving from whatever source, would be held separately from the Fund's

^{1/} The Fund would presumably have the authority to make temporary investments of amounts held in an escrow account pending payments.

other assets, and those other assets could not be used to meet obligations incurred by the escrow account. In particular, no guarantee could be provided by the Fund's General Resources Account. 1/

IV. Possible Advantages and Concerns Relating to Administration of Escrow Accounts by the Fund

As noted, escrow accounts are likely to play an important role in supporting certain debt and debt service operations. While administration of such accounts would in principle be consistent with the Fund's purposes in present circumstances--as required by Article V, Section 2(b)--it has not been suggested that such accounts should necessarily be placed with the Fund. They could, for example, presumably be placed with other international institutions, central banks, or commercial banks, and the parties to debt reduction operations may well have their own preferences with regard to location. There may, however, be reasons the parties would find it advantageous to request the Fund to administer such accounts. This section reviews possible advantages and discusses concerns that have been raised.

1. Advantages

First, the Fund's expertise in the economic adjustment program underlying the debt operation, and its likely familiarity with the details of the operation, may be seen as beneficial to an efficient operation. The Fund has extensive experience in the handling of administered accounts in a manner that is professional, discreet, and impartial. Moreover, the Fund would have no financial interest in the transactions involving these accounts. Both members and banks may find advantage in the recognized neutrality and integrity of the Fund, and these factors could be crucial in determining the member's choice for the management of such operations.

Second, administration of escrow accounts by the Fund may also involve lower cost to the member, and because of this, there may be financial reasons for a member to request the Fund's services in this respect. While the Fund has established provisions for reimbursement of

1/ See "Further Considerations on the Mobilization of Resources in Association With the Structural Adjustment Facility (SAF)," EBS/87/190 (9/2/87), pp. 7-9.

the expenses of administering some accounts, 1/ provision has not been made for charges for services rendered in connection with accounts established at the request of individual members. Actual transaction costs and an operational margin would normally be levied by official institutions with whom investments are placed by the Fund. Such costs would, however, generally apply wherever an escrow account was located, and other depositories might normally be expected to levy an administrative charge in addition.

It is not expected that the cost to the Fund of administering such an account would be significant, and it would not at this stage be proposed by the staff to levy an administrative fee. However, the situation would be monitored and, in the event the Fund was requested to administer a substantial number of escrow accounts, the question of a fee might need to be reconsidered. Even in that case, however, it seems likely that any such fee, if limited to cost recovery, could be lower than fees charged by other financial organizations.

Third, both members and banks may find advantageous the protection that is afforded by the Fund's immunities. As is the case with other administered accounts, the Fund would hold legal title to the amounts held in an escrow account administered by it, and therefore the account, its assets and income, and its operations and transactions authorized by the instrument would enjoy the status, immunities, and privileges of the Fund under Article IX in all member countries, and under Article III of the U.N. Convention on Privileges and Immunities in countries that have accepted the Convention with respect to the Fund. 2/

Specifically, Article IX, Section 3 accords the Fund, its property, and assets complete immunity from every form of judicial process, except to the extent that the Fund expressly waives its immunity. The immunity extends both to the initiation of legal proceedings against the Fund and to the enforcement by legal process of any judgment against assets held by the Fund. Furthermore, Article IX, Section 6 provides that all property and assets of the Fund must be free from restrictions, regulations, controls, and moratoria of any nature, and Article IX, Section 4 exempts the Fund's property and assets from any form of

1/ For the 1976 Trust Fund, the General Resources Account (GRA) of the Fund was reimbursed annually by the Trust for the expenses of conducting the business of the Trust. Reimbursement to the GRA of expenses for conducting the ESAF Trust is made from the Special Disbursement Account. The GRA is also compensated, based on a formula, for the expenses of administering the SFF Subsidy Account. Provision for reimbursing to the GRA for expenses relating to the Oil Facility Subsidy Account was made but not utilized.

2/ See Selected Decisions, Thirteenth Issue, pp. 464-481. See also Proposed Second Amendment to the Articles of Agreement (Report by the Executive Directors to the Board of Governors), p. 19.

seizure by executive or legislative action. 1/ Resources held in escrow accounts administered by the Fund would therefore be immune from any attachment, seizure, or restrictions by creditors or official authorities. It is the primary significance of these provisions to provide assurance that the Fund will be able to draw upon assets it holds to meet authorized disbursements without being subjected to the control or restrictions by the authorities of any member.

Finally, questions of confidentiality may arise in the context of accounts for the purpose of debt reduction. Two aspects should be distinguished. First, there could in some cases be a desire for anonymity regarding contributions to such an account, say, by a third party. Audit and reporting procedures, including those of the Fund, do not require the disclosure of the identity of individual contributors to an administered account, and this might in some cases facilitate contributions to the escrow accounts.

Second, the issue of nonpublication of the position of the account is unlikely to arise in connection with the type of account under consideration here, i.e., a "collateral" account. 2/ In order for such an account to serve its function as collateral, it is necessary that the position of the account and a summary of operations under it be available regularly to all parties involved. Moreover, in accordance with the Fund's By-Laws, the account would need to be audited and the External Audit Committee would have access to all information and provide a report to the Board of Governors through the Managing Director and the Executive Board. The report would include the financial statements showing the summary position of the account. The audit report would be published in the Annual Report, and the financial statements would be published as part of the Fund's quarterly financial statements.

2. Concerns

In the recent discussions, several Executive Directors have expressed concern that the administration by the Fund of escrow accounts for interest support--which might involve the making of payments from the accounts to commercial bank creditors over a relatively long period of time--could give rise to misperceptions damaging to the Fund. For example, it might be necessary to make payment from such an account at a time when the member concerned no longer had a Fund program, was out of compliance with its program, or even had fallen into arrears to the Fund. The concern is that disbursements from an account with the Fund

1/ See the discussion of privileges and immunities in "Substitution Account - Privileges and Immunities," SM/80/53 (2/22/80).

2/ If a member should request that the position of an account not be published, the Fund could consider, on a case-by-case basis, whether it would agree to administer the account in light of this departure from its normal practice.

in such circumstances could lead to confusion and misunderstanding of the Fund's policies with regard to the administration of its own resources, including its policy of not providing those resources to members with overdue obligations to the Fund.

As has been explained above, there would be clear legal and financial separation between any such escrow account and the other accounts and assets of the Fund, and the Fund would be administering resources on the member's behalf, pursuant to specific conditions agreed between the member and its relevant commercial bank creditors. Placements to the account would be of member's resources (or possibly resources of other contributors). Resources of the Fund would not be involved, and the member's position vis-à-vis the Fund would be separate and distinct from its position vis-à-vis commercial bank creditors. These facts would be known to the parties. Even so, it could be argued that the complete separation of assets and operations would not be well understood by all. To meet this difficulty, it would seem desirable that, if the Fund were to accept a request to establish such an account, it should be made absolutely clear, not only to the parties immediately involved but also to the membership and the financial community in general, that the Fund would be acting on the member's behalf, upon instructions or under specified rules, with no involvement of its own judgment or resources, and no obligation or responsibility beyond that provided in the instrument. This would be explained in the papers presenting proposed accounts to the Executive Board and could also be reflected in the Annual Reports and, if desired, in an appropriately worded press release upon the establishment of an account.

A second area of concern is that the Fund might, by virtue of administering such an account, be drawn into a dispute between the parties regarding the appropriateness of a payment from the account. In the arrangements under consideration, assets held by the Fund in the escrow account would provide collateral against the discharge of liabilities between parties to a contract. Provision must be made to ensure that the creditor for whose benefit the amounts are placed in the escrow account will be given access to those resources in the case of nonpayment by the debtor. Consequently, the contract would have to define clearly the conditions for use of these resources and the scope of the security arrangement. These conditions would be established by agreement between the parties. The Fund would not be a party to the contract.

The instrument governing the escrow account would, however, have to establish the conditions for the release of resources by the Fund. In line with the envisaged role of the Fund as administrator operating under instructions, an appropriate procedure could be that the Fund be informed by the creditor that the conditions for release of resources have been met. (Presumably, commercial bank creditors would appoint a common agent through which communications with the Fund would take

place.) The Fund would then ask the debtor to confirm that these conditions have been met and would disburse when the confirmation is received.

Should the debtor object to the release of resources, the Fund would be faced with a situation in which the payment obligation under the underlying contract is in dispute. Such a dispute could arise for various reasons. For example, it might be argued that, contrary to the creditor's notification, payment under the contract has actually been made, that no default has occurred because the debtor has set off its debt against an equivalent debt of the same creditor to it, or that the unpaid debt is outside the scope of the contract secured by the account. As the Fund would not be responsible for the settlement of such disputes, appropriate procedures for their settlement would have to be in place before the establishment of the account. For example, a procedure could be envisaged under which the parties would appoint an arbitrator, and would inform the Fund of their agreement to submit any dispute to arbitration. Unless the dispute were settled by mutual agreement, the disputed amount would be disbursed by the Fund only upon communication of the arbitral award, and to the extent specified in the award.

These or comparable procedures would affect the disbursement of resources from the escrow account. The Executive Board would need to be satisfied that the procedures adequately protected the position of the Fund, and they would need to be reflected appropriately in the instrument to be adopted by the Fund.

V. Concluding Remarks

In light of the above, the staff would suggest that the Fund be open in principle to the administration of such escrow accounts at the request of members. A receptive attitude to such requests would seem consistent with the Fund's central institutional role in the debt strategy, its specific role in supporting members' debt and debt service operations, and the desire that the management of the debt situation remain a collaborative effort. It would also be consistent with the Fund's authority under Article V, Section 2(b), and its performance of comparable depository services for members in the past. A receptive attitude would not, however, imply a Fund view that such accounts necessarily had to be placed with the Fund. The member would decide, according to the requirements of the case, whether to request an account with the Fund. In each case, whether to establish such an account upon request would be for decision by the Executive Board in light, inter alia, of the Board's judgment regarding the compatibility of the proposed instrument with the requirements of the Fund.

